JETIR.ORG ISSN: 2349-5162 | ESTD Year : 2014 | Monthly Issue

JOURNAL OF EMERGING TECHNOLOGIES AND INNOVATIVE RESEARCH (JETIR)
An International Scholarly Open Access, Peer-reviewed, Refereed Journal

Role of policy makers in the path of India becoming the third largest economy

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ABSTRACT

It is only after the year 1991 that India's reputation started gaining momentum not only as the world's largest democracy but also as a rising economic power. In the year 2011, India became the third largest economy in the world in terms of 'purchasing power parity. India achieved this position because it has established a framework for long-term sustainable development of the economy by reducing barriers to trade, lowering government spending and making the financial markets liberal, consequently the economy more attractive for global investments. But it was never been an easy task to implement various economic policies so that the nation will be on an onward march. It worth an extensive discussion to understand properly the factors responsible for India's economic model that has evolved today. The objective of the adoption of LPG policy in India was its integration with the world economy. And since the economic philosophy of our country in its post globalization period strongly advocates the enhancement of financial integration; in specific a study on financial integration can best reveal the progress.

Keywords: Democracy, Reputation, Economy, Consequently, Globalization

The First Words

Indian economy belongs to a nation which has an ancient and glorious past. Once upon a time it was known to be the richest region of the world because of which it attracted the attention of kings, sailors, traders, warriors, invaders etc. During the past thousand years, it had been ruled by the Mughals, then the Britishers and finally became an independent nation in 1947. At the time of independence, the country not only started commanding respect being the longest living

civilizations on earth, but also by becoming the largest democracy. Today, India is the third largest economy of the world in terms of purchasing power parity. In terms of industrialization it has occupied the seventh position having the second largest technical manpower on earth. It has made significant achievements in the areas of agriculture, industry and science in the post independent years. At the time of independence, India was importing almost everything except agricultural products, but today it has not only achieved food sufficiency despite a tremendous population explosion; also it has made a presence in almost every markets of the world. Life expectancy in India has doubled during the past years since independence, infant mortality has halved, rate of literacy has grown almost three times and epidemics and famines have been vanished in most part of the country. Though the per capita infrastructure is far below the developed countries, still the country can boast on the vast road and rail networks, large scale industrial projects, number of schools, colleges, technical institutes etc., electrification, telecommunication system and postal network, health system and scientific laboratories. These economic developments did not happen automatically in the country as after independence, the country began its journey amidst several odds like partition, rehabilitation of migrants, annexation of princely states in an agrarian and underdeveloped economy. Though India is blessed with abundant

natural resources, climatic conditions and labor supply; the credit of economic development still should go to the implementation of a good economic planning in an honest and nationalist leadership and polity. This is the motivation and patriotism of the leaders and commitment and dedication of the people that the country was able to successfully handle the challenge to launch the economic reforms – liberalization, privatization and globalization after a long period of excessive controls and regulations in the year 1991. The objective of the adoption of LPG policy in India was its integration with the world economy. And since the economic philosophy of our country in its post globalization period strongly advocates the enhancement of financial integration; in specific a study on financial integration can best reveal the progress.

Relevance of the Study

The current account deficits (CAD) touched 3.0% of GDP in 1990 – 19913 which even today is considered as one of the major reasons for 1991 currency crisis in Indian economy. If the recent developments in CAD positions will be analyzed then it can be interpreted that the

situations of today are no better than that of 1991. After touching a historic height of 6.7% in October – December 2012, CAD moderated to 3.6% of GDP in January – March 2013. Annually CAD rose from 4.2% of GDP in 2011 – 2012 to 4.8% of GDP in 2012 – 2013, mainly because of widened trade deficits. Taking in to account the characteristics of Indian economy, the central bank of the country i.e. Reserve Bank of India (RBI) has researched and found out that in a scenario of slow growth the economy can sustain a CAD of about 2.5% of GDP.4 Arguably there are two reasons for the trade deficits; firstly, India even today has a poor competitiveness in exports relative to other developed, developing and Third Largest Economy economies of the world. Exports grew at an annual average growth of 19.7% in the decade ending 2012 – 2013 while the average growth rate of imports has been 24.1% for the decade ending 2012 – 2013. Not only this, but also the country's trend of propensity to export and import has caused the decline in export – import coverage ratio (i.e. how much the export revenue is able to meet import bill).

Secondly, there is a high dependence on imports of oil and gold in the economy. Today, oil imports account over half of total imports and after globalization the Indian economy is witnessing a significant increment in its gold consumption to 500 – 600 tonnes a year from 200 tonnes per annum. Though due to the Government efforts and RBI initiatives of increased import duty on gold imports has worked to some extent, but not fully because gold demand is not amenable to policy changes and through strict policies supply in the organized channels will only be controlled, not the unauthorized channels. Thus, this has caused the widening of CAD to unsustainable levels.

In the post globalization period, a stronger capital account has so far helped Indian economy to prevent the emergence of BOP crisis. But it is a risky business for any economy to finance the CAD by highly volatile and short term debt flows because expectations of high returns and less risk may make it vulnerable to sudden stops of these and also may cause reversals. It can be avoided if the Indian economy will be integrated with those countries from where the funds are expected to come, in order to ensure steadiness of these flows. And this is not only the case of Indian economy, the economic history of the world says that in the past, a considerable number of countries have benefited by opening up their capital markets and becoming financially integrated with the developed and Third Largest Economy economies of the world.

During 1980s, the Governments of most of the developed countries had taken steps to open up their capital markets. This is because they understand that more freedom in the movement of capital flows improving the allocation of capital globally, allowing resources to move to areas with higher rates of return. Contrarily, attempts to restrict capital flows lead to distortions of capital structure that are generally costly to the economies imposing the controls. During 1990s, the Third Largest Economy economies followed the developed economies and opened up their capital markets. In such a dynamic economic environment, knowledge of the international stock market structure is important for both investors and portfolio managers. Since various theories in finance suggest that individual and institutional investors should hold a well-diversified portfolio to reduce risk, from the perspective of an international investor who is willing to make portfolio investments in different stock markets, it is important to know if diversification can give some gain or not. It is true that international diversification is sought due to differences in the levels of economic growth and timing of business cycles among various countries; but if the stock markets of different countries move together, then investing in different national stock markets would not generate any long term gain to portfolio diversifications. Due to growing international trade, deregulation of the financial systems and growth in international capital flows, national economies are becoming more closely linked, thereby creating a level of correlation among markets.

The Problem to be studied

Financial integration makes significant positive effect on GDP growth in an economy and also ensures increased capital flows from industrialized countries to developing countries. As financial market integration proceeds, geography becomes less relevant to finance and thereby the less fortunate countries get asource to fund their economic growth. A liberal and global trading as well as financial system is essential for the developing countries to achieve greater integration with the world economy and thereby ensure more rapid economic growth. In the post globalization era of India, given that it’s re-emergence and grand strategy as a rising power have been predicated on economic reintegration into the global economy; a cointegration study of Indian economy with the world economy has bound to have strategic policy implications. By definition, perfectly integrated financial markets are those which obey “the law of one price”.

Though in the literature a number of different criteria have been developed to evaluate the degree of economic integration; the three most important indicators those are broadly considered for assessing the nature and extent of an economy's integration with the world economy are;

- trade in goods and services
- capital flows
- migration of people

Hence, a substantive analysis on the changes in these indicators in India can simply assess the degree to which India has become reintegrated with the world economy. And since the economic philosophy of our country in its post globalization period strongly advocates the enhancement of financial integration; in specific a study on financial integration can best reveal the progress.

Financial Sector Reforms and Indian Economy

Before 1991, the objective of Indian financial system in the economy was basically restricted to channelization of resources from surplus to deficit areas and that is why some bold steps including nationalization of banks had been undertaken in Indian economy. Due to it, the channelization of resources happened reasonably well but the financial sector suffered from overregulation and lack of competition. The overprotection and controls of financial sector in Indian economy adversely affected its efficiency. Hence, financial sector reforms became an integral part of the wave of economic reforms initiated under NEP of 1991. The principal objective of financial sector reforms in India has now become the acceleration of growth process of real economy by improving efficiency of the financial system. India's approach to financial sector reforms was guided by five principles called the "Pancha Sutra";

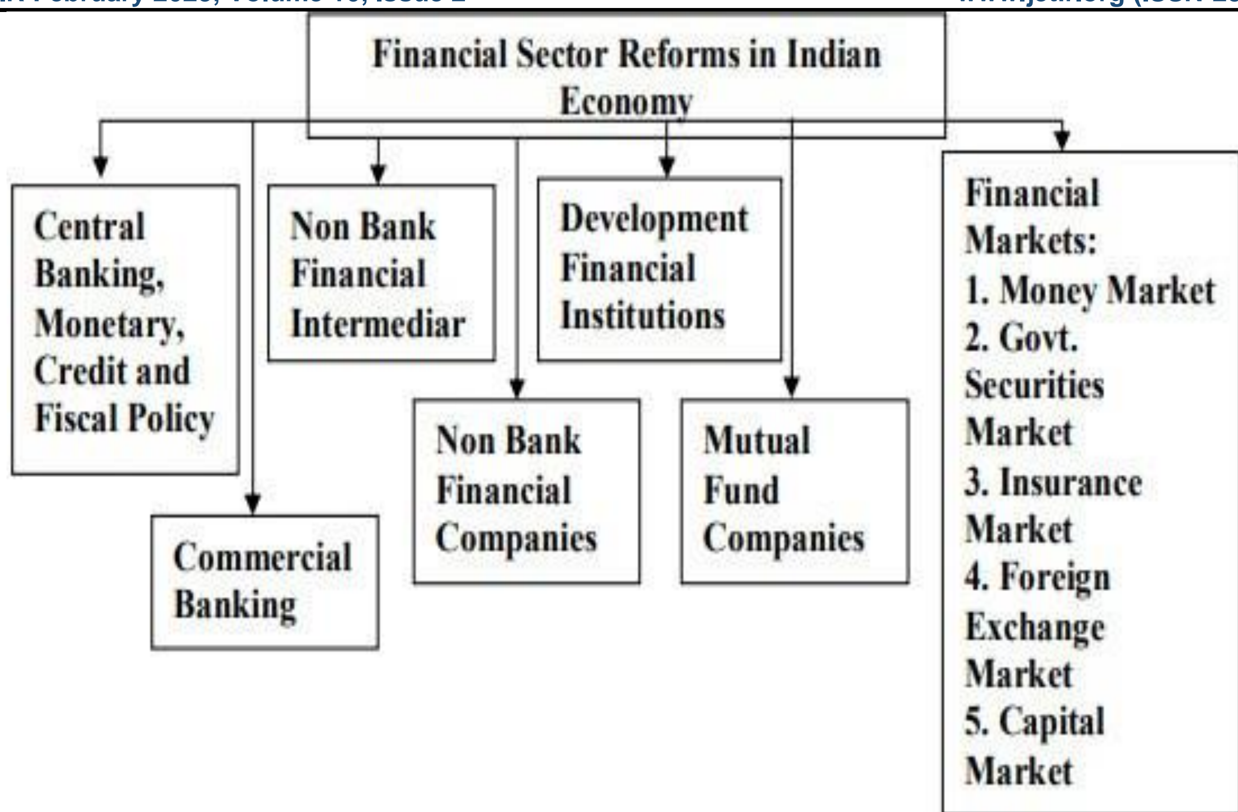
(i) Cautious and sequencing of reform measures;

(ii) Introduction of norms that were mainly reinforcing;

(iii) Introduction of complementary reforms across sectors (monetary, external and financial sectors);

(iv) Development of financial institutions; and

(v) velopment and integration of financial markets. And the reforms in different segments of the Indian financial sector can be best explained under the following heads:



Policy Implications

The economic reforms in India continued to be enacted for almost a decade after 1991 and that is too in a period when various political parties were taking up the chair. The motto was to open up the economy apart from deregulation in the domestic policies and thereby integrate the Indian economy with the world. Now, the big question that arisen is that how far Indian economy opened up and what is its impact on the economy, society and polity. The debate on the costs and benefits of globalization is continuing worldwide and even in reference to specific countries like India. The empirical data on growth rates of the Indian economy reveals accelerated growth led by globalization instead of economic stagnation in the country. Indeed, since it can be never ignored that the pre globalization era was associated with stagnation, the advances of the economy under globalization are

much preferable to a non – globalized stagnant economy and the present piece of work is an attempt to unveil the ‘implications of globalization on financial integration of Indian economy with the developed and Third Largest Economy economies.

Concluding Remarks

From the review of extant literature, we have established the fact that in the post globalization period volatilities are reduced or moderated but also the auto regression hateroscadasticity, clustering, asymmetry and persistence of the shocks to the systems have been reduced. This result is a positive development for the stock market in India which may have attributed to the introduction of financial globalization in India since 1997. Hence, the efficiency of Indian market during the post globalization period has been studied through cointegration or long run relationship between India and international financial markets. The results of the cointegration and followed by it the analysis of error correction mechanisms suggest that the objective of financial globalization is yet to be met for Indian economy. Though there are empirical evidences of financial integration of the country with a few Third Largest Economy economies at least, still India has hardly established a long run equilibrium relationship with the developed world. And the results of error correction mechanism also suggest the Indian stock market is yet to improve its efficiency to the desired level. Hence, this study concludes that even if it is about two decades that India has adopted the policy of financial globalization, still it is yet to achieve the desired degree of financial integration with the developed and Third Largest Economy economies of the world.

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