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The Financial crisis in the economy and its solution: A review

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Abstract :-

India's economic growth has been declining to an all-time low, whereas the world's economy is growing. The Indian economy is facing a severe slowdown with a GDP growth of 6.3% for the fiscal year 2020. The growth rate is the lowest in the last 6 years. It is also projected to further slow down by 6.2%. The available data shows that the Indian economy is facing a crisis due to some important factors like increased unemployment, rural distress, liquidity crunch, and some international factors. These are the main reasons for the economic problem in India

The basic reasons for the ailing of the Indian economy are

A financial crisis may have multiple causes. Generally, a crisis can occur if institutions or assets are overvalued and can be exacerbated by irrational or herd-like investor behavior. For example, a rapid string of selloffs can result in lower asset prices, prompting individuals to dump assets or make huge savings withdrawals when a bank failure is rumored. Contributing factors to a financial crisis include systemic failures, unanticipated or uncontrollable human behavior, incentives to take too much risk, regulatory absence or failures, or contagions that amount to a virus-like . If left unchecked, a crisis can cause an economy to go into a recession or depression. Even when measures are taken to avert a financial crisis, they can still happen, accelerate, or deepen. . It is now widely recognized that the Indian economy has been facing a major economic crisis with the situation deteriorating rapidly since August 1990. While the present economic crisis has been the result of a gradual accumulation of the combined effect of various forces operating in the economy during the last decade, its symptoms have become clearly noticeable after January 1991 with the country's foreign exchange reserves dropping sharply to the lowest level ever of Rs 1,877 crores, which is barely enough to finance the country's imports for 13 days only. It is hardly surprising, therefore, that considerable attention is being devoted to the analysis of India's economic crisis in order to generate appropriate policy options and instruments to pull the country out of the crisis. A critical analysis of the Indian situation shows that the major elements of the present economic crisis are as follows :

- **The deepening foreign exchange crisis**

  The Foreign Exchange Crisis The intensity of the foreign exchange crisis is brought out by the following indicators:
  - There has been a sharp decline in foreign exchange reserves from the level of Rs 8,151 crores in March 1987 to Rs 1,877 crores in early January 1991 . While the stand-by IMF loan of Rs 3,275 crores in the third week of January 1991 has temporarily boosted our foreign exchange reserves, the declining trend in the forex reserves has continued un abated during the subsequent period. Thus, the country's foreign exchange reserves have again dropped to Rs 2,620 crores as of May 17,1991.
  - Although the country always had a sizeable trade deficit during the eighties, the level of trade deficit has increased sharply during 1990-91 to cross the Rs 10,000 crore mark for the first time in Indian.
  - Thus, the average level of trade deficit which used to be around Rs 650 crores per month during 1988-89 and 1989-90 has now increased to around Rs 900 crores per month. At this rate, the stand-by IMF loan availed in January would not last long, even after taking into account small adhoc loans that we have been able to obtain after January 1991. Hence there is an urgent need to raise enough short-term credit at the earliest.
  - There has been a significant deterioration in India's credit rating especially during the last few months. This has led to a decline in the availability of short-term credit even on relatively more stringent terms and conditions, thereby further accentuating the problem of financing the country's monthly import requirements.
- **Growing fiscal imbalances**

  A high degree of fiscal imbalance has emerged as another major problem facing the Indian economy especially after 1986. The latter half of the eighties has been marked not only by high and growing budget deficits, but also by attempts on the part of the government to create a surplus in the capital account to finance its revenue deficit. This unhealthy tendency of borrowing money to finance current consumption expenditure of the government reached an alarming proportion in 1990-91 when the revised estimates of revenue deficit turned out to be Rs 17,585 crores, while the overall budget deficit was reported to be Rs 10,772 crores, indicating a net surplus of Rs 6,813 crores on capital account. Moreover, the fiscal deficit, which represents the actual difference between aggregate government expenditure and current revenue reached the highest ever level of Rs 43,331 crores in 1990-91 (Table 3). Thus, in the year 1990-91, nearly two-fifths of the revenue deficit has been financed by capital account surplus and the size of overall fiscal deficit has turned out to be as high as 8.6% of GDP.
- Increasing rate of inflation

  The silver lining in the dark clouds of the deepening economic crisis is represented by the basic strengths acquired by the Indian economy during the eighties. Even the severest critics of India's macroeconomic management during the eighties have to

admit that the Indian economy had acquired a strong growth orientation and had succeeded in shifting to a higher path of long-term economic growth during this period. Moreover, the economy had developed much greater resilience to weather fluctuations, enabling the country to achieve self-sufficiency in food grains and the building up of adequate buffer stocks of food grains. The country had also achieved a significant increase in the annual growth rates of exports, especially in the latter part of the eighties as compared to the earlier period. A strong and fairly well diversified industrial base had been built up. The climate for industrial investment had improved considerably with the latter part of eighties showing a remarkable buoyancy.

- Slackening of overall economic growth
  The strategy to deal with the present economic crisis and to restore the healthy growth of the economy should be derived on the basis of an objective evaluation of the available alternatives in the light of the existing circumstances. However, in practice, macroeconomic strategy formulation invariably gets linked with political ideologies. A classic example of this is provided by the policy prescriptions suggested by a group of Left Economists in a statement adopted at a recent seminar. They have recommended that the appropriate method for curbing the balance of payments deficit would be through direct curbs on imports. Moreover, they argue that the government should not opt for a significant cut in the fiscal deficit because major cuts in fiscal deficits would plunge the economy into a deep recession. Thus, according to the group of Left Economists, "Opting solely for a reduction in the fiscal deficit and that too through a cut in capital expenditures, as appears likely under IMF pressure, will not only push the economy into a recession immediately, but also adversely affect future growth prospects. In our view the government should opt for a much smaller cut in the fiscal deficit than the two per cent reportedly suggested by the IMF and actually proposed by the Finance Minister." The main conclusion drawn by the Left Economists from their analysis of the present economic crisis is as follows: "Resort to a second IMF loan is not the only option available to the country. Rather, through a combination of a stricter import regime and appropriate budgetary policies, the country can achieve the required balanceof payments adjustment, without either generating a recession of the intensity that the IMF package would result in or cutting welfare expenditures."

- Deceleration in industrial growth
  It appears that there is some confusion here between the short-term and the long-term aspects of the present economic crisis and the remedial action required to tackle it. While policy measures designed to curb imports during the first half of the current financial year (1991-92) as a means to ease short-term liquidity problems are justifiable in terms of sound economic reasoning, the permanent use of this method as a longterm solution to the country's balance of payments problem seems absurd especially in the light of the existing economic structure. Today, many of our existing industries are dependent on the import of raw materials for their regular production.

The available information indicates that the list of industries where import content in raw materials consumed exceeds 25% includes important industries like chemicals, manmade fibres, fertilizers, pharmaceuticals, paints, textiles, cables, paper, mini steel, consumer electronics, gems and jewelry, etc. Some of these industries cater predominantly to the requirements of the common man and some of them are export oriented. Moreover, most of these industries have high growth potential. Hence, permanent curbs on import of raw materials, as suggested by the Leftist view, would retard the long-term growth of such industries and seriously affect their capacity utilization, which would in turn lead to recession coupled with a decline in overall cost efficiency.

- Low per capita income
- Dependence on agriculture of the large section of the population
- The problem of rising population and limited resources.

Various economicfactors that affect the economy of India. They are:

- Population and human resources
- Natural resources
- Capitalism
- Investment patterns
- Occupational structures
- Market extents
- Technology

The growth of the Indian economy has been declining since 2016. Since March 2020, Covid -19 has been deteriorating the economy of India. Even before Covid -19, India's economy was crushed to a severe extent. The Centre for Monitoring Indian Economics, an independent research firm, has raised industrial production "from down to downer" during the last few years.Also, economic experts have contradictory concerns about the ailing of India's economy. Most of them converge on a few factors and have similar ideas for ailing India's economy.

Reasons and Solutions for Economic Problems in India

There are many reasons for the ailing Indian economy that are not limited. We shall briefly discuss a few of them on which there is no conflict of thinking among economic experts.

Lesser Investments

Investment is the main key to the economic growth of any country. It helps in business activities from establishment to development of business. Investment creates more opportunities for jobs, higher earnings, and higher spending. This lesser investment cycle is the main reason for the ailing economy of India. FIIs have withdrawn their money from the Indian market in the last few years.

Solution for this reason

Investment revival is needed for the growth of the Indian economy. There are several steps that need to be taken by the government of India, including,

- The raising of its investments in public Infrastructures and assets.
- Investment of Foreign Institutional Investors (FIIs) to be attracted.
- Relocation of India's supply chain would provide some support for the export outlook.

Inefficient Agricultural Policy and Climatic Conditions

In India, a lot of agricultural produce gets ruined due to the lack of sufficient agricultural policy. In one part, produce gets wasted due to higher production, and in the other part, surplus produce gets wasted due to mismanagement of storage. In the case of sugar production, the sugarcane yields 60% more returns than its comparable crops, and many farmers adopt the cultivation of sugarcane, leading to a surplus. This surplus production contributes to low farmer incomes.In India, much of the agricultural land cultivation depends upon climate conditions, and a poor monsoon leads to a lower area under cultivation resulting in lower rural income generation. The Indian agricultural sector has managed a large population in occupational engagement and the livelihood of the rapidly increasing population of India. As per a survey of the World Bank, in 2014, nearly 47 percent of the working population in India was engaged in agriculture, whereas it had contributed hardly 17 percent to the national income. This low productivity per person in the agriculture sector could not attract the government's focus towards this sector for their betterment. The expansion of industries also failed to attract enough manpower from this sector.

Solution for this reason

Government should make policies for agricultural development, proper storage and distribution of agro products, and management of rural manpower employment when there is no work in agriculture for them.

Unemployment

Unemployment is not a one-day problem. Since India won freedom, it has been a burning issue, and no government has given due weight to this problem.In the last few years, many people have lost their jobs, and the government lacks sufficient aid. The increasing number of educated-unemployed problems added to the woes of the country.

Solution for this reason

The Government of India should widen the platform of the public and private sectors for creating more jobs and promote new areas of the business to convert job seekers to job creators/providers. The government should focus on the expenditure on education, skill training, research, and development.

Hike in Oil Price

Petroleum products are one of the main contributors to the ailing economy of India. It is a major player in the economy and gives a clear growth rate. A hike in prices affects the economy of India.

Solutions to this reason

Government should make policies for alternative energy resources, green energy, nuclear energy, wind energy, solar energy, etc. These energies reduce air pollution and also create other opportunities to some extent.

Slow Demand for Consumer Products and FMCG

A sharp fall in demand for consumer products is a basic concern of an economic slowdown. The rural market of India has been facing this slowdown for the last few years. This impact is seen in the market of fertilisers and agricultural inputs manufacturers. The fast-moving consumer goods FMCG market has also seen a big slump. The FMCG market has expanded from metro cities to rural markets and has been slowing down its market drastically. GST and other tax reforms have drawn liquidity from public hands.

Solutions to this reason

The government should recognise this FMCG market and give a proper concentration so that this macroeconomic market can be developed and the government gets to benefit in return in the form of taxes.However, this paper argues that with very limited fiscal maneuverability and the limited traction of monetary policy, policy measures to restore the Indian gross domestic product growth back to its potential rate of 8–9% must focus on addressing the structural constraints that are holding down private investment demand. The profitability of our exports should be systematically improved, so that selling in the domestic market does not necessarily remain more profitable than selling in the international market, as is the case today in many domestic industries.This would require, among other things, improved access to critical, imported raw materials and streamlining of various export incentives. The past experience shows that relatively faster growth of exports has been experienced by those industries which had ready access to imported inputs at international prices. Export incentives should be linked to a much greater extent with net exports rather than gross exports, i.e., exports less import content of exports. This would ensure relatively faster growth of value added exports and also simultaneously encourage internationally competitive import substitution. There is a need to pursue more vigorously the policy of depreciation of the real effective exchange rate. A depreciation of this magnitude was perhaps overdue especially in view of high rates of inflation experienced by the Indian economy during the last two years. It is interesting to note here that during the period April- December 1990, the real effective exchange rate of the Rupee had in fact gone up by about 5.5% and this period was also marked by a sudden sluggishness in India's exports. As against this, the earlier period (1986-89) was marked by a significant decline in real effective exchange rate coupled with significant increase in exports measured in terms of US dollars. The analysis of time series

data on India's exports and index of real effective exchange rate for the period 1980-81 to 1990-91 shows that one per cent decline in real effective exchange rate of the rupee leads to 1.8% increase in the volume of exports. Hence, at this juncture, it is necessary to follow the policy of steady depreciation of the Rupee at a rate higher than the average differential between the domestic and the international inflation rates. Such effective depreciation of Indian Rupee in real terms would lead to a significant improvement in the competitiveness of India's exports and at the same time also improve the viability of several import substitution projects which in turn could result in a reduction in import intensity in Indian manufacturing. There is a need to focus urgently on the turnaround of loss making public enterprises. Privatization of loss making public enterprises would not yield significant financial returns and, hence, it may not be of much help in reducing fiscal deficit in the near future. In the case of financially viable public enterprises, there is a need to facilitate their growth.

Conclusion:--

In addition to the long-term policy measures mentioned above to restore the economy on the path of rapid and healthy economic growth, it is equally necessary to resolve the immediate problem of liquidity crunch arising out of the accumulated liability of mounting short term debt that has to be repaid in the near future. However, such cushion would not last long enough to enable the country to design and implement a package of major policy changes that could lead to a successful macroeconomic turnaround over the next few years. Hence,tapping such sources for getting small additional funding cannot be considered as an effective alternative to obtaining a large medium-term loan as early as possible. Similarly, the recent measures such as higher bank margins on LCs, revision of interest rates for export credit and modifications in the clearance procedures for large transactions by Forex dealers also belong to the category of adhocfire fighting measures aimed primarily at easing the immediate liquidity problem. It is evident that such measures cannot be expected to provide lasting solutions to the current economic crisis. In fact, some of these measures, if continued over a longer period, may adversely affect our export performance in the coming years. In view of this, in the present circumstances, there is apparently no effective alternative to approaching IMF for a large medium-term loan to resolve the problem of liquidity crunch over a period long enough to allow the economy to achieve a successful turnaround. At this juncture, the IMF loan appears to be more like a necessary condition to overcome the present economic crisis. Whether it would also turn out to be a sufficient condition or not depends essentially upon the manner in which we reformulate our economic strategy and the degree of success that we achieve in its speedy implementation during the next few years. The economy of India is a fast-growing economy. The present economic scene after Covid -19 in India is more or less encouraging. Still, we are far from economists' expectations of achieving employment, poverty eradication, education for all, and industrialization. Government can come out from the present situation of an ailing economy. With focused targets and remedial measures to resolve the economic problems, India will surely become a developed economy.India's financial sector is not deeply integrated with the global financial system,

which spared it the first round adverse effects of the global financial crisis and left Indian banks mostly unaffected. However, as the financial crisis morphed in to a full-blown global economic downturn, India could not escape the second round effects.

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