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32. A CRITICAL STUDY ON GLOBAL RECESSION - 2008 AND ITS IMPACT ON INDIA

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ABSTRACT

In recent years, the Indian Economy experienced a pronounced slow down in economic activity. In many ways, the slow down looked like a typical recession driven by a fall in aggregate supply. Seven notable shocks explain this event. They are

- Increase in excess demand
- Increase Money supply
- Fall in the real GDP
- Fall in the composition of agriculture to GDP
- Increase in unemployment rate
- Lower capital inflow
- Unfavorable BoT

The responsiveness of fiscal and monetary policy quickly to this events and their impact in rectifying the problems is analyzed in this paper.

INTRODUCTION

Trade cycle or business cycle refers to the phenomenon of cyclical booms and depressions, also called expansion and contraction of the economy. In a trade cycle there are wave like fluctuations in aggregate employment, income, output, price and demand. Economies pass through periods of good trade characterized by rising demand and prices and low unemployment, altering with periods of bad trade characterized by low demand, falling prices and high unemployment. The occurrence of these phases does not have a fixed time period. During prosperity, demand, output, employment and income keep rising till it reaches a peak. High demand, employment and income result in rise in price. Prices rise (inflation), but wages, salaries, interest rates, rentals and taxes do not rise in the same proportion. The gap between price and cost increase the margin of profit. Large profit expectation leads to rapid widespread expansion in economic activities. This expansion gradually leads to disequilibrium in the economy in the form of over full employment and high inflation- both indications of end of prosperity and beginning of recession. The seeds of recession are thus contained in the expansionary or prosperity phase itself. Continuous expansion begins to put strain on economic resources. The increasing demand of resources leads to

√ Scarcities of labour, raw material etc. leading to rise in costs relative to price. This in turn brings down the profit margin.

√ Scarcity of capital leads to rise in the rate of interest. This makes investment costly and lowers business expectation.

Rising prices reduces consumption. Also after a certain increase in income, consumption stabilizes, leading to stagnant demand. This causes piling of inventories/low sales. Government control on capital flows is another big reason for succesfull handling of recession.

AGGREGATE SUPPLY DECREASE IN THE SHORT-RUN AGGREGATE MARKET

- Shock to the short-run aggregate market caused by a decrease in aggregate supply. A decrease in aggregate supply in the short-run aggregate market results in an increase in the price level and a decrease in real production. The level of real production resulting from the shock can be greater or less than full-employment real production. The causes of decrease in aggregate supply are the following

- A decline in the size of the population or a decrease in the labor force participation rate, both of which decrease the quantity of labor available for production.

- Depreciation of capital goods, which decreases the quantity of capital available for production.

- The depletion of existing mineral deposits or fossil fuels, both of which decrease the quantity of land resources available for production.

- A decrease in education which decreases the quality of labor resources.

- A decrease in technology which decreases the quality of capital resources.

- An increase in wages or energy prices, both of which raise economy-wide production cost.

AGGREGATE DEMAND INCREASE - SHORT-RUN AGGREGATE MARKET

Shock to the short-run aggregate market is caused by an increase in aggregate demand. An increase in aggregate demand in the short-run aggregate market results in an increase in the price level and an increase in real production. The level of real production resulting from the shock can be greater or less than full-employment real production.

CAUSES OF INCREASE IN AGGREGATE DEMAND

An increase in consumer confidence brought on by periods of prosperity.

- Expectations of higher inflation rates in the near future.
- A decline in interest rates associated with natural business-cycle activity or expansionary monetary policy.

- Increasing net exports.

- Decrease in taxes by the federal government resulting from expansionary fiscal policy.

- An increase in state or local government purchases, and/or a decrease in state or local taxes.

MONEY SUPPLY - AGGREGATE DEMAND DETERMINANT

An increase or decrease in the money supply produces a corresponding increase or decrease in aggregate demand. Other notable aggregate demand determinants include interest rates, inflationary expectations, and the federal deficit. A key function of the Federal government is controlling the total amount of money circulating inside the economy. Money is responsible to undertake the four aggregate expenditure, consumption expenditure, investment expenditure, government purchases, and net exports.

- With more money, aggregate

expenditures are greater.

- With less money, aggregate expenditures are lower.

FALL IN THE REAL GDP

An emerging economy is one which produces more goods and services to maintain the standard of living of its people. An ideal production is one, where we don't find rising prices. It is reflected in the country's GDP. It is viewed in two different forms. On the one hand, it is the total income of everyone in the economy. On the other hand, it is the total expenditure on the economy's output of goods and services. As such, both views clearly state that GDP shows the performance of the economy. Table below throws light on growth rate of GDP at constant prices (2004-2005) from 2007-08 to 2012-13 (AE)

Industry	2007 - 08	2008 - 09	2009 - 10^	2010 -11@	2011 - 12*	2012 -13 (AE)
I. Agriculture	5.8	0.1	0.8	7.9	3.6	1.8
II. Industry	9.7	4.4	9.2	9.2	3.5	3.1
Mining & quarrying	3.7	2.1	5.9	4.9	-0.6	0.4
Manufacturing	10.3	4.3	11.3	9.7	2.7	1.9
Electricity, gas & water supply	8.3	4.6	6.2	5.2	6.5	4.9
Construction	10.8	5.3	6.7	10.2	5.6	5.9
III. Services	10.3	10.0	10.5	9.8	8.2	6.6
GDP at factor cost	9.3	6.7	8.6	9.3	6.2	5.0

^: third rev. estimate, @: second rev. estimate, *: first rev. estimate, AE: adv. Est.
Source: Central Statistics Office (CSO)

Compared to the year 2004-05, the production in the agricultural and manufacturing sector has shown a declining trend. The fall in the growth rate in agriculture is very higher than the growth rate of industry. It is because of the operation of both pull and push factors in the economy. Changes in seasonal conditions and urbanization, reduces not only the labour force participated rate in agriculture but also reduced the area of cultivation. Thus the fall in the net area sown and the productivity thereby put a serious setback in the agricultural sector. Thus a higher degree of variability is being noticed in the performance of agriculture with respect income generation in the manufacturing sector, the growth rate is moderate in the years 2007-08, 2009-10 and 2010-11 where as poor performance is noticed in 2008-09 and 2011-12. It is estimated to very poor in 201213 as 1.9. With regard to service sector, the growth rate has been almost steady and gradual from 2007-08 to 2009-10. It is the main growth driver. As a result of its expansion, the economy becomes vibrant and dynamic, provides necessary strength, resilience and buoyancy to the economy in the event of commodity producing sectors having fared poor. It is the correct time to revitalize the performance of both agriculture and industry in a gradual and harmonious way to achieve 7 to 8 percent annual growth. For achieving this goal we need a much higher saving level and larger domestic and Foreign Direct Investment.

OVERALL ASSESSMENT

Thus continuous expansionary path in which India moves after the implementation of economic reforms, now put severe strains in the economic resources resulting in slow down in all economic activities. Thus creating chaos and confusion in the minds of the people. Those shocks which are analysed empirically above are summarized as follows:

√ Fall in the Growth rate of GDP from 9.3 percent in 2007 – 08 to 6.2 percent in 2011 – 12 at factor cost.

√ Fall in the primary, secondary sectors share in GDP.

√ Increase in the Current Daily status unemployment which includes open and disguised unemployment.

√ Deficiency in the level of domestic savings and capital inflow to encourage investment in infrastructure.

√ Increase in money supply resulting in increase income and stagnant demand because of rising price level.

√ Widening trade deficit because of the non competitive nature of the exports.

√ India’s trade deficit widened to 1086 INR Billion from 966 INR Billion in Dec. as crude oil imports surged.

SUGGESTIONS

For sustained economic growth, it is suggested by the XIIth five year plan that, 9 percent of the GDP is invested for infrastructural development. Current rate of investment is 6 percent of GDP only. 40 percent Gross Domestic Saving and Gross capital formation is required to ensure a self propelling growth of the economy. Hence efforts should be taken by the policymakers to formulate monetary policy in such a manner to increase Gross domestic savings efficiently and to use fiscal instruments in a successful manner to provide strong infrastructural base. This will solve the problem of joblessness.

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