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# US Recession Might Not Affect Indian Growth

The recent recession in the US economy has cast a grim shadow on the economic growth around the world. Stock markets all over the world have taken a beating, following foreign institutional investors' (FIIs) selling spree due to fear of slowing growth rates. With stock markets nose-diving, hydrocarbon prices plummeting and prices of basic commodities including that of food going northward, the fear of an economic recession in the global economy is looming large. Even though the crisis has not reached our shores yet, it is really a moot point today as to what country like India needs to do if the crisis really deepens further.

As we know very well by now, the global economy is prone to go through cyclical boom and bust. Hence, there is nothing extraordinary about the impending recession or stagflation threat. However, the global economic situation is not the same today as was during the 1930s forcing the Roosevelt Administration to come with the famous 'New Deal' proposals. These proposals were predicated on Keynesian prescriptions of increasing public expenditures to cope with the raging recession in the US economy. The situation is also quite different from the crisis of 1971 when the fixed exchange rate system collapsed, precipitating the ushering of the extant system (a judicious mix of both fixed and floating exchange rates).

Before we really get down to the brass tacks, trying to manage recession and its implications, one has to appreciate that the situation is definitely not the same today as it has earlier been. With the deepening and thickening of the process of globalisation, the inter-dependence among the countries of the world has become more complex. The gradual shift of economic balance of power has changed the global realities. There was a time when the US or the Europe would lead the world economy by their sheer weight and the latter was greatly affected by the negative or positive vibes emanating from either of the two. The global dependence on these blocks through cascading trading ties made it impossible for the world to avoid any development in those countries.

This monopoly situation also made these leading economies quite imperious vis-a-vis the developing/underdeveloped countries often forcing the latter to toe their lines. But the processes of globalisation and liberalisation have afforded a semblance of independence for some of the weaker economies. The emerging complex inter-dependence of economies has facilitated a diversification of trading ties to the advantage of some of the developing countries. These developing countries, today, have been jumping on each other's bandwagon to better secure their economic interests vis-a-vis the developed world.

That is why the threat of recession to such countries including India and China is not as real as it is made to appear. They are reasonably insulated from the ill-effects of the US recession for the simple reason that they are not as overly dependent upon the US as some of the countries are. It is the latter countries, who have skewed economic ties with the United States, are feeling the pinch more. So, countries like Japan or South Korea or some countries in the Europe which have deeper economic ties with the United States and don't have diversified trade profile, should really have genuine reasons to worry. The US recession can really dampen the pace of growth in these countries by way of reduced exports and inflow of foreign exchange.

The countries like India and China should not get panicky as their trading ties are much more diversified. Both these countries, accounting for almost half the world population, have only a small portion of their trade linked to the United States. Of their total exports, not more than 20 per cent go to the United States. Besides, these two countries' growth has been more or less dependent on a sound foundation of strong domestic consumer market. The middle class in these countries has been growing handsomely to provide a broad-based consumer base with substantive purchasing power capacity. It is the consumption behaviour of this growing middle class that has become the latest target of the United States for the snowballing food crisis in the world.

If these two countries have managed to survive the negative impact of the US recession, the reason lies in the fact that the high economic growth rate of both these countries are propped by a strong domestic consumer base. So, while you had the US or the Europe leading and influencing the world economic growth at one time or even now, the situation may be different very soon with these two countries leading the global growth by the sheer weight of the size of their economies. By being less dependent on the US, now reeling under a mild recession, these economies are better insulated and secure than any other country.

This fact is well realised by everyone else and that is why when the US has been experiencing a recession, countries like India and China have been trusted with more and more investment in the form of increasing FDI, FII, NRI remittances and deposits thereby increasing demand for the Indian rupees. This has resulted in building an upward pressure on the rupee, making it further dearer after appreciation of its exchange rate vis-a-vis dollar and other leading currencies.

The US economy is experiencing recession also because of its inability to cut the production costs. The developing countries with their cheap labour and skilled manpower provide better investment options to industries thereby motivating many of them to relocate and outsource their operations. This has not only resulted in reduced employment opportunities for the Americans, but has also reduced their purchasing power, thereby affecting demand and inducing recession. The fact also remains that so far Americans have been living off borrowed money (parked in the form of US treasury bonds by the developing countries including India and China), made available to them at increasingly cheaper interest rates thereby creating an unsustainable bubble waiting to burst.

So arguably, these two countries should have less reason to worry about the US recession as their growth is self-induced than dependent completely on exports. However, such a recession should definitely be seized as an opportunity to further strengthen and streamline their macro-economic financial structure and thereby put their own house in order.

So, at a time when the US Fed has been trying to prime pump its economy by way of reducing the interest rates substantively, countries like India need to be more careful where its central bank has been following a 'dear money' policy for quite some time in its bid to contain the 'inflation demon'. But as we know that it was Keynesian economics of welfarism that saw the US economy out of recession in the thirties, meaning thereby, that we need to spur public expenditure more than contain it. That is why, a moderate inflation is always said to be healthy for any economy as that is the sign of a growing economy backed by a growing demand.

If inflation has been rising in this country, the reasons for the same have to be found and fixed. But raising interest rates and cash reserve ratio (CRR) is definitely not a right approach. Such moves will not only have a dampening impact on the entrepreneurship, but will also discourage investment and further growth. The same would not only result in blocking huge amount of idle money from being utilised for productive purposes, but would also increase the state debt by enhancing the financial burden for servicing those savings by higher interest rates.

This would also make government's own borrowing dearer thereby further straining the resources available for public expenditure. It would also negatively affect the fiscal situation by bloating our fiscal deficits. Inflation has been rising also because of the growing food prices. It is felt that the tendency to siphon out fertile land for industries or for bio-fuels or decreasing investment in agriculture has led to reduced productivity and production thereby directly fuelling the inflation. One feels that there is an urgent need for a second 'Green Revolution' and more public investment in agriculture.

Last but not the least, the very fact that inflation has not yet resulted in wide scale public discontent and outrage and still continues to be a debating issue confined only to the political class is because of the fact that rising prices have been accompanied with increasing purchasing power capacity of the public. With more demand chasing fewer supplies, it is at the level of supplies that we need to intervene. The government needs to ensure that more investment, both private and public, are suitably made to further produce the basic goods and products for availability to the common public at an affordable price and that itself would take care of the inflation problem. More broad-based investment would not only result in more demand creation, but would also put in place adequate supplies to cater to those demand, thereby spurring economic growth further. Such a step would also keep the dreaded recession at bay.

## Salient Points

- Global economic recession at present is not the same as was during the 1930s forcing the famous 'New Deal' proposals.
- The emerging complex inter-dependence of economies as a result of globalisation has facilitated a diversification of trading ties to the advantage of some of the developing countries.
- The middle class in developing countries has been growing handsomely to provide a broad-based consumer base with substantive purchasing power capacity.
- The US economy is experiencing recession also because of its inability to cut the production costs.
- The developing countries with their cheap labour and skilled manpower provide better investment options to industries thereby motivating many of them to relocate and outsource their operations.
- India and China should use recession as an opportunity to further strengthen their macro-economic financial structure.
- A moderate inflation is always said to be healthy for any economy as that is the sign of a growing economy backed by a growing demand.
- Raising interest rates and CRR is not a right approach. Such moves will have a dampening impact on the entrepreneurship and will also discourage investment .
- Inflation has been rising also because of the growing food prices partly due to diverting out of fertile land for industries.
- More broad-based investment would result in more demand creation and ensure adequate supplies.