

Indian Economy and Growth of Financial Market in the Contemporary Phase of Globalization Era

Malayendu Saha*

Department of Commerce, University of Calcutta, Calcutta, India

There has been a passive impression that the maturity of Indian economy with most economic and social indicators owes a favour to the opening up of the economy and subsequent integration into the global trade, investment and financial liberalization. Moderate to excellent performance in industry, agriculture and service sector, expansion of international trade, gradual increase in GDP and increased faith of foreign institutional investors for capital inflows are some of the dynamic features of the growth process. The financial sector, particularly the capital market arena, has also been experiencing incredible progress during the last decade. The contribution of the present paper lies in focusing the growth of Indian economy and its financial sector using the different economic and financial indicators. It is observed that while the country has liberalized its international trade and investment regime, the economy is still insulated from international competition. The Central and State policymakers should exercise innovative measures to address to the challenges to lead India to become one of the leading economic powerhouses in near future.

Keywords: liberalization; Indian economic environment; GDP; growth; financial market

Introduction

There has been a pervasive impression that the acceleration of Indian economy with most economic and social indicators has been the consequence of economic liberalization introduced by the government in early 1990s. The economic elites, both within and outside the country hailed the country's macroeconomic performance and high growth rates of the gross domestic product (GDP) as the new growth 'miracle' in the developing world and as the new major power in the global economy.

The growth process, if reviewed during the plan periods, has observed some dynamic characteristics. Some of the features of this dynamism include: gradual increase in GDP, real per capita income, agricultural and industrial production, expansion of the industrial and export sector, application of modern technology in agriculture, industry and service sectors, achievement of self-reliance in the production of food grains and capital equipments, increasing faith of multinational companies for institutional investments and rising confidence of Indian counterparts in overseas mergers and acquisitions. Despite heavy pressure of population and unemployment, the economy gradually moves forward towards economic self-reliance with strong

industrial and infrastructural foundation. The financial sector, particularly the capital market arena, has also been experiencing incredible progress during the last two decades. According to many, the maturity of Indian economy with most economic and social indicators owes a favour to the opening up of the economy and subsequent integration into the global trade, investment and financial liberalization. Since then, there has been a paradigm shift in the configuration of the economy resulting in increasing importance of external trade and foreign capital inflows and supplementing further buoyancy to the capital market. Indeed, after four years of spectacular growth, the economy experienced sluggishness during 2008-09.

The factors inimical to growth included global economic slowdown, subprime crisis in the US, tensed global equity and credit markets, increasing commodity prices particularly the price of crude oil and binding infrastructure bottlenecks. These have also impacted the capital and current account of the balance of payment (BoP) with extreme volatility in the stock market prices and exchange rates similar to other emerging economies. Relationship between the development of financial market and economic growth dates back to as early as during the early twentieth century (Schumpeter, 1911). The possible directions of causality between financial sector development and economic growth were highlighted by Patric (1996) in his 'supply lending' and 'demand

* Email: m_saha2@rediffmail.com

following' hypothesis. According to Patric (1996), 'supply lending' refers to intentional creation and development of financial institutions and markets that help to increase the supply of financial services and lead to economic growth. The 'demand following', on the other, is the growth of the economy which causes increased demand for financial services and, in turn, leads to development of financial markets (Deb and Mukherjee, 2008).

Studies by King and Levin (1993a, b), Levin and Zervos (1998), Demircuc and Maksimovic (1996) have found positive causal effects of financial development on economic growth in line with the 'supply lending' hypothesis. Robinson (1952), in supporting the 'demand following', argued that financial development primarily follows growth in the real economy as a result of increased demand for financial services. Habibullah (1999), Chang (2002), Bhattacharyya and Sunsubramaniam (2003) made some specific studies on developing countries like China and India. They found some incredible development in the financial sector in India, especially after the opening up of the economy during the last two decades. Studies by Agrawalla and Tuteja (2007), Sarkar (2007), Chakraborty (2008) have also observed the similar linkages between financial market and the growth of Indian economy.

While most of the earlier studies try to capture the inter-linkage between stock market and the growth of Indian economy over the large span of time, the present study endeavours to discuss on the issue during 2000-2010, when most part of the world economy including India, to some extent, were worst affected by the subprime crisis which later transformed into global financial crisis. The study has not considered any recognised model to identify the relation between the stock market and Indian economy rather it deals with some relevant data from different sources to come to some conclusion.

The remaining part of the paper is organised as follows: section two talks about the methodology and data, section three discusses on the growth of Indian economy, the overall performance of financial markets is discussed in section four, section five deals with the major challenges to the Indian economy including the financial market in the days to come.

The paper ends with some concluding observations in section six. The contribution of the present paper lies in focusing the growth of Indian economy and its financial sector using the different indicators like the growth in GDP and its various contributors for the former and the performance of stock market, mutual funds, foreign investment inflows, mergers and acquisitions etc for the later.

Research Methodology

Information for this paper is drawn from some well recognised data sources, such as reports of Indian National Sample Survey Organisation (NSS), annual Economic surveys published by the Ministry of Finance, Government of India, reports of the World Bank etc. For some variables, information are considered since 1991-1992, since the introduction of opening up of the Indian economy, nonetheless, they provide very useful pointer to the processes that unfolded during the first decade of economic reforms in the country.

India: The Economic Growth Story

The macroeconomic growth of a country is generally determined through its pace of economic progress. Since the initiation of economic liberalisation by the Government, the country has positioned herself as one of the most powerful markets emerging in Asia, boasting the fourth largest economy worldwide in terms of GDP, and the tenth largest in terms of market exchange rates. The country experienced a strong push towards an extensive reform programme comprising internal and external economic liberalization, sustained domestic deregulation and an intensive integration with the global economy. The reforms moved at a snail's pace during seventies and then went up in the eighties.

The average growth rate during 1992-93 to 1996-97 was 6.6%, came to 5.5% during 1997-98 to 2001-02 and reduced substantially to 3.8% during 2002-03 because of sharp, drought-induced fall in agricultural output. From then onwards there was significant improvement in the rate of growth averaging over 9 per cent during 2005 to 2008. The GDP growth rate was 9.5 per cent during 2005-06 and rose to 9.7 per cent in 2006-07 but declined marginally to 9.2 per cent during 2007-08. The proximity drivers of this growth spurt included the sustained investment boom, increase in productivity, unusual buoyancy in international economic environment and a demand-and-technology driven acceleration of modern services output. Subsequently, the economy observed substantial resilience during 2008-09, after the growth momentum continued nearly for four years, and the economic growth decelerated to 6.7 per cent due to the global financial crisis.

The three factors that helped India to cope up with the crisis and soften the blow were: i) the robust, well-capitalised and well-regulated financial sector, (ii) gradual and cautious opening up of the capital account and iii) the large stock of foreign reserve. In 2009-10, the GDP growth beat all expectations and

reached 7.4 per cent to establish that the recovery from the slowdown was well underway. The recent phase of growth was driven by robust performance of the manufacturing sector on the back of government and consumer spending. Moreover, the fiscal stimulus measures taken by the government, together with a loosening monetary policy also helped in pushing up the overall GDP growth.

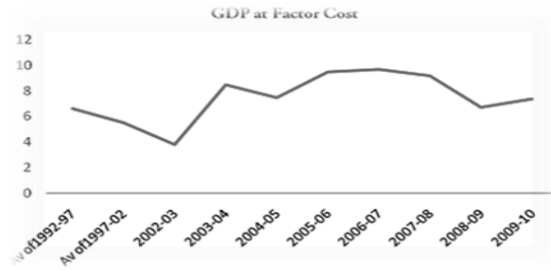


Figure 1. GDP at factor cost

Since 2001, the country has been fast emerging as a global manufacturing hub with a remarkable acceleration and notable double-digit growth rate during 2006-2007. Encouraged by an increasing presence of multinationals, scaling up of operations by domestic companies and an ever expanding domestic market, the Indian manufacturing sector has been averaging more than 9 per cent growth during 2004-08, with a record 12.5 per cent in 2006-07. While the growth slowed down during 2008-09, it remained impressively positive during the early stages of global economic downturn.

Output in the capital goods sector registered annual growth of 9 per cent during 2007-08, which is significantly slower than the nearly 16 per cent average for the period 2003-07. Consumer goods output, which enjoyed double-digit annual gains during 2004-06, slowed modestly from 7 per cent during 2007 to 6 per cent during 2008.

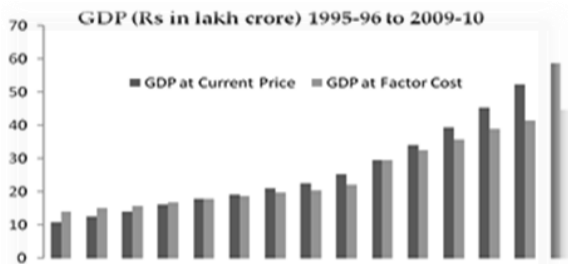


Figure 2. GDP in 1995-96 to 2009-10

The economic survey report considers 1993-94 as the base year and has indicated that the index of industrial production has increased to about 221.5 in 2005-06, 247.1 in 2006-07 and 304.2 in 2009-10.



Figure 3. Growth of service sector

The emergence of India as one of the fastest growing economies attributed to the rapid growth of its service sector. Contribution of services to GDP in the period 2001-2004, has been more than 60 per cent per annum and nearly 63 per cent of the GDP in 2007-08. In the last ten years (1994-2004), the service sector has grown on an average by 7.9 per cent per annum, ahead of agriculture with growth of 3 per cent and manufacturing sector with growth of 5.2 per cent per annum. Among the most talked-about aspect of India’s booming tertiary sector is the surge of the information technology (IT), and in particular, an impressive growth of the export of software and ITeS. The ratio of the IT sector output to the country’s GDP increased from 0.38 per cent in 1991-92 to 4.5 per cent in 2004-05 and over the same period the IT services exports grew at a phenomenal 47.5 per cent per annum.

According to Central Statistical Organisation, the services sector continued to grow during the fourth quarter of 2008-09. Trade, hotels, transport and communication grew 6.3 per cent in January-March 2009 as compared to 5.9 per cent in October-December 2008. As per NASSCOM’s Strategic Review 2010, the BPO sector continues to be the fastest growing segment of the industry and is expected to reach US\$ 12.4 billion in 2009-10, growing at 6 per cent.

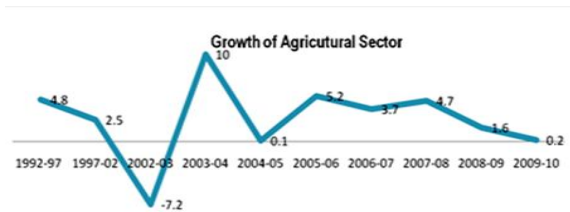


Figure 4. Growth of agriculture sector

Agriculture is one of the strongholds of the Indian economy and it accounts for 18.5 per cent of the GDP and provides employment to 58.2 per cent of the work force. It is evident that there is only a marginal increase of 2.4 per cent aggregate growth in the

agriculture sector as compared to growths of about 8.1, 9.0 7.8 per cent in industry, service and manufacturing sector. The average growth rate of agriculture and allied sectors during 2006–07 and 2007–08 has been more than 4 per cent as compared to the average annual growth of 2.5 per cent during the 10th Five-Year Plan. The growth decelerated from 4.9 per cent in 2007-08 to 1.6 per cent in 2008-09, and subsequently to a meagre 0.2 per cent mainly on account of the high base effect of 2007-08 and a fall in the production of non-food crops including oilseeds, cotton, sugarcane and jute. The total food grain production in 2007-08 was 230.78 million tonnes as against 217.3 million tonnes in 2006-07.



Figure 5. Growth rate of contributors to GDP%

There has been substantial improvement in the economic infrastructure consisting of transport and communication, generation and distribution of conventional and non-conventional energy, banking, finance and insurance facilities, development of social overheads like health and educational facilities during the different plan periods. This developing infrastructure helped sustaining India's growth rate during the recent global meltdown. The index for six core industries comprising crude oil, petroleum refinery products, coal, electricity, cement and finished carbon steel rose by 2.9 per cent in March 2009 over March last year.



Figure 6. Growth rate of contributors to GDP%

The Indian foreign exchange market witnessed far reaching changes since early 1990s following the phased transition from a pegged exchange rate

regime to a market determined exchange rate regime in 1993 and subsequent adoption of current account convertibility in 1994 followed by substantial liberalisation of capital account transactions. The current account balance is usually regarded as the single most widely monitored indicator of a nation's external balance position. In India, the position remained comfortable throughout the period 2000-01 to 2007-08, ranging between a high of 2.3 per cent of GDP in 2003-04 and a low of minus 1.5 per cent in 2007-08.

The relative strength of the current account balance has been concurrent with the marked rise of India's merchandise trade to GDP ratio from a meagre 0.5 per cent during early 1990s to 23 per cent in 2000-01 and then to 35 per cent in 2007-08. Due to contraction in global trade volume India's merchandise exports showed a negative growth during 2008. However, there was a turnaround during 2009-10 in merchandise export when the monthly average growth was 32.9 per cent. Merchandise imports, on the other, also contracted and subsequently rebound during 2009-10.



Figure 7. India's trade balance

Acceleration in the economic growth is also depended on total factor productivity. Studies showed that both industry and service sector had recorded increase in productivity it was more pronounced in case of the latter. Significant lowering of the import duties also helped productivity gains in industry. By 2006, the average share of imports and exports in GDP had risen to 24 per cent. Software exports increased more than six folds from USD 5.7bn in 2000-01 to USD 37bn in 2007-08 raising the contribution to GDP from 1.2 per cent to 3.2 per cent. During 2000-01, the imports and exports recorded USD 50.54bn and USD 44.56bn respectively with a trade balance of (-) USD 5.98bn. The trade balance in 2009-10 rose to USD 108.16bn with imports USD 286.82bn (increase of about 56.75 per cent from

2000-01) and exports USD 178.66bn (increase of 40.09 per cent from 2000-01).



Figure 8. India's foreign exchange reserve

India's balance of payment (BoP) has been characterised by deficit in current account and surplus in capital account during 1990-91 to 2000-01. The position underwent major shifts from 2001-02 when the current account balance turned positive for three consecutive years up to 2003-04. The balance then moved back to deficit territory and the economy experienced a current account imbalance of 1.5 per cent of GDP in 2007-08 and increased sharply to 3.2 per cent in 2008-09. The impact on the capital account was more pronounced as the capital account surplus dropped from a record high of 9.2 per cent of GDP in 2007-08 to a meagre 0.8 per cent of GDP in 2008-09. And this is the lowest level of capital account surplus for India since 1981-82. The decline in exports of goods and services in response to weak global demand had a dampening impact on overall GDP. However, a higher current account deficit led to stronger absorption of foreign capital and, in turn, implied higher investment activities financed by foreign capital contributing to stronger recovery of growth. The position improved during 2009-10, with turnaround in exports in the latter part of the year and resumption in capital flows.

Foreign exchange reserves (FERs) in India have increased not only in absolute terms but also in relation to other variables like SDRs, gold and foreign currency. FERs have grown significantly from a paltry USD 9.22bn in 1990-91 to USD 25.2bn during 1994-95. The growth continued with the reserves touching USD 279.06bn during 2009-10. The outward looking policy helped to accentuate the huge reserve to manage not only rising imports but also external debts, monetary expansion and liquidity growth. With capital inflows exceeding current account deficits, foreign exchange reserves increased to USD 15.1bn (1.9 per cent of GDP), USD 36.6bn (4.0 per cent of GDP) and USD 92.2bn (7.9 per cent of GDP) during 2005-06, 2006-07 and 2007-08

respectively. During 2008-09 (April-December) the FERs declined to USD 20.4 billion (2.3 per cent of GDP) due to global financial crisis.

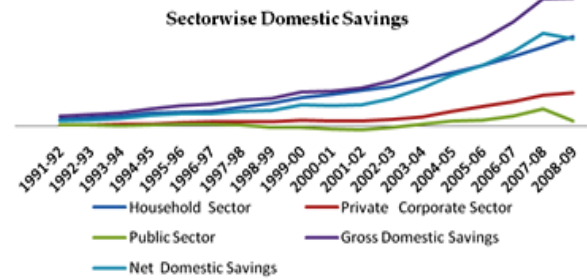


Figure 9. Sectorwise domestic saving

Development of India's Financial Markets

India's financial market began its transformation path in the early 1990s. The introduction of Securities and Exchange Board of India (SEBI), repealing of the Controller of Capital Issues (CCI) removed the administrative controls over the pricing of new equity issues. The capital market, consist primarily of debt and equity markets, played a significant role in mobilising funds to meet the public and private entities' financing requirements.

The advent of exchange-traded derivative instruments in 2000, such as options and futures, also enabled investors to better hedge their positions and reduce risks. The debt market of India is mostly comprised of government and corporate bond. The contours of the government bond market began taking shape around 1992 as a result of the government's broad-based attempts to reform the financial sector. Moreover, the high fiscal deficits and public sector borrowings led to a bigger size of the government bond market. The size of the corporate bond market, in contrast, remained quite shallow during the mid-2000.

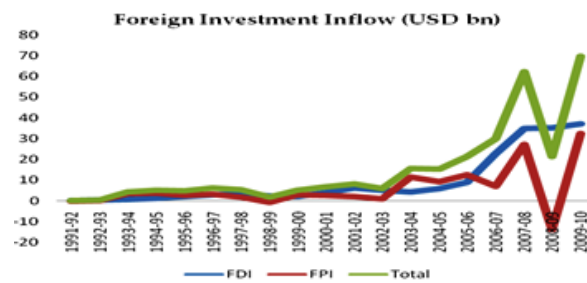


Figure 10. Foreign investment inflow

Significant growth acceleration in recent years is underlined by distinct increase in savings and

investment rates. The period 2002-03 to 2007-08, observed a notable transformation in the level and composition of aggregate savings and investment in the economy. The investment rate between early 1990s and the first year of 2000 was about 24 per cent of GDP, in the next five years it rose sharply and increased to 35.5 per cent in 2006-07. The rate then moderated from 37.7 per cent in 2007-08 to 34.9 per cent in 2008-09 mainly on account of a decline in the investment of private corporate sector. Gross domestic savings (GDS) as a proportion to GDP was 23.9 per cent in the 1990s with a simultaneous increase in the rates of financial savings of the household sector and private corporate sector. The rate continued to improve rising from 26.4 per cent in 2002-03 to 32.42 per cent in 2005-06 with an average of 31.4 per cent during the tenth five year plan.

The aggregate savings rate declined from a moderate 36.4 per cent in 2007-08 to 32.5 per cent of GDP during 2008-09, reflecting a sharp fall in public sector savings on account of the fiscal stimulus measures. The net financial savings during 2008-09 was 10.4 per cent of GDP at current market price, higher than 9.8 per cent during 2004-05. Despite a slower growth in bank deposit interest rates, a turnaround in the household financial savings during 2009-10 was possible due to revival in the other components. Sharp recovery was noted in the household savings in life insurance, public provident fund, small savings, senior citizen deposit schemes and mutual funds. The private corporate sector savings, as a ratio of GDP, increased from about 6.6 per cent in 2002-03 to 8.4 per cent in 2008-09 and the public sector savings which was negative in 2002-03 increased steadily to 5.0 per cent in 2007-08 and again reduced to 4.4 per cent in 2008-09. The private sector investment showed a sharp increase from 23.8 per cent of GDP in 2004-05 to 25.0 per cent in 2008-09. The savings-investment gap in the public sector stood at (-) 5.1 per cent in 2004-05 that increased to (-) 8.0 per cent in 2008-09.

The development of equity capital market took a more progressive trajectory than the bond market, largely reflecting the government's *laissez faire* approach to the segment. The domestic market boomed over the past seven years, with market capitalization increasing from less than USD 300bn to over USD 1tn during this time frame. The growth in the market was fuelled by both domestic and foreign investors. Domestic investors enjoyed a thriving economy during the last few years, though the majority of the households still interested in keeping their savings in bonds and fixed deposits, many turned towards equity investment through mutual funds. Foreign institutional investors (FIIs) and non-resident Indians (NRIs) also increased their

levels of investment as liberalisation of investment caps and participation in derivative markets allowed them to hedge risks.

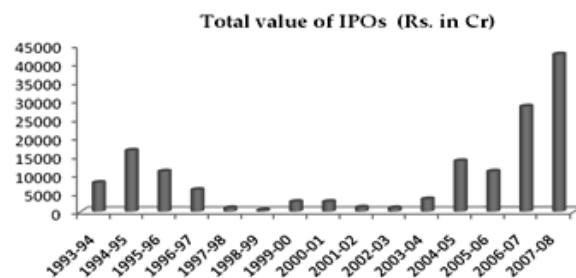


Figure 11. Total value of IPOs

In India, foreign direct investment (FDI) inflows amplified significantly in the post reform era with streamlining of regulations, radical changes in the policies, astounding corporate performance and increased confidence of the investors. The service sector in India became a major destination of FDI inflows and within the sector, financing, insurance, real estate and business services witnessed a large increase in their share in FDI inflows to India between 2002-03 and 2007-08. The computer software industry also experienced a growth of 28 percent CAGR during the same period. The huge market for computer hardware coupled with availability of skilled workforce boosted the inflow of FDI in this sector. FDI ceilings increased gradually in various sectors like mining, petroleum, civil aviation, real estate and several other industries over the last few years.

The FDI inflow simply doubled in first year of reforms in 1992-93 to USD 55.9bn as compared to USD 13.3bn in 1991-92. The growth momentum continued till 1997-98. However, a mixed growth was observed during 1998 to 2004. The reduction in inflow was due to East Asian Crisis in 1997-98. FDI inflow in India rose more than five times during 2003-07. Growth rate became positive from 2004-05 and the investment was maximum during 2009-10. The rapid growth of the economy made India as one of the most attractive destinations for foreign capital inflows. The net capital inflows that were 1.9 per cent of GDP in 2000-01 increased to 9.2 per cent in 2007-08. It again decreased in 2008 due to the global financial crisis. Foreign portfolio investment (FPI) also added buoyancy to the Indian capital markets. From a meager USD 4bn during 1991-92, the amount rose to USD 124.92bn during 2007-08. However, the investment got some major setback during 2008-09 when FDI came down to (-) USD 138.55bn and then came back sharply in 2009-10 with a mammoth USD 323.75bn. The initial effect of the subprime crisis

was, in fact, positive, as the country received accelerated inflows during September 2007 to January 2008. This contributed to the debate on “decoupling,” where it was believed that the emerging economies could remain largely insulated from the crisis and provide an alternative engine of growth to the world economy. The argument soon proved unfounded as the global crisis intensified and spread to the emerging economies through capital and current account of the balance of payments (BoP). The net portfolio flows to India soon turned negative as FIIs rushed to sell equity stakes in a bid to replenish overseas cash balances.

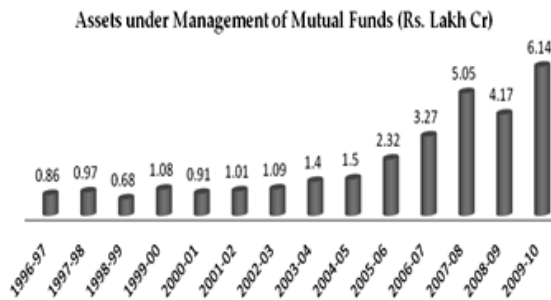


Figure 11. Assets under management of mutual funds

Domestic companies, both large and small cap, were allowed to list abroad by way of American Depository Receipts (ADR) and Global Depository Receipts (GDR) since 1992. Owing to global financial instability, the Indian stock market experienced several impulsive events and the amount raised through the ADR route remained quite volatile. Only in recent years, the issuances have picked up steadily with the amount raised USD2bn during 2000-2010.

In the primary market, diverse arrays of companies from entertainment to finance industries built up capital through initial market offerings (IPOs). Banks, financial institutions, construction and infrastructure companies were the most frequent issuers in recent years. The number of IPOs amplified rapidly since mid-1990 when the markets first began to take off and generated a substantial amount of capital in the past several years. The primary market was quite depressed during 1995-96 to 2002-03. The overall decline was attributed to factors generating on the demand and supply sides. The scams in the secondary market also affected the primary market adversely. The resource mobilised in the primary market declined sharply from a moderate Rs. 27,633cr in 1994-95 with 1692 issues to only 26 issues worth Rs. 4,070cr in 2002-03. The market, however, turned back sharply from 2003-04 with a considerable increase in both volume and value. The

number of issues increased to 139 with amount mobilized Rs. 23,382cr during 2005-06. Of the 139 issues, public issues were comprised of 103 (Rs. 23,294cr) and right issues of 36 (Rs. 4,088cr). A significant recovery was observed both in volume and value from 2007-08. The amount collected rose by 12.4 times from Rs. 3,434cr to Rs. 42,595cr.

The strength of Indian economy, its vibrant stock market, exemplary financial performance of the corporate, increased demand of the energy sector and private equity fuelled IPOs in 2006-07 and 2007-08. During 2007-08, capital amounting to Rs. 42,595cr was raised through 85 IPOs. Top global private equity funds such as Carlyle, Blackstone, Texas Pacific and Warburg Pincus, as well as local funds, were the key drivers of the strength of Indian IPO markets. In 2008, the amount of capital raised averaged close to Rs. 500cr per IPO versus a mean IPO size of less than Rs. 10cr in the mid-1990s. When the global crisis hit from mid-2008, the market fell dramatically and between January 2008 and March 2009, the market declined 60 per cent and the P/E ratios dropped over 45 per cent over the same period. During 2009, IPOs in India dried up several large equity offerings, including those from reputable business houses.

The stock markets became volatile, reacting to fears of a widening global credit crunch and fears of a U.S. recession. After the tough 2008 and lack lustre 2009, the year 2010 was an action packed year for the Indian primary market, which saw not only revival of the Indian primary market, but also setting of several new records in the Indian Public issue market. As much as Rs. 71,114cr was raised during 2010 through 70 public issues comprising 62 IPOs (Rs. 39,710cr) and 8 FPOs (Rs. 31,403cr).

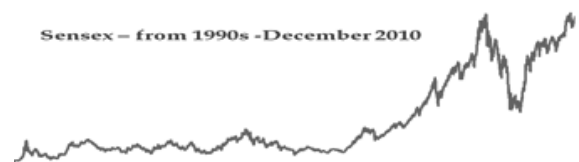


Figure 12. Sensex- from 1990s- December 2010

During 1997-98, the amount raised through private placement almost doubled from Rs. 15,066cr to Rs. 30,098cr in 1997-98 and in 2000-01, the amount went up to Rs. 67,837cr. The total resource mobilised during these years accounted for nearly 88 per cent of the total resources from the primary market.

The contribution of the public sector during 1996-97 was much higher than the private sector. Later, the private sector started dominating the process contributing more than 54 per cent of the resource mobilised in the private placement market

during 2001-10. Also the total number of issues raised manifold. From a meagre 130 issues in the private sector and 118 in public sector during 1997-98, the number rose to 2482 in 2009-10, of them private sector contributed 2265 issues and the public sector 217 issues. The amount amassed through this process also amplified by more than five times and reached a huge amount of Rs. 342,445cr during 2009-10. However, due to the global crisis there was some set back in the total amount of accumulation of Rs. 204,057cr during 2008-09. A change in the government policy in 1993 led to the entry of private corporate and foreign institutional investors into the mutual fund segment, taking the tally of mutual fund institutions to 37 by end-March 2004 with assets under management of Rs. 139,615cr and subsequently reached to Rs. 613,979cr – and increase by 615.4 per cent since 1997 from Rs. 85,822cr. The contributory factors were comprised of: setting up of new banks and financial institution-sponsored mutual funds in the late 1990s, tailor-made schemes introduced by them and high rate of return by some schemes. However, resources mobilized by mutual funds experienced certain hold-up during 1995-96 and 1996-97.

The subdued stock market conditions coupled with a perceived lack of transparency in the functioning of some of the renowned mutual fund institutions, delayed refunds, poor accountability and lack of efficient services were the causes of poor performance of many mutual funds resulting in low or even negative returns thereby. In 2000-01, the AUM declined sharply by about 20 per cent and then turned around and rose by around 60 per cent during 2001-02. AUM again increased by more than 22 per cent in 2003-04 and rose further by nearly 360 per cent to Rs. 5.05lakh cr in 2007-08.

A major set-back observed during 2008-09 due to the global financial crisis which had a massive impact not only in the stock markets in various countries but also to the mutual fund industry. The resources mobilised rose from Rs. 2,695cr during 1998-99 to Rs. 94,063cr in 2006-07 and then reached its peak of Rs.148,485cr in 2007-08 and then turned negative to Rs.(-)24,641cr in 2008-09. However, the situation reversed during 2009-10 and was Rs. 78,545cr in 2009-10. Increased volatility in financial asset prices, growing integration of national financial markets with international markets, development of more sophisticated risk management tools, wider choices of risk management strategies to economic agents and innovations in financial engineering helped the growth of financial derivatives worldwide and in India, one of the most successful developing countries in terms of a vibrant market for exchange-traded derivatives. Since its inception in June 2000,

derivatives market exhibited exponential growth both in terms of volume and number of traded contracts. The market turnover had grown from Rs.2365cr in 2000-2001 to Rs. 11010482.20cr in 2008-2009.

The annual turnover, market capitalisation and the BSE sensex increased sharply from 1991-92. The unprecedented buoyancy in the stock market was due to the liberalisation measures introduced by the government. During 1999-2000, the BSE turnover witnessed a sharp increase of 119 per cent. The market was driven by FII inflows, improved corporate performance, sound macro-economic fundamentals and upgrading of India's international credit ratings from stable to positive by international credit rating institutions.

In 2000-01, the increase in turnover declined to 46 per cent due to slowdown in FII inflows, increase in international crude oil prices, payment crises at some stock exchanges etc. BSE market capitalisation jumped to Rs. 17.5lakh cr during 2004 and on October 30, 2006 the sensex joined a select club of global indices which crossed the 10,000 mark and continued to trade above that mark. The year 2008 marked the victory by sensex touching 21000 in the beginning of the year. However, Indian equities ended lower in January on the worries that the economy may not be as insulated on the global sub-prime crisis as previously thought.

The robust performance of the Indian stock markets can also be seen in the huge increase in the funds mobilized by the corporate India. During 2007-08, India Inc mobilized a whopping US\$ 8.13 billion through issue of shares on rights issue, which is almost an eight-fold increase over US\$ 926.32 million raised in 2006-07. In fact, the mobilization of the funds in 2007-08 was more than the combined mobilization of the preceding 12 years. Simultaneously, a whopping US\$ 13.07 billion has been raised through by India Inc through public issues, according to data compiled by Prime Database.

Some Major Challenges

India had made a very slow, deliberate and cautious approach for her reform process which ultimately helped to spur an appreciable economic growth. In spite of such rapid growth during the last few years some issues remain unattended and need a thorough review and attention.

The most serious concern is the emerging high double-digit food inflation. Unpredictable weather patterns, unseasonal rains, supply-chain inefficiencies, wastages and lack of cold storage and processing facilities to smoothen the supply curve

compounded the problem of inflation in India. Moreover, the rapid recovery in the economy and rising petrol and diesel prices has also brought forth the challenge of higher inflation. Farmers in India are squeezed from both ends, paying higher labour and input costs due to rising prices and not receiving better realisation for their produce, despite higher food prices. As India moves to sustain vibrant economic growth to meet its “inclusive growth” objectives, it definitely needs to invest heavily in both human and physical infrastructure.

The stimulus packages, though pepped up economic activities, have contributed to an increased fiscal deficit (6.8 percent of GDP), the highest in this decade. The combined fiscal deficit (Centre and States) comes to 10.5 percent. The FY 2010 also run up a high current account deficit (4.1 percent of GDP) even as the rupee appreciated by 11 per cent against US dollar during this period, mainly on account of high capital inflows. The infrastructure bottlenecks, superfluous administrative controls, corruption, rigid labour laws, high interest rates, shortage of skilled labour in some sectors, are some of the areas of concern.

By international standards the experience of India’s equity markets is a singular one. Despite the existence of traditional equity exchanges, India’s equity market has now completely transformed the market mechanisms used in trading, clearing and settlement. In every economy, there is a problem of linking up savings of household to investment by firms. This allocation of such funds as resources for the purpose of investment is a crucial function of the financial systems. Coupled with the expansionary fiscal policy, the initiatives have had a favourable impact on domestic monetary, real and financial sectors.

As compared to developed countries which are presently facing recessionary trends, the Indian economy has merely had a moderation in growth during 2008-09. On a preliminary assessment, the economy evinces early signs of turnaround. It is also a matter of satisfaction that the performance of the capital market has lately shown signs of revival of investor interest and confidence – both domestic and foreign institutional investors. The rupee appreciated significantly during 2007, raising concerns about the competitiveness of Indian industry.

In nominal bilateral terms vis-à-vis the dollar, the appreciation has been particularly notable, reaching successive nine-year highs as it rose about 12 percent over the year. Although the increase has been lower in nominal and real effective terms—only about 7–7½ percent—the appreciation of the effective rupee has taken it out of the historical range in which it fluctuated during most of the last decade.

Roadmap for the Future

India has tremendous potential advantage in its demographic transition. Such demographic advantage, however, is the one time gift to the countries which needs to be capitalized with the backing of appropriate economic, social and political institutions and policies. Otherwise, it could easily lead to higher levels of unemployment and give rise to social unrest. This growing inequality is bound to feed the fury of the majority of youth which is getting pushed into nowhere in absence of jobs. If our policy makers realize the incipient danger through this demographic transition and shun their elitist policy myopia, it would prove to be the greatest dividend to us through this demographic learning. Policy makers need to have better knowledge of the exogenous factors like damage to natural environment, land use, water use, deforestation and forest degradation, loss of biodiversity, energy production, and exploitation of non-energy materials etc influencing various economic activities such as farming, forestry, grazing or fishing and how to manage them and ensure efficient use of resources.

Rural India calls for a radically different approach to improve farm sector’s growth performance by identifying rising disparities between the agricultural and non-agricultural sectors and deteriorating quality of the public services. For increasing the agricultural growth, community farming should be encouraged. Proper use of fertilizers and pesticides should be pressed upon, especially encouraging use of organic manure and bio fertilizers, to minimize input cost and increase yield. While the capital market reforms are impressive, there are still areas that present major problems. The market has still not recovered from its sluggish IPO markets. The debt market presents the biggest problems and consequently, many large Indian companies look to foreign capital markets for longer term debt and equity. Finally, the fact that pension funds and banks cannot invest freely in private sector debt or equity eliminates major demand from the market. The trends of total international capital flows into India are positive, where portfolio capital flows are invariably short term and speculative and are often not related to economic fundamentals but rather to whims and fads prevalent in international financial markets. The FDI also does not reveal stable trend so far in India. It may, thus, be contributed towards neither industrial production nor economic growth. There are two reasons for this, one the amount of capital inflows to the country has not been enough and two, the amount of capital that does flow in, is not utilized to its full potential (Mazumdar, 2005).

Conclusion

Though the country's economy is booming, India must confront a number of challenges to sustain rapid economic growth over the long run. Sustaining such growth will require the government to fast track the reforms in many areas to free the economy from the clutches of political vagaries and bureaucratic control. Moreover, the policymakers should identify reforms in policies as well as institutions to accelerate growth and also to make the growth inclusive.

Where reforms in policies include fiscal, monetary and financial sector to ensure macroeconomic stability, the institutional reforms are necessary to strengthen the financial institutions and to ensure appropriate incentive and accountability. India should also take initiatives to overcome the challenges to foster labour-intensive manufacturing and agricultural sector and broaden economic prosperity. While the country has liberalized its international trade and investment regime, the economy is still too insulated from international competition. If the Central and State policymakers exercise leadership and address the challenges, India will become one of the leading economic powerhouses in near future.

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