

# [India: current economic reforms and its impact on credit ratings essay](https://assignbuster.com/india-current-economic-reforms-and-its-impact-on-credit-ratings-essay/)

Indian government is pushed into dark corners from all sides. Policy paralysis, rising food prices and inflation are creating huge unrest among the general public. The corporate sector too is not happy with the way the government is functioning.

Global rating agencies like the Standard and Poor’s and the Moody’s have downgraded India’s credit rating from ‘ Investment’ grade to ‘ Speculative grade’. Also it has come out heavily criticizing on the Congress’ leadership over its inability to convince neither its own allies nor the opposition and push the reforms measures. Also, Congress is widely split within itself on economic policies and there is serious opposition to any kind of attempt towards liberalization of the economy. But things have started rolling recently after the new finance minister has taken charge. A host of new announcements have started coming up to save the sliding economy. This is widely perceived as Reforms 2.

0 in continuation to the reform measures which Dr. Manmohan Singh had initiated during 1991. The government has started wooing foreign investments and rationalising subsidies. The cabinet has approved to open up FDI in major sectors like airlines, retail and insurance which have created political heat. Some key allies have seriously condemned the move and left the coalition, creating serious threat to the smooth passage of reform measures through the parliament. There is another story to Congress’s backing the PM’s reforms measures.

Sonia’s brain child “ Food Security Bill” needs money which becomes practically impossible without considerable foreign investments. This is one of the major selling points for Congress in the forthcoming elections. Corporate sector though praise the current move is well aware that the current measures are not sufficient to revive the economy overnight. A host of reform measures like the Goods and Services Tax, Restructuring of State Electricity boards, new land Acquisition are long pending. So far, Credit ratings have not positively responded to the government’s measures. Also India’s GDP growth forecast for 2012-13 remain gloomy at 5.

5 per cent and has not been revised by any of the major banks or credit rating agencies. Standard and Poor’s in its recent press release said that it is willing to revise India’s credit rating if it continues with its steps to reduce fiscal deficit and increase growth prospects. However, the rating agencies have also warned that there is an equivalent chance of downgrading the rating if the political climate worsens further. Weaker economic growth and its impact on tax receipts, subsidies exceeding the budgeted limit contribute to the fiscal deficit adding to the woes.

Country’s credit rating is majorly affected by the following factors: 1. Increase in per capita income enhances tax collection. Therefore the country can repay its debt quickly due to the revenues earnt ( rate of repayment)2. Increase in economic growth(measured by country’s GDP)3. Inflation rate4. Economic development5.

Persistent current account deficit affects the sustainability6. Foreign debt /GDP7. Real exchange rate8. Default history9.

Ratio debt/GDP10. Ratio reserves/imports1. Regulatory quality, rule of law, accountability and political stabilityThe current situation needs continuous inflow of money to sustain the momentum of growth that has been triggered. One of the ways to raise capital for this is to infuse foreign capital in the equity market. This is already present in the nation in the form of FDI in the various sectors.

Though this has been in the limited proportions, however, due to the crunch of the liquidity in the system and limited capacity of the Government to bail out the current situation, it is of paramount importance that liquidity be infused into the system by the various players. The current moves that have been initiated by the Government have helped to inject liquidity into the system. Also, certain industries and sectors are too huge that require deep pockets for financing. The instance of which can be cited as the Airlines’ industry in the nation. The fate of Kingfisher Airlines and many more which are diving into the red needs to be stalled so that it doesn’t deteriorate further.

The capital which is required for rescuing these cannot be borne by the Government which itself is struggling with its huge fiscal deficit. So, an alternative to it can be liberalizing or freezing the reservations that have been set by the government in these sectors. Though the reservations had been set keeping in mind the protection of the domestic investors, the need of the hour is to infuse the system with capital. So the recent move of the 49% FDI in the aviation will not only help the airline company with the capital but also get efficiency in the system of their operation due to the global experience of the investor.

Also, due to the association with a foreign brand will help in projecting a better brand for the company. Also, the management can avail exploit cheaper foreign markets, thereby enhancing its operations. Another segment that has caught the eye of the Govt is the insurance and the pension funds. India’s pension fund market is worth â¹15.

4 lakh crore and it not sufficiently well exploited. This sector requires an infusion of an additional â¹62000 crore. In fact, due to the booming Indian economy, this sector is not even exploited properly and by increasing the FDI limit to the proposed 49% will definitely invite more competition in this sector. This in turn will not only take the load off the Government but also give its recipients and beneficiaries better returns on their investments. The Government can provide better vigilance on the pensions and the insurance by setting up an Investment Board.

Dealing with the FDI in the retail, the Government has to take care about the policies and the long term effects of the introduction of the FDI in the retail. The Government should ensure that in the process of the introduction of the various policies of the FDI, it should help in better domestic sourcing and help in the better employment creation at the local level and at the same time ensure that the local kirana stores aren’t hampered. FDI in retail will definitely help to swamp the market with a plethora of options, which in turn will increase the competition in the market and also help to reduce the prices of the goods. This will also reduce the dominance of the multiple levels of the middlemen that exist along the hierarchy leading to better take away for the farmers.

Also, the Government should help to promote and attract investors towards the sectors that provide rural employment and also capital infusion e. g. Khadi industries, which will help to boost the fabric sales manufactured in India in the foreign market. De-regulation of oil prices will give the Government a cushion against the fluctuating fuel prices by the in the nation – thereby reducing the amount of subsidies given by the Government on the fuels. Curtailment of Expenditure: Government should focus to increase the ratio of the spending in the capital expenditure (health, infra-projects, education) in the overall expenditure.

Such measures will definitely help to reduce the fiscal and the current deficit. This in turn will give a boost to the economy and hence will increase the investor confidence, which will help in the capital inflow in the nation.