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DAILY EDITORIAL ANALYSIS

TOPIC

India's Looming Financial Crisis

INDIA'S LOOMING FINANCIAL CRISIS

In Context

- India is currently experiencing a credit boom, driven by optimism about the country's digital infrastructure and financial innovations. However, this growth is not without its challenges and potential dangers.

Risks and Consequences

- **Jobless Growth and Economic Policy:** For three decades, economic policies have failed to generate job-rich manufacturing growth. Instead, successive governments have relied on the financial services sector to drive GDP growth, contributing over a quarter of GDP growth in the last decade.
- **Chaotic Financial Services Industry:** Liberalization has led to a large and disorganized financial services industry. A mix of large commercial banks, major non-banking financial institutions (NBFCs), and numerous smaller players, including fintechs, have engaged in risky lending practices to sustain profits.
- **Post-COVID Lending Surge:** The COVID-19 pandemic exacerbated financial sector issues, redirecting lending towards households with stagnant incomes. Fintechs, in particular, have offered loans at high-interest rates to desperate borrowers, increasing financial stress.
- **High Household Debt Burden**: While India's overall household debt-to-GDP ratio may seem low compared to international standards, the debt-service-to-income ratio is alarmingly high. This indicates a growing strain on household finances and raises concerns about debt sustainability.

Historical Parallels and Future Implications

The current situation in India has alarming similarities to past financial crises in other countries.

- **US and Spain Pre-2008 Crisis**: Before the 2008 financial crisis, the US and Spain experienced high household debt-service-to-income ratios, similar to current levels in India. This high debt burden precipitated major economic downturns when households cut back on spending to manage their debt.
- **India's Debt-Service Ratio**: At 12%, India's household debt-service-to-income ratio is among the highest in the world. This high ratio indicates that a significant portion of household income is dedicated to debt repayment, leaving less for consumption and savings.

Implications for India's Economy

- **Economic Contraction:** A financial crisis could lead to a sharp contraction in economic activity, as households and businesses cut back on spending to repay debts.
- **Increased Inequality:** The most vulnerable segments of society would bear the brunt of the crisis, exacerbating existing inequalities.
- **Job Losses:** The crisis could lead to significant job losses, further worsening the already dire employment situation in the country.
- **Long-Term Damage:** The financial crisis could cause lasting damage to the economy, hindering its long-term growth potential.

Major steps taken to deal with India's Looming Financial Crisis

- **Monetary Policy Measures:** The RBI has implemented various measures to manage liquidity in the financial system like raising Repo Rates to curb the inflation.
- **Fiscal Policy Measures:** To increase the spending on infrastructure projects and social welfare programs to stimulate economic growth and create jobs.
- **Tax Reforms:** There have been efforts to simplify tax rules and improve tax collection to increase revenue. For example, the GST.
- **Ease of Doing Business:** The government has implemented several reforms to make it easier for businesses to operate in India.

- Programmes like **'Make in India'** and **'Start-up India'** are strengthening the country's manufacturing infrastructure, innovation and entrepreneurship landscape. The passing of Jan Vishwas (Amendment of Provisions) Act, 2023 rationalizes businesses.
  - India ranks 63rd in the World Bank's Doing Business Report (DBR), 2020.
- **Attracting Foreign Investment:** The government has taken steps to attract foreign investment to support economic growth.
- **Financial Sector Reforms:** There have been ongoing efforts to strengthen the banking sector and improve financial inclusion.

Way Ahead

To prevent a financial crisis, India needs a multifaceted approach to address the structural issues and mitigate the risks associated with rapid credit growth.

- **Downsizing the Financial Sector**: The financial services industry needs to be scaled down to better align with productive borrowing needs. This requires tighter regulation and oversight to ensure that lending supports sustainable economic activities.
- **Exchange Rate Adjustment**: Weakening the rupee could help expand exports and provide a buffer against economic downturns. A more competitive exchange rate would make Indian goods cheaper on the global market, boosting export revenues.
- **Focus on Job Creation**: Policymakers must prioritize job-rich manufacturing growth to reduce reliance on the financial sector. Investments in human capital, infrastructure, and industrial development are essential to create sustainable employment opportunities.
- **Financial Education and Consumer Protection**: Enhancing financial literacy and consumer protection can help households make informed borrowing decisions and avoid falling into debt traps. Strengthening regulatory frameworks to curb predatory lending practices by fintechs and other lenders is also crucial.
- **Monitoring and Managing Household Debt**: Regular monitoring of household debt levels and implementing measures to manage debt burdens can prevent a debt-driven economic crisis. Policies should focus on ensuring that household borrowing supports productive investments rather than mere consumption.

Mains Practice Question

[Q] Discuss the structural issues and policy choices that have contributed to the current credit boom in India. Evaluate the effectiveness of these policies in promoting sustainable economic growth.

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