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IMPACT OF GLOBALIZATION AND INDIAN EXTERNAL SECTOR

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ABSTRACT:

In this research paper an attempt is made to study the dimensions of globalization process on Indian external sector during 1990's. At the outset the globalization process taken place in the Indian economy is analyzed. Trends on the front of Indian external sector are discussed next and broad conclusions are presented at the end.

The decade of 90s can be described as the decade of the globalization process for the Indian economy. While the early years of the decade witnessed the first phase of economic reforms in industrial, finance and external sectors, the final years saw the beginning of the second phase of economic restructuring. Globalization process over the last decade have provided export friendly environments with simplified procedures conducive to enhancing export performance. The focus of these reforms has been on liberalization with basic trust on outward orientation focusing on export promotion activity moving away from quantitative restrictions and improving competitiveness of Indian industry to meet global market requirement. Over the years, significant changes in the Exim policy helped to strengthen the export production base, availability besides focusing on quantity and technological up gradation and improving competitiveness. Steps have also been taken to promote exports through multilateral and bilateral initiatives identification of thrust areas and focus regions.

The broad conclusions of the study indicate that the decade of globalization process was successful in executing supply response as evidence in the higher growth of GDP, comfortable foreign exchange reserve, improving short-term debt profile, moderate inflation and buoyant exports.

However, the above-mentioned trends on the front of major dimensions of the external sector indicate that the globalization process has not bestowed its much favorable influence on the Indian economy. The full benefits of globalization process are yet to be achieved. It may be due to slow pace of India's opening up. Trade growth, FDI inflows and technology transfer to India have yet to come in a big way. Also globalization polices are yet to influence the exchange rate regimes and external debt front on more favorable lines. This indicates that India's program of globalization process has been a mixed bag of success and failure; a final judgment on it has to wait. The reduction in the multiplication of export promotion schemes and freeing of imports are positive features. Liberalization of trade regime, removal of import and exchange control and progress towards lower and less dispersed bands of tariffs indicate that the Government is dismantling quantitative restrictions by 2002 as per WTO requirements.

A major outcome of Indian globalization process in the 1990s has been the evolution of the external sector with considerable inner strength to meet the challenges of foreign as well as domestic shocks. This has been demonstrated at the time of Asian financial crisis and related contagions and adverse spillover effects from mid-1997 to mid-1999. Economic sanctions on India by the major developed

countries in May 1998 and the more recent international oil price shock since the early 1999.The adjustments to these shocks have been smooth but they also left scars. The situation shows that India can minimize or even avert as in the past, the adverse effects of such shocks in future by strengthening the country's economic fundamentals like strengthening of policy stances in areas of exports, POL imports and foreign investment flows. This will greatly help India to grow in an environment of a viable BOP, reasonably stable exchange rate, a sustainable external debt profile and an external sector with durable strength and vigor.

KEYWORDS: *market economies , International trade , developing countries , Globalization.*

0.1 INTRODUCTION

During the past decade world's market economies have become integrated like never before. International trade as a share of gross domestic product has reached very high levels even in developing countries. Due to this there seems to be a general consensus among policy planners in developing countries that greater integration with the global economy (globalization) will greatly enhance the well – being and the standard of living of developing countries. Globalization implies a regime of perfect competitive markets with no entry or exit barriers. Globalization has been the catchword for international political economy discourses in the 1990s, particularly after the decline of the so – called socialist regime in Europe.

Globalization process in the world economy in the form of freer flow of goods and services across nations, international movements of finance capital and labour migration has been strengthened in the decade of 1990s, particularly after the revolution of information technology and concerned global actions to initiate the process of policy globalization process based on trade liberalization, technological collaboration and participation of foreign equity and portfolio investment in different parts of the world. The collapse of the Soviet economic system in the early 1990s has given a political fillip to this process.

The formation of the WTO at the conclusion of the GATT negotiations has marked the beginning of multilateral surveillance of the trading arrangements that are evolving under the new global order. The enthusiasm for free trade is primarily due to two factors. The poor economic performance of the closed and restrictive economy like India, vis – a – vis the spectacular performance of the newly industrialized countries in the Pacific basin, encouraged policy are price stability. Secondly, emboldened by the success World Bank and IMF had with countries following outward looking policies, trade liberalization has become the single most important criterion for World Bank and IMF lending. Short and long term lending by the World Bank and IMF, to developing countries, are often predicated upon and explicit promise to open up the economy. It is therefore, conceptually important to recognize the fact that the recent wave of liberalization is in many cases a policy response to address a very desperate domestic economic conditions. Against this background an attempt is made to study the dimensions of globalization process on Indian external sector during 1990's. At the outset the globalization process taken place in the Indian economy is analysed. Trends on the front of Indian external sector are discussed next and conclusions are presented at the end.

0.2 GLOBALIZATION PROCESS IN INDIA:

Keeping aside the initial compulsions, largely driven by international oil price crisis, to open up a window or two to the world trade system, the feeling that the Indian economy could no more continue with its import substitution strategy, cultivated during 50's and 60's, Indian economy started opening up its frontiers to the world outside during late 70's and early 80's.It was the first time efforts were made to improve 'productivity', 'efficiency' and 'competitiveness'. India could no more keep aloof from the rest of the world, particularly if technological advances occurring elsewhere would have to be assimilated and adapted to India's own production requirements. Anticipating export growth potential of certain areas, a selective import liberalization approach was put into operation to gain international competitiveness. Import of technology, modern capital equipment and its ancillaries, specified categories of industrial raw materials, etc., all on a highly selective basis, was the summary of the trade liberalization philosophy of the eighties. Naturally, its impact was limited. Nonetheless, it set the trail ablaze. Since 1986 or 1987, every now and then, the economy witnessed one or the other liberalizing element till we enter the nineties.

In July 1991, a new economic era commenced. Wide ranging policy reforms, encompassing all major sectors of the economy (trade, industry, agriculture, foreign investment and foreign technology, financial sector, public sector, and so on) were put through, with a rare degree of political resoluteness. The new trade policy aimed at eliminating discretionary controls on international trade transactions, reducing the nominal as well as the effective protection available to domestic industry, and bringing domestic prices closer to world prices. Three dimensions of the new trade policy, namely a rapid dismantling of quantitative restrictions on imports and exports, a substantial reduction on taxes and subsidies on trade and suitable adjustments in exchange rate, need to be underlined. The process of a near total dismantling of quantitative restrictions on imports and exports signaled a dramatic departure from the past policy regimes. In the sphere of exports also, the negative list consisted of the same three principal categories. Reduction in import and customs duties was the other landmark of the new trade policy.

It is against this background that India's going to the WTO in 1995, and accelerating further the process of trade liberalization, would seem to be natural and inevitable. In the opinion of the then policy makers, duly supported by a strong academic and public lobby, WTO's membership was likely to bring higher growth, accelerated export expansion, and a better earning and living standard. Perhaps, the hope of benefiting from expanding export opportunities weighed heavily, if not exclusively, compared with the damage that an unbridled flow of imports under the neo – liberal free – trade discipline of the WTO might inflict on the domestic economy. In any case, during the past five years, India has gone on par with the implementation of most of the agreements signed with the WTO. The process is still on and yet disturbing signals have started surfacing on many fronts.

The impact that WTO – membership would make on the Indian economy is an issue of paramount national importance. It is a little pre – mature to make a judgment, at this stage, essentially because things have just started evolving. A neat picture will emerge well after all agreements are implemented world – wide, net of neutralizations and modifications that might come off because of the voices being raised by the developing economies, including India, and the countervailing strategies to be unleashed by the vested trade interests. Recently, India herself has completed the last bit of the opening – up on April 1, 2001. Furthermore, this is hardly the stage at which we can scientifically delineate the effect of a particular agreement, or a specific aspect of the same, on the concerned sector, free of other inters – connections. Hence, the best we can do is to make some conjectures on the basis of what this been going on in the recent past. Indeed, this is our only analytical choice, since the kind of economic regime that may emerge in the next few years would only a reaffirmation, and a gradual extension, of the globalization and trade liberalization polices set afloat during the first half, and comprehensively expanded during the second half of the 1990s when WTO came.

In recent years, there have been intense discussions in the academic as well as policy circles regarding the second generation economic reforms in our country. It must be recognize that while the first generation economic reforms in July 1991 was initiated as per the conditionality of the IMF loan that we took at that time to salvage India's credibility in the world financial market, the second generation economic reforms at the turn of the 21st century has been guided by our compulsions to conform to the norms set by the WTO in matters of trade policy, to which India committed herself at the conclusion of the Uruguay round of GATT negotiations. Many of the changes that are now contemplated in the functioning of the Indian economy are basically the offshoots of the standards and norms prescribed by the WTO

0.3 TRENDS ON THE FRONT OF EXTERNAL SECTOR:

The decade of 90s can be described as the decade of the globalization process for the Indian economy. While the early years of the decade witnessed the first phase of economic reforms in industrial, finance and external sectors, the final years saw the beginning of the second phase of economic restructuring. Globalization process over the last decade have provided export friendly environments with simplified procedures conducive to enhancing export performance. The focus of these reforms has been on liberalization with basic trust on outward orientation focusing on export promotion activity moving away from quantitative restrictions and improving competitiveness of Indian industry to meet global market requirement. Over the years, significant changes in the Exim policy helped to strengthen the export production base, availability besides focusing on quantity and technological up gradation and improving competitiveness. Steps have also been taken to promote exports through multilateral and bilateral initiatives identification of thrust areas and focus regions.

(A) Trends in Growth of Foreign Trade and BOP:

The globalization process of the 1990s facilitated India to move away from a closed economy framework towards a more open and liberal economy. The selected indicators of external sector presented in tables 1 and 2 reveal that there have been significant improvements in the structure of the external sector during the period of globalization process. The export cover of import rose sharply from an annual average of 62 percent during pre period of globalization process to 74 percent during period of globalization process. The ratio of exports and imports to GDP rose from an annual average of 13.2 percent during pre period of globalization process to an average of 19.9 percent during period of globalization process. The current account deficit as percentage of GDP declined from an annual average of 7.9 percent during pre-globalization process to a well manageable level of 1.2 percent during period of globalization process. The capital account of BOP has also undergone a major structural change in favour of non-debt creating foreign investment flows. Foreign exchange reserves were built to a very comfortable level of about 8 month of imports from a critical level of about two months of imports in June 1991. External debt and debt service indicators marked sustained improvements over the 1990. External debt as a percent of GDP, declined gradually from 38.7 percent at the end of March 1992 to 21.9 percent at the end of March 2000. Also debt service payments on external debt as a percent of current receipts declined gradually from 35.3 percent in 1990-91 to 16.0 percent in 1999-2000. The strength of the external sector has enabled India to with stand fairly well the Asian financial crisis contagion and the related adverse spillovers.

The Balance of payment summary presented in table 3 indicate that during the period of globalization process the current account deficit in 1999-2000 was contained to 0.9 percent of GDP. After some set backs in 1998-99, mainly as a fall out of East Asian crisis and partly due to the economic sanctions on India, capital flows improved significantly in 1999-2000. The moderation in current account deficit and the sharp increase in net capital inflows resulted in a large accumulation of official foreign exchange reserves. On BOP basis they rise rate by a substantial 6.14 billion. Invisible flows continued to maintain an upward trend during period of globalization process. Private remittances account for the bulk of private transfer receipts. Despite revival of world trade, exports of developing countries like India continue to be threatened by the emerging projectionist sentiments in some sectors in the sense of technical standards, environmental and social concerns. The turn around in exports in 1999-2000 was led sharp rise in exports of manufactured goods while enhancing their share in total exports to 81.6 percent. The composition of imports shown wide variations in import growth across commodity groups result in a sharp jump in share of these imports in total imports to 32.8 of percent in 2000-2001.

On the external front globalization process has enhanced India's competitiveness in labor and skill intensive industries, reduced the dependence of competitive industries on inefficient domestic suppliers and infrastructure and enhanced domestic competitive conditions, exports have been growing at 20 percent in dollar terms. What is more significant is that the share of manufactured goods in the exports basket has risen while that of primary products has fallen. A recent study covering the post period of globalization process brings out that the export intensity has increased, where as imports intensity has decreased. Both trade deficits and BOP current account deficits have considerably narrowed down. Various BOP indicators bring out continued improvement in the external sector.

The achievements in the external sector appear to be more credible. This is perhaps because the measures taken have been coherent and were so far reaching.. The best way to ensure continued stability and viability of the BOP is by increased foreign exchange earnings from the export of goods and services to a sufficient level to pay for the imports and all other external payments on the current account. This requires control of inflation to maintain appropriate real effective exchange rate vis a vis other competing nations.

(B) Trends on Foreign Financial Inflows:

The globalization polices are expected to increase the extent of foreign financial inflows into our country, which are in the form of Foreign Domestic Investment (FDI) in joint ventures/subsidiaries of MNCs; commercial borrowings from foreign investments/banks; loans and grants from world monetary institutions or deposits from non-residents and foreign equity contributions etc. However, these foreign financial inflows would be beneficial only if these are non-debt generating, which would help to build up long lasting capital.

The trends relating to the foreign financial inflows presented in Tables 4 and 5 reveal that Indian globalization polices produced immediate promising results. Number of foreign technical and financial collaborations and FDI proposals started inundating the Indian economic environment. Also overall economic and industrial growth rate and saving and investment rates indicated a positive trend.

The trends in the portfolio foreign equity investments presented in Table-4 reveals that these flows increased at a very high rate during period of globalization process. Similarly deposits from NRI have also been steadily increased at an annual rate of over 2 percent. Due to these flows Indian foreign exchange reserves, which are very low in 1990, increased from $2.24 billion in 1991 to $ 41.12 billion at end Jan 2001 providing cover for about 8 months of estimated imports in 2000-2001.

In terms of aggregate annual inflows, FDI maintain its declining trend since 1999-98.But inflows in the year 2000-2001 however are showing signs of improvement. Despite progressively declining volumes of inflows, Mauritius and the USA continued to be the largest source of FDI for India. Apart from Mauritius and USA, Japan, Italy and Netherlands respectively were the other three major contributors of FDI during 1999-2000. Though these trends are showing a positive outlook however a look at the components of foreign financial flows, the comparative position of inflows of FDI into India, the sect oral distribution of FDI in India and the existing gap between actual and approved FDI Inflows into India Indicates a different picture.

The nature of the component of foreign financial inflows in Indian which are presented in Table-4 shows that much are excess of debt generating foreign assets and these higher proportion of debt generating assets only adds to the country's liability of repaying debt, even out of available non-debt-generating foreign resources the proportion of foreign equity are in such ratio and they are purely profit oriented and instantly flies out at slightest shortfall in return.

India's comparative position of FDI inflows given in Table-5 reveals that India remained as a marginal recipient of FDI flows. India shares in total world FDI flows increased from barely 0.12 percent to 0.74 percent or in value terms the rise is from $0.17 billion to $ 2.59 billion during 1995-1996. Similarly the sect oral distribution of the FDI flows of India presented in Table 6 shows its failure to permeate into significant areas of the economy. Up to 1996-97 FDI Flows proportionately declined in the areas of transport equipment machine and machine tools and chemical sector. This indicates the unfavorable direction relating to the sect oral distribution of the FDI flows in the Indian economy.

However, from the table 6 it can be noticed that the engineering industry continues to attract the largest value of FDI inflows and this industry experienced aggregate inflows of $326 million. Electronics and electrical equipment industries were the second largest recipient of FDI with aggregate inflows amounting to $172 millions. Food and dairy products had a sharp increase in FDI with inflows increasing from $19 million in 1998-1999 to $121 million in 1999-2000. Another industry witnessing increase in FDI inflows during 1999-2000 was pharmaceuticals where aggregate FDI during 1999-2000 rose to $54 million compared to $28 million in 1998-1999.

The same pessimistic picture can also be found in case of the actual FDI inflows into the Indian Economy. The data presented in table 7 shows the reluctance of the foreign investors to make generous investments in India is quite evident from the gap between the value of FDI approved by the FIPB of India and the corresponding actual FDI inflows. During the period 1991-1997, the actual FDI as proportion of the approved FDI has declined from 42.7 per cent to 16.1 per cent in 1993 and to 20.9 per cent in 1997.

The recent trends in capital account (Table 3 in BOP), which had shown an impressive surplus of $ 10.4 billion in 1996-97 is a lower9.39 billion in 1997-98**.** Total net capital inflows in 1998-99 reduce further to $7.86 billion which levels in 1997-1998.Portfolio investments has continues to decline from 1995-96 to 1998-99. The significant decrease in portfolio investment was partly a result of contagious from the East Asian crisis that affected the emerging market. However after some set backs capital flows improved significantly in 1999-2000. Net inflows of capital account of BOP rose to $ 10.31 billion in 1999-2000.

0.4 CONCLUSION:

The decade of globalization process was successful in executing supply response as evidence in the higher growth of GDP, comfortable foreign exchange reserve, improving short-term debt profile, moderate inflation and buoyant exports.

However, the above-mentioned trends on the front of major dimensions of the external sector indicate that the globalization process has not bestowed its much favorable influence on the Indian economy. The full benefits of globalization process are yet to be achieved. It may be due to slow pace of India's opening up. Trade growth and FDI inflows to India have yet to come in a big way. This indicates that India's program of globalization process has been a mixed bag of success and failure; a final judgment on it has to wait. The reduction in the multiplication of export promotion schemes and freeing of imports are positive features. Liberalization of trade regime, removal of import and exchange control and progress towards lower and less dispersed bands of tariffs indicate that the Government is dismantling quantitative restrictions by 2002 as per WTO requirements.

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