POST -LIBERALIZED FOREIGN TRADE AND FOREIGN INVESTMENT IN INDIA

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ABSTRACT

The assignation of Prime Minister Indira Gandhi (1984) and Rajiv Gandhi (1991) crushed the International Investors confidence on the unstable Indian economy. The Crises of BOP compelled India to follow the bail out conditions of IMF and to open its closed economy to the entire world, by adopting the policies of liberalization in 1991. Under liberalization the structured economic reforms were initiated in the trade, investment, deregulations, privation, tax reforms etc., these reforms encouraged the competitions and globalization was slowly embraced. The main objective of the then Govt. was to transform the Indian economic system from socialization to capitalization, so as to achieve high economic growth and industrialize the nation for its well being. However, NDA Government slows down the speed of liberalization due to coalition politics and vested political interests, but could not de-regulate the liberalization. Liberalization has changed the scenario of Indian trade and investment as many advantages are explored in these sectors. The impacts of liberalization have been seen in the foreign trade and foreign investment in India in post liberalized periods, as its imports, exports and foreign investments were reported in US$ millions 300609, 182235 and 51167 respectively in the year 2009-10, showing huge advancement from the 1991-92. Indian economy became the second largest growing economy of the world after China. Due to liberalization India reached to 124th rank out of 179th rank of economic freedom index in 2009 under PPP terms. This shows that India is stepping toward complete liberalization. This research paper tries to show the trends and interrelationship between foreign trade & foreign investment, Imports & Exports and FDI & FPI in Post liberalized periods (1992-93 to 2009-10).The role of foreign investment in curving deficit BOT has also highlighted.

***Keywords**: BOP- Balance of Payment, Govt. - Government, NDA- National Democratic Alliance, GDP-Gross Domestic Product, FDI- Foreign Direct Investment, FPI- Foreign Portfolio Investment , BOT- Balance of trade, IMF- International Monetary Fund, FII- Foreign investment institutions, PPP- Purchasing Power Parity, FIPB-Foreign Investment Promotion Board, GDRs- Global Depositary Receipts, ADRs-American Depository receipts and ASEAN-Association of South East Asain Countries, etc.*

Introduction:

The economic liberalization in India refers to ongoing economic reforms in India that started on 24 July 1991. Before the process of reform began in 1991, the government attempted to close the Indian economy to the outside world. After Independence in 1947, India adhered to socialist policies. In the 1980s Prime Minister Rajiv Gandhi initiated minor economic reforms.

In 1991, India faced a balance of payments crisis; it had to sell 67 tons of gold to Union Bank of Switzerland and Bank of England as part of a bailout deal with the International Monetary Fund (IMF). In addition, IMF asked India to undertake a series of structural economic reforms. As a result of this, the government of P. V. Narasimha Rao and his finance minister Manmohan Singh (the present Prime Minister of India) started breakthrough reforms, although they did not implement many of the reforms of IMF. The neo-libel policies i.e., opening of international trade and investment for the entire world, deregulation, initiation of privatization, tax reforms, and inflation-controlling measures etc. etc. were initiated under liberalization. The main objective of the government was to transform the economic system from socialism to capitalism so as to achieve high economic growth and industrialize the nation for the well-being of Indian citizens (Goldar, Biswanath, and Saleem, H.N. 1992)[1]**.**

Until the liberalization of 1991, India was largely and intentionally isolated from the world markets, to protect its economy and to achieve self-reliance. Foreign trade was

subject to import tariffs, export taxes and quantitative restrictions, while foreign investment was restricted by upper-limit equity participation, restrictions on technology transfer, export obligations and government approvals; these approvals were needed for nearly 60% of foreign investment in the industrial sector. These restrictions ensured that foreign investment averaged only around $200 million annually between 1985 and 1991. India's exports and imports were stagnant for the first 15 years after independence, due to general neglect of trade policy by the government of that period(s) and poor industrialization.

Every Country requires international investment for enhancing the production, trade and distribution capabilities. The need for international investment is more pronounced in the developing countries where the capital is a scare[2]. World Bank report (1999) has advocated the need of foreign investment. It say that the development priorities of developing countries includes achieving sustained income growth for their economies by raising investment stakes for strengthening technological capacities, skills, improving the competitiveness of their exports in world markets, distribution the benefits of growth equitably by creating better employment opportunities, and protecting the physical environment for future generation.

There are two major types of international investment i.e., foreign direct investment (FDI) and foreign portfolio investment (FPI). FDI [3] occurs when and investor based in one country (the home country) acquire an asset in another country (like host country) with the interest to manage the asset. The home country also transfers assets such as technology, management and marketing. Foreign direct investment often involves the setting up of subsidiaries in foreign countries for the domestic production of commodities/ services which previously were imported. Indian FDI has adopted two policies namely automatic route & FIPB route Automatic route allow 100% investment in physical assets in India in certain areas without any restriction, whereas the FIPB route is in the control of Govt. and 49% stake is allowed under FDI.

Whereas FPI (Schuunnan,F.J.,2001)[4] normally involves the investment in financial stocks, bonds and other financial instruments, further, the portfolio capital moves to the recipient country which has revealed its profitability and has comparative advantages over the counterparts in investing country. Portfolio capital unlike FDI is affected largely by individual sub account holders and Foreign Investment institutions (FIIs) through the mechanism of capital market. Portfolio investment by nature is speculative. It is very selective and changes time to time, this tendency of shifting the Capital investment from one country to another country may creates a crises for the/ in the receipting country. In 1992, India opened up its economy and allowed FPI in its domestic sock market. Since then FPI has emerged as a major source of private capital inflow in this country. India is more depended in FPI than FDI as a source of foreign investment. FPI is created by GDRs/ ADRs[5] (raising money from abroad through issue of shares) and Offshore funds (funds raised outside India to be invested in India). The attraction of the FPI in India is due to low tax rates, low *interest* rates, high dividend rates, and high exchange rates etc.

FDI and FPI both are important in India for economic development. These investments have some natural distinction which allow the investors to invest in FPI as compared to FDI i.e., FDI is a Investment in physical assets where as FPI is a Investment in financial assets, FDI is for a long term and FPI tends for a short run.FDI is difficult to withdraw where as FPI easy to withdraw.FDI is non speculative where as FPI is speculative and FDI abides interest in management where as FPI has a fleeting interest in management (Itay Goldstein & Assaf Razin (2005)[6].

Today India is mainly characterized as a market economy. Indian government coalitions have been advised to continue liberalization. India grows at slower pace than China, which has been liberalizing its economy since 1978. Due to liberalization, India has shown a growth in GDP (2009-10) over 8%.

Re-liberalized FDI policy (2005) allows up to a 100% FDI stake in ventures in the construction sector, including built-up infrastructure and construction development projects comprising housing, commercial premises, hospitals, educational institutions, recreational facilities, and city- and regional-level infrastructure. Despite a number of changes in the FDI policy to remove caps in most sectors, there still remains an unfinished agenda of permitting greater FDI in politically sensitive areas such as insurance and retailing. Industrial policy reforms have substantially reduced industrial licensing requirements, removed restrictions on expansion and facilitated easy access to foreign technology and foreign direct investment FDI[7]. However in the years 2008 & 2009 financial meltdown and recession affected the foreign investment flow in India.

Review of Literature:

Many researches have been made on foreign trade and foreign investment at individual topic or on foreign trade & foreign investment collective levels. Some of these are explained below:

Baswanath Goldhar (2011)[8]: in his research article “Trade liberalization and manufacturing employment” advocated that the high wage rates given to Indians, invited the foreign goods in India, thus increasing the imports in post liberalized period.

K.S. Chalapali Rao (2011)[9]: Expressed in his research paper “FDI Caps in India & Corporate Control Mechanism” that the appropriate proportion of directors in the BODs and their direct intervention would be enlarged, if the policy objectives for better exports are to be achieved.

Anussi Pal (2011)[10]: in her article “Indian Jute industries in the Globalization Era: Structure & Performance” expresses that the most traditional industries are slow to adopt themselves to the fast changing scenario in the international and domestic market, due to the traditional

policies followed over a number of years, which reduces the demand of Indian goods in international market.

T.N. Srinivasan (2011)[11] explained in the article "Determinates of export decision of firms" that the model and estimates about the decision of Indian firms and their participation in international trade are individual and the firms are an important sole determinant of the decision of export.

Arvind Virmani (2011)[12]: in his research article "IMF reforms 2010: Do they mirror global economic realities" Advocated the issues of Governance and reforms at the IMF level in the Context of the emerging macroeconomic configuration.

Sumitha Francis (2011)[13]: in her article "A sectoral impact Analysis of the ASEAN- India free trade agreement" revealed that Import liberalization in immediate goods encourage multinational corporation to undertake production nationalization access in the region in the sectors: transport, equipment, industry, chemical. India's deeper integration in production network in such sectors increased the production in the country for export.

Swati Mehta (2011)[14]: In her research article "Economic reforms, technological intensity and industrial development in India" revealed a slower growth rate for value added for about 77% of the industries in post liberalized period. Further, no significant structural transformation with in the organized manufacturing sectors was found. The results thus, refute the neo-liberal optimism regarding reforms.

Nisha Taneja (2011)[15]: in her article "An approach to prune India's Sensitive list under SAFTA" explained that a systematic approach and economic rationale for pruning India's sensitive lists under the south Asian free trade agreements. Thus, these lists include and exclude the items as per the export conditions of SAFTA.

Stephary Groffith Jones (2011)[16]: In his article "Curbing hot capital flows to protect the real economy" revealed that developing countries are once again is the destination for speculative capital flows. This inflow increases the crises levels leading to currency depreciation and asset bubbles in developing countries. Many of these nations are deploying prudential capital regulations to stem these flows. However this may be partial remedy to the problem such measures should coupled with action by developing countries in order to fully steer control to productive use and to avoid future crises.

Salabh Mehrotra (2009)[17] : in his book " impact of Globalization on Indian Economy" reveals that Post globalization era in Indian economy has led to an unequal-competition- a competition between the giant and the dwarf Indian enterprises.

Many more studies have been incorporated in the foreign trade and foreign investment, i.e., M. K. Datar (2011), M. Jaya Ram (2011), Berman & Machin. (2000), Bin Xu (2000), Rohit Negi (2011) and many others i.e., Edgardo Favaro, KAS Murshid , EPW Research Foundation , R.K Sen, K.C Roy, S.K Singh, Nisha Taneja, Rishi Banga, D.P Chudhary, E. Willson, B.P Singh, M.V Kapade, Myrdal, & Chenery etc. etc. They all have explained the pro- cons of external trade and foreign Investments in pre and post liberalized periods in national and international levels. But the Comparison and growth in the variables of foreign trade & foreign investment have not studied in the post liberalized periods in India. Thus, the study "Post-liberalized foreign trade and foreign Investment in India has been selected for the present analysis.

Objectives of the Study:

This study has been incorporated to achieve the following objectives in post liberalised 91992-93 to 2009-10) period in India:

1. Growth of foreign trade (exports, imports and trade deficit (TD) and foreign investment (FDI, FPI and FI).
2. Degree of relationship in the variables of foreign trade (imports & exports) and the variables of foreign investment (FDI & FPI) as well as degree of relationship between FI & Imports, FI & Exports and FI & TD.
3. Explained variance for degree of determinants between exports & Imports variables.
4. Explained variance for degree of determinants between foreign investment & exports, foreign investment & imports and foreign investment & trade balance/trade deficit.

Methodology:

To achieve the above mentioned objectives the following statistical methods have been applied**:**

1. Percentage method: This is applied to find out the years over years (YOY) changes in exports, imports and foreign investment. Secondly the percentage method has also been applied to find out the percentage of imports over exports. This is calculated as below:

$$\textit{Percentage (\%)} = \frac{\textit{indivisual observation}}{\text{Total observations}} \times 100$$

2. Coefficient of Correlation: this is applied to find out the degree of relationships between the variables imports & exports, FDI& FPI and Foreign investment & Trade deficit (TD). This is calculated as below:

$$\text{Coefficient of correlation(r)} \quad \frac{\sum xy}{\sqrt{\sum x^2 \times \sum y^2}}$$

Where x, y are the deviations from respective means.

$\sum x^2$ = Sum of squares of deviations from mean of x.

$\sum y^2$ = Sum of squares of deviations from mean of y.

3. Co-efficient of Determinants: This is applied to determinates the explained variance in the variables i.e., exports & imports and foreign investment & trade deficit, foreign investment & exports, and foreign investment & imports.

$$\text{Co-efficient of Determination } (r^2) = \frac{\text{Explained Variance}}{\text{Total Variance}}$$

4. Coefficient of Variation: This is applied to find out the degree of variations in the variables i.e., imports, exports, FDI, FPI, foreign investment(FI) & trade deficit/trade balance(TD). This is calculated as below:

$$\text{Coefficient of Variation} = \frac{\sigma}{\bar{X}} \times 100$$

$$\bar{X} = \sum X / N$$

$$\sigma = \sqrt{\sum x^2 / N}$$

5. Growth Rate: This is applied to find out the growth rate in the variables: imports, exports, FDI, FPI, Foreign investment (FI) and trade deficit (TD). This is calculated as:

Growth rate : $\sqrt[n]{P_n/P_0} - 1$

Where Pn stands for figure of end year, Po stands for figure of beginning year and n stands for a number of years.

Results:

The results of the study have been explained in three forms: a). Foreign Trade b). Foreign Investment and c). Foreign Investment and Foreign Trade as below:

Foreign Trade:

This section attempts to analyze the effect of economic reforms on foreign trade in India. This is studied with exports, imports and trade balance/trade deficit in US$ at current market prices from 1992-93 to 2009-10. The percentage changes over years over years (YOY) for exports & imports and yearly percentage of imports over exports have studied in the present analysis. The dependence of imports on exports has been analyzed in Table 1 below:

A look at the table 1 reveals the fact that aggregate exports of India Show an ever rising trend between 1992-93 to 2009-10 (except few years). Similar phenomenon is observed for aggregate imports. A further look at these figures show the fact that aggregate imports are invariably exceeding the aggregate exports during period under reference and thus trade balances are reported as with negative sign from 1992-93 to 2009-10. This implies that exports are increasing but with slow speed as compared to with the imports, which further shows that imports liability of Indian economy has sizably increased during the post reform periods.

A look at the percentage figures reveals the fact that both exports and imports registered a rise years over years (YOY) for the entire study period. However, this rise is quite fluctuating YOY and no specific cause may rightly be assigned rather this seems to the phenomenal or depending upon the then prevailing circumstances in the economy. Maximum rise in the exports is found as 28.91 % in the year2007-08, while the lowest rise is 0.56% in the year 2001-02. Similarly maximum rise in the imports has been seen in the year 2005-05 (48.47%) and lowest rise was observed in the year1997-98 (4.57%). However, the decrease in imports & exports in few years is due to international slowdown.

A look on the percentage of imports over exports reveals that the imports are more than 100% in all the years of study. This shows that the exports component are not the only reason for imports but imports are funded from other internal and external sources, which is increasing the trade deficit in India.

The co-efficient of co-relation between exports and imports reveals that there is very high degree positive correlation (+.92) between exports and imports of India during the period under study. The coefficient of determinants shows that 84.64% variations in imports are explained by exports only. The co-efficient of variation reveals 88.5% variation in the distribution of exports data and 103.47% variation in imports data, which shows high variation in both variables. The higher variation in Imports figures depicts that the changes in imports are at faster speed as compared to exports. The growth rate in the trade deficit reveals (80.50%) trade deficit in the period under study. Imports and exports have shown the growth of 66.27% & 52.97 % respectively in the study period.

Foreign Investment:

The figures of foreign Investment (FDI & FPI) have been shown in table 2 indicating net Foreign Direct Investment (FDI) and net foreign Portfolio Investment (FPI) with Net Foreign Investment (FI) from 1992-93 to 2009-10 to find out the degree of relationship between FDI&FPI, growth rate in these two variables, dispersion in these variables along with percentage change years over years (YOY):

Table 2: Foreign Investment
US $ millions

Year	Net direct Investment	Net Portfolio Investment	Net Foreign Investment	% in Net foreign Investment (YOY)
1992-93	315	244	559	320.30
1993-94	586	3567	4153	642.98
1994-95	1314	3824	5138	23.72
1995-96	2144	2748	4892	-4.77
1996-97	2821	3312	6133	25.37
1997-98	3557	1828	5385	-12.20
1998-99	2462	-61	2401	-55.41
1999-00	2155	3026	5181	115.79
2000-01	4029	2760	6789	31.04
2001-02	6130	2021	8151	20.06
2002-03	5035	979	6014	-26.22
2003-04	4322	11377	15699	161.04
2004-05	1292	9315	10607	32.43
2005-06	3034	12494	15528	46.39
2006-07	7691	7062	14753	5.00
2007-08	14065	29261	43326	193.68
2008-09	19639	-13854	5785	-86.65
2009-10	27567	23600	51167	684.47

Source: Economic survey Govt. of india,2005-06 to 2010-11.

A look at the net figures of the direct investment (FDI) shows various ups & downs in the entire study period. It was lowest in the beginning 1992-93, 315 US$ millions and reached to 27567 US$ millions in 2009-10. A further look at the figures reveals the fact that some market growth has been observed in the portfolio investment as it was 244 US$ in 1992-93 and reached to 23600 US$ in 2009-10. It was also observed negative in the years1998-99 (-61) and 2008-09(-13854). Another look at the table shows a general rise from 559 US $ to 51167 US $ from 1992-93 to 2009-10, With downward variations in the years 1995-96,1997-98,1998-99,2002-03, & 2008-09 in net foreign investment (FDI plus FPI). Such variations in the foreign inflows may also be attributed to the changes in the government policy towards the inflows of foreign funds of various natures. Figures further reveals that the percentage change in the foreign investment in the YOY change was 320.85 % in 1992-93 from previous year, but this change has been recorded 684.47% in the year 2009-10 over to year 2008-09. This fluctuation has been observed from -4.77% to 684.77% during the years under study.

The co-efficient of correlation between FDI & FPI has been recorded +.33, which is lower degree positive co-relation between these variables. The coefficient of determination between FDI & FPI is 10.89%. This depicts only 10.89% variation in FPI is explained by FDI and rest of variations are due to other factors. The growth rate in net foreign investment reveals a growth 171.26% under the period of study, where as the growth rates of FDI & FPI have been registered as 164.41 % & 176.11% in the period of study. The coefficient of variation in the distribution of data of FDI & FPI reveals the variation of 127.68% in FDI and 170.79% in FPI. This depicts that the growth and variation are more in foreign portfolio investment as compared to foreign direct investment during the period under study.

Thus, it shows that FPI is growing at faster speed as compared to FDI and the overall growth in the net foreign investment is increasing at faster speed. This shows that foreign investment (FDI& FPI) is good for the economic development of India, but the variation in the flow of investments is not a significant for smooth growth in the economy.

Foreign investment and foreign Trade:

The foreign investment (FI), foreign trade (imports & exports) and trade deficit have been analyzed in table 3 to find out the degree of relationship, growth rates and co-efficient of determinants in these variables:

Table 3: Foreign investment and foreign Trade (In US$ millions)

year	Net Foreign Investment (FI)	Exports	Imports	Trade Deficit (TD)	TD as % of FI
1992-93	559	18869	24316	-5447	974.41
1993-94	4153	22683	26739	-4056	97.66
1994-95	5138	26855	35904	-9049	176.12
1995-96	4892	32311	43670	-11359	232.20
1996-97	6133	34133	48948	-14815	241.56
1997-98	5385	35680	51187	-15507	287.97
1998-99	2401	34298	47544	-13246	551.56
1999-00	5181	37542	55383	-17841	344.35
2000-01	6789	45452	57912	-12460	183.53
2001-02	8151	44703	56277	-11574	1360.05
2002-03	6014	53774	64464	-10690	177.76
2003-04	15699	66285	80003	-13718	87.38
2004-05	10607	82150	118779	-36629	345.33
2005-06	15528	105152	157056	-51904	334.26
2006-07	14753	128888	190670	-61872	419.38
2007-08	43326	166162	257629	-91467	211.11
2008-09	5785	189001	308521	-119520	2066.03
2009-10	51167	182235	300609	-118374	231.35

Source: Economic survey Govt. of india,2005-06 to 2010-11.

A look at the figures of the foreign investment (FI) and trade deficit (TD) show various ups & downs in the entire study period. It was lowest in the beginning 1992-93, 559 US $ millions and reached to 51167 US $ millions in 2009-10. A further look at the figures reveal that trade deficit was 5447 US$ millions in 1992-93 and reached to 118374 US$ millions in 2009-10.

Secondly the trade deficit as percentage of net foreign investment reveals the fact that it was very high in the year 2008-09 (2660.03%). However, it was 974.34% in the year 1992-93 and came down to 231.35% in the year 2009-10. This shows that foreign investment is some how reduced the trade deficit in some years but it failed to demolish the trade deficit entirely.

The co-relation co-efficient between the foreign investment & exports and co-relation coefficient between foreign investment & imports have been recorded as +.356, & +.376 respectively. Hence both of co-relations are lower degree positive correlations. This shows that increase or decrease in foreign investment could increase/decrease the exports/ imports in similar direction but not in similar proportion. The coefficient of determinants shows that only 12.67% exports are explained by foreign investment and only 14.13% imports are explained by foreign investment, which is insignificant.

The growth rate in foreign Investment reveals a growth of 171.26% under the period of study, where as the growth rate of trade deficit has been revealed as 85.81%. This shows that the growth rate of foreign investment is more but the trade deficit growth is also very alarming.

In a significant development a lower degree negative correlation (-.37) has been worked out between FI and trade deficit (TD). This shows that the growth in FI reduced the trade deficit, but this ratio is very low. Thus, an assumption may be made with the behavior of the figures that in the coming year's foreign investment will reduce the trade deficit growth rate.

Conclusion:

The study Post- Liberalized foreign trade and foreign investment in India (1992-93 to 2009-10) has shown that Liberalization, if, has augmented the size of exports in absolute terms, then, import burden also accounted in the economy leading the unfavorable or negative trade balance. It looks that the process of economic reforms has influenced both the exports and imports of India but imports are influenced more favorably than exports. The results show that there is a greater demand for imported-goods in the domestic market either due to low cost of production or due to better technology of production or due to the operation of large scale economies for imported-goods, either consumer or capital goods or both goods.

Further, it can be stated that post liberalization could not benefit much to augment the exports of India in relative terms along with rising burden of trade balance on the national economy which obviously affect adversely the foreign exchange reserves and the overall balance of payment position of India.

The present growth rate 171.26% of foreign investment is significant, The growth rate of FDI(164.41%) and growth rate of FPI (176.11%) also reflects a sound pace of investments, but, declination of FDI is also not satisfactory which shows that investors are not interested to invest directly in foreign investment in India, their preference is being changing from FDI to FPI. The present policy parameters for foreign direct investment look adequate enough to serve the needs of the country, but, the danger is that pressure has been growing off late in the name of liberalization and laxity to desire these parameters. This dangers needs to be guarded well for the comfortable health of the economy.

In the last it is concluded that foreign investment has made some major impacts on foreign trade (exports, imports & trade balance) in India in liberalized period, but are very marginal. Hence, foreign investment cannot be said as main determinates of foreign trade in India in post liberalized period. Similarly the exports are also not the main consideration for imports as the imports have been observed more than exports in all the years of study. Further, the adverse relationship between foreign investment and trade deficit is also satisfactory, assuming that in near future the trade deficit will come down with the increase of foreign investment. Thus, the study satisfies the objectives.

Limitations of The Present Study:

The scope of present study is very limited as it studied the trade in goods and ignored the trade in services. Impact of exchange rates in the prices of imports & exports has not been explained. There are some major variations between the years in the figures; the accurate reasons of such variation have not been explained. Data(s) in the present study have been considered from the year 1992-93 instead of 1991-92. Most advanced statistical tools could not be applied due to non availability of suitable information(s).

Suggestions for further studies:

There is much more scope to enlarge the present study as the foreign trade and Investment of pre liberalized periods may be studied with the figures of post liberalized periods and more suitable tools like t-test, z-test, chi square test etc., can be applied for more effective analysis. In addition to it the other factors like employment, prices, standard of living, infrastructure development, retail outlets, TNCs & MNCs etc. etc. can be studied along with foreign investment. Composition and directions of foreign trade can also be studied in post liberalized period(s).

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