Chapter-1

Introduction

1.1. Background

With the opening up of the world economy due to liberalization and globalization, the world economic structure has seen a lot of changes from the former isolated and distinct economic societies to dependent, integrated and cohesive economic interaction where each country represents a resource base and a growing market and an effect in one part of the world has an impact in the other. Developing and underdeveloped countries have benefited immensely and overall economic conditions, business, infrastructure and development have improved rapidly in the last two decades. Poverty alleviation has been one of the most important advantages such countries have gained from the global economy.

While the advantages of global economics cannot be denied and is visible for all to see, there are critics around the world who have reservations on such policies as the income disparity in these countries has given rise to further inequality. Moreover, the environmental impact has been substantial.

Liberalization and global economies attract huge foreign direct investments and this should be factored in when assessing the impact of globalization. Moreover developing countries such as China, Russia, Brazil and India have spurred internal companies in setting up their operations across the globe to become multinational corporations through acquisitions, mergers and Greenfield investments.

India’s liberalization story began in 1991 after the Gulf War crisis that created a foreign exchange crunch in the country. India was not in a position to fulfil its commitments internationally leading to policy changes to address serious concerns as well as to meet the criteria given by international funding agencies. When the World Bank offered to bail India out, their conditional loan included India’s commitment to open up industry and markets to foreign investors, allow multinational companies to enter the country
and change internal policies related to industry, trade & commerce and open up the economy leading to the economic policy shift in 1991.

Global economy means different things to different people and each social milieu will have its own perspective. Like most phenomena in economics, globalization also does not have a universal definition. According to Guy Brainbait, globalization is the opening up of world economies for the purposes of trade and commerce. It leads to an increased involvement and integration in finance, equity markets, industry, infrastructure and communications. A globalization process involves setting up of base and operations, M&A deals, international employment opportunities and transfer of technology and capital by international companies. However, this also brings with it disease, pollution, environmental damage cultural integration. With increasing employment opportunities due to infrastructural and industrial development, human resources also move across continents to offer labour, expertise, consultancy and professional services.

Thus any country on the path of liberalization like India for instance would need to revisit its existing company laws and policies, removing restrictions in FDI and commercial operations and transactions. It would need to develop policies that encourage JV’s and M&A’s and allow multinationals to enter commercial markets. It would need to allow Indian companies to invest abroad and allow the outbound transfer of foreign exchange thus impacting foreign exchange regulations. It would need to allow imports of all industrial goods and raw materials to facilitate manufacturing by reducing the entry barriers, taxes, import duties etc thus impacting taxation policies. India’s liberalization policies incorporated all these elements.

1.2. Problem Statement

Globalisation is a term that has recently come into use (along with liberalization and privatization) covering all facets of life- political, economic, social and cultural. It has been widely used to describe the increasing internationalization of financial markets and of markets for goods and services. Globalisation refers above all to a dynamic and multidimensional process of economic integration where by national resources become
more and more internationally mobile while national economies become increasingly interdependent. The following statement sum up the meaning of globalization:

Globalisation is so advanced that the integration of developing countries in the global economy and the increased openness of their markets provide a major, perhaps the most important opportunity to raise incomes in both developing and industrial countries in the long run. The sea change in policies in developing countries and their increasing integration into world trade and finance are underpinning the projects for economic growth in these countries and growth in trade.¹

It is very much clear from the above statement that the globalization has become a good tool for the overall development of the economy. With the advent of globalization and liberalization, India’s international financing and trade is getting momentum.

In 1991, the country was facing balance of payment crisis due to the internal and external factors, resulting in lack of foreign exchange reserves to meet the country’s requirements. High rate of inflation and poor credibility of India in the international financial markets compelled the policy makers to think about a new policy frame work and that was to move towards the policy of globalization.

The policy of globalization was initiated through new economic reforms and the government took a number of policy initiatives. First effort was made to step up exports. Secondly, imports were liberalized and thirdly, in place of debt-creating capital inflows, non debt-creating inflows such as FDI as well as portfolio investment were encouraged. These efforts were supported through restrictive administrative controls and barriers, which act as obstacles to the free flow of exports and imports.

These reforms were introduced by the government mainly to bridge the gap of balance of payments by improving the position of foreign exchange reserves. Balance of payments and foreign exchange reserves are interrelated concepts. Because balance of payment is said to be balanced if the total amount of foreign debits equal the total

¹ Michel Bruno, Chief Economist, World Bank.
amount of its credit.\footnote{2} Balance of payments records changes in assets holdings and liabilities abroad, not the levels of these items. In this way, it resembles more a ‘source and uses of funds statement’ and not a balance sheet. If we talk about balance of payments in a little broader sense then generally it includes two types of accounts; current and capital account. The major components of current account transactions are the transactions of goods and services or we can say that the summation of trade balance and the invisible gives the current account. Whereas capital account consists of capital movements in the form of foreign investments, long term and short term loans in the form of external assistance and commercial borrowings and banking flows. Both accounts are interdependent because the negative balance of current account is offset by the positive balances in capital account and vice versa. If we talk in terms of Indian economy, balance of payments has seen drastic changes in terms of capital account transactions. In this net foreign investment has changed majorly. In 1990-91 net foreign investments were Rs. 183.5 crore and in 2001-02 it reaches up to Rs. 25246 Crore.\footnote{3} It shows that the foreign investment in the country have increased after the introduction of globalisation.

But the question here is, from which resources we are getting these reserves? We have to see whether these investments are leading our economy towards a healthy and stable economy or it is creating problem for our economy. In such a situation problems like problem of confidence, adequacy, optimality, inflation etc. are arising, which are related to balance of payments and foreign exchange reserves.

It’s always good to have a healthy situation of foreign exchange reserves but at which cost we are filling the gap of balance of payments and generating the reserves is a problem, which needs to be answered. All the questions like; whether the position of reserves in India is adequate or not, if not then what should be the level of adequacy and on which parameters we should measure the level of adequacy, are some of the questions which could be answered only through a detailed study of the balance of payments and foreign exchange reserves situation in India and especially after the introduction of globalisation.

\footnote{2} It is prepared on the principal of ‘Double Entry System’ of book keeping. Uses of funds are shown as debits and sources of funds are treated as credit.
\footnote{3} Govt. of India, Ministry of Finance, Economic Survey, 1998-99, page 571-74
1.3. Globalisation in India

As mentioned earlier, India was facing an international financial crisis and balance of payments issues after the Gulf War wherein India’s forex reserves were down to only USD 1 billion with inflation as high as 17 per cent. With increasing fiscal deficit and lowering international confidence in India amongst international investors and non-resident Indians, the country was staring at the prospect of not being able to service its debt.

At the same time international economics and politics around the world was also changing in Europe, South East Asia, South America and South Africa.

All these factors acted as catalysts for India to change its policies and open up its economy and markets to the world. Many steps were taken to introduce these changes partly, in 2004-2006, on the insistence of the IMF and World Bank and partly due to internal and external compulsions including:

Table 1: Compulsions for Economic Policy

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<th>Devaluation</th>
<th>Disinvestment</th>
<th>De-licensing</th>
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**Devaluation:** The Indian Rupee was devalued by 18-19 per cent against the US Dollar to help alleviate the balance of payment situation.

**Disinvestment:** The Government took the radical step of selling or partly giving up management and control in many Public Sector Undertakings allowing private enterprise into hitherto protected markets.

**De-licensing:** Licensing was a major issue during the pre-liberalization days and many logjams that were created by the various licensing procedures needed for industry were removed. Industrial licenses were not required for industries being set up 25 kms outside towns with a population of 1,000,000 for e.g. Only 6 industrial categories need licensing requirements due to environmental impact or security issues.

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Permitting Foreign Direct Investment: This was one of the biggest hurdles to international commerce but with liberal policies in place that allowed FDI in many sectors, paved the way for a lot of foreign exchange inflows into the country that came in as capital and not debt.

FDI is allowed in most sectors without any stringent restrictions or conditions and companies can come in directly. There is no limit to the ownership share foreign investors and multinational companies can own in most of these sectors. Further the Government has also allowed foreign direct investment in hitherto protected domains such as insurance and defence which allows 26 per cent FDI, integrated township infrastructure which allows 100 per cent FDI, tea plantations which also allow 100 per cent FDI subject to limiting ownership to 74 per cent within 5 years.

Foreign Direct Investment has also been increased in commercial banking and financial institutions. Industries coming up in SEZ’s are allowed 100 per cent FDI so also are internet based business to business sites, ISP’s sans gateways, email and voice mail service companies. The Foreign Investment Implementation Authority among other departments also aids the Government in carrying out its aggressive FDI policy.

The Non Resident Indian Scheme was created to attract repatriation and investments from Indian citizens living abroad. All the advantages of the FDI norms for foreign investors can be availed of by non resident Indian investors as well. Additionally there are relaxations for NRI held companies where the majority shareholding of 60 per cent or more is held by an NRI.

Opening up the public sector space for private players Most public sector companies were offered to private companies on a majority holding basis to facilitate transfer of ownership and management.

Abolition of the (MRTP) Act was another radical measure as it allows companies to expand and grow without having to take permissions.

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Import restrictions and barriers were removed to allow companies to import raw material, industrial goods and commercial products.

Customs duty was reduced to 30 per cent from the earlier 300 per cent.⁷

Financial sector reforms were also incorporated to allow ease of restriction in banking, insurance, stock markets as well as deregulating interest rates that could be levied by banks and financial institutions all led to major fiscal policy changes increasing competition amongst local and international institutions.

1.4. Foreign Exchange Reserves in India: An Overview

There is no single definition of foreign exchange as its constituents; asset ownership and cash convertibility are hotly debated amongst economists all over the world. There is also the fact that some reserves may not be owned by the Government. However the IMF’s definition of foreign exchange reserves in their Balance of Payments Manual, and Guidelines on Foreign Exchange Reserve Management, 2001 is the most widely accepted by Governments across the world.

According to the IMF, foreign exchange reserves are international assets that can be utilized at any time to meet debt or that can be used to leverage balance of payments shifts by influencing the exchange rate amongst other uses.

Forex reserves include ownership of assets by the government without encumbrances. Foreign exchange that belongs to citizens, corporations and banks etc is not taken into account whilst estimating forex reserves of a country. In India, the RBI (Reserve Bank of India) holds and controls the forex reserves on behalf of the Government. This is possible due to the Reserve Bank of India Act, 1934, which also defines reserves and the RBI’s control in its preamble. Forex reserves include international gold and foreign securities held by the bank and any domestic assets held in reserve. The Act defines

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components of reserves, minimum reserves required and the way these reserves can be used.

Conventionally, India managed its reserves by keeping the relevant amount of import outflows required for a certain number of months which effectively meant that the Reserve bank would hold reserves equal to the value of expected imports over a specified number of months. However, towards the end of 1990, India’s reserves had gone down to barely 3 weeks. This led to the foreign exchange crisis which necessitated loans from international agencies and the balance of payments crisis.

Indian agencies continued to maintain reserves based on import bills till 1994. This attitude changed after the High Level Committee on Balance of Payments chaired by Dr. C. Rangarajan, and of which this author was a Member – Secretary tabled its report suggesting changes in the way forex reserves were viewed. It recommended a more holistic approach to foreign exchange reserves.

The reasons for maintaining forex reserves impact the amount of reserves that need to be available at any given point in time. Policy makers constantly weigh alternatives to ensure that the level of forex held in reserve is suitable to meet priorities. The main concepts related to forex reserves are:

a) Reserves=marginal social benefit=social marginal cost
b) Reserves= marginal productivity of reserves + interest on assets =marginal productivity of actual resources

Instead of stressing on import levels, this structure emphasizes stable forex rates. Thus many variables can be referred to when computing the foreign exchange reserves requirement by analyzing impact and accruals. These variables can be classified into four categories to enable appraisals and assessments which can act as a guide for the monitoring agency.

The first category is money reserves and the minimum amount required indicated by the ratio of reserves and broad money or base money which will indicate the probability levels of outflow and withdrawal of capital from the country which could be
due to little demand or an inept financial and banking structure. However, the money criteria have its limitations.

Countries with adequate demand for money and which back their own currency will have higher demand ratios and lower reserves to money which, although it seems to indicate a higher probability of outflows may not really be the case and thus one cannot make an accurate assessment. It also does not correlate well with international economic meltdowns and financial crises.

Forex levels stand at USD 285.5 billion. Of this 6.2 per cent or USD 17.71 billion is in gold reserves with the RBI which is almost double the earlier 3.7 per cent or USD 10.3 billion held earlier. If value is considered then gold currently stands at 10 per cent which is around the levels recommended by the European Central Bank which advocates a 15 per cent gold value reserve. Incidentally the ECB is the only central bank that has recommended gold to reserves ratio.  

Foreign exchange includes currency, cash, gold, special drawing rights, an IMF international reserve currency and deposits with the International Monetary Fund. India’s forex levels include foreign currency assets of over 90 per cent of the total reserves at USD 268.3 billion, and special drawing rights pegged at USD 5.27 billion with deposits being valued at USD 1.59 billion.

The world’s largest foreign exchange reserves lie with China with USD 2132 billion which includes USD 1500 billion in dollars comprising of bonds, cash and treasury bonds. Since over 70 per cent of China’s forex is in dollars, it not a diverse portfolio. Brazil, Korea and India are working at consolidating a large forex base as well.

RBI has reported that their forex reserves are now currently USD 285.520 billion. These levels change due to currency fluctuations since a variety of cash assets in different currencies lie with the bank.

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9. ibid
10. ibid
11. ibid
1.5. Objectives of the Study

a. To explore the level of foreign exchange reserves in balance of payments.
b. To find out the adequacy level of foreign exchange reserves.
c. To find out the impact of globalisation on foreign exchange reserves.
d. To formulate the short run strategies for meeting the challenges of globalisation on Indian foreign exchange reserves.
e. To design the long run strategies for the better use of the opportunities provided by the globalisation for Indian economy.
f. To evaluate the adequacy level of foreign exchange reserves in terms of the macro-economic stabilization in the country.

1.6. Hypotheses

The current research being conducted would play a crucial function in the situation. The current research follows a mixed descriptive pattern which employs both qualitative and quantitative pattern. The current study is an extensive one. The study also uses both primary and secondary data. The sampling design used in the extant research is that of convenience sampling. The sample data is collected on basis of the post-reform data available during the period of 1995 to 2005. The data is thus a time series data. The data employed chiefly pertains to Balance of Payments. The researcher would focus on aspects linked to the balance of payments, foreign exchange reserves and the like. To make desired inferences, the current study comprises of testing the hypothesis and employs varied quantitative statistical modes including multi regression analysis, co-relation and the like. The data for the survey is gathered from the sources outlined subsequently:

1. Indian Economic Survey, govt. of India, Ministry of Finance, New Delhi.
2. World Development Indicators, World Bank, Washington, D.C.
5. Balance of Payments Manual, IMF.
However without prior bias, we shall consider the null hypothesis that:

\[ H_0: \text{Globalization has not improved the status of foreign exchange reserves in India.} \]

Against the null Hypothesis

\[ H_1: \text{Globalization has improved the status of foreign exchange reserves.} \]

1.7. Scope of the Research

Globalisation has revolutionized the developed and developing economies of the world. Keeping in view the positions of Indian economy in 1991 and the progress made by some of the developing countries with the advent of globalisation, Indian government introduced the various reforms, which are generally termed as tools of globalisation. Till now our economy has seen various changes in terms of position of exports, imports, balance of payments, foreign exchange reserves, FDI’s and FII’s. etc. The most important change out of them is the strengthening of our foreign exchange reserves. Our reserves have increased mainly because of increase in FDI’s and FII’s. Today we can say that we are self-sufficient as far as foreign exchange reserves are concerned. But for how much time period we will be able to hold these good reserves with us, we can’t say anything. This vague situation of the economy is a matter of concerned. This situation is vague because if we look towards the situation of balance of payments then we can see that we are still incurring trade deficits, it means we have less number of exports than imports. Data of previous years shows that the exports have increased but the rate of increase of imports is more.

In such situation question arises, if it is good to have good exchange reserves, which are largely collected through FDI’s and FII’s , instead of exports earnings? This situation demands more money supply in terms of Indian rupee and the result of it is quite visible in terms of inflation. We have already crossed the mark of 6 in January 2007. This position of the economy has created a very interesting situation, we are
achieving a steady growth rate of 8 per cent but simultaneously rate of inflation has also increased. Now the question arises, if it is very necessary to increase the foreign exchange reserves beyond a point? If not then what should be the defining line for the adequacy of reserves? Because in the absence of adequacy, problems like confidence in the economy, volatility of exchange rates, slow growth rate of economy etc. will start bothering the economy. In such situation it becomes very important to have a system, which tells the policy makers not only about the adequacy of reserves but also about the components of reserves, which needs to be look after before defining the level. This will help the economy in countering the problems, which we have discussed earlier. So it becomes very important subject, which needs to be explored. Many research have been conducted on the subject of globalisation and its impact on various aspects like trade, FDI, growth etc. but not many have given emphasize on the field of balance of payment and foreign exchange reserves. It makes the current study very important in such scenario.

1.8. Review of Literature

Most countries have accepted the definition provided by the International Monetary Fund\textsuperscript{12} for the convenience of framing polices and smooth operation. The IMF definition of reserve considers it as those external assets that are available in the market voluntarily to the monetary authority and are controlled by them for the purpose of direct financing, paying off external imbalances, enabling indirect regulation on the amount of such imbalances by intervening in the exchange markets, thus affecting the currency exchange rates.

Standard measurement of international reserves considers all those imaginative international reserve assets of a country, though the amount of foreign currency that the corporate bodies banks hold are not included within the definition of the ‘official holdings of international reserves’.

The RBI Act of 1934 lays down provisions where the RBI would play the role of the ‘custodian of foreign reserves’, managing reserves with specific objectives, in the preamble of the act. The term ‘reserve’ takes into consideration foreign reserves in gold assets form as well as foreign securities form ,and domestic reserves in ‘bank reserves’

form in the banking department and the issue department. Relevant sections in this RBI Act clearly identify the composition of the foreign reserves, areas in terms of instruments and securities where these reserves of a country should be kept, and the minimum reserve system. Therefore in India, the statute very clearly and conservatively lays down guidelines about its reserves management, about the constituents of forex reserves, the custodian looking after it, and the modes of operating it. RBI performs this role in a certain structure as decided by the government of India

1. **M. Jezer Jabanesan (1984)** - Stability of rupee exchange rate could be maintained with the help of liberalization and anti-smuggling managerial strategies. But it should not be done on the cost of over-estimation of the rupee. The study has shown concerned about the stability in absence of which portfolio flows from an overvalued currency country to an undervalued currency country should not be underestimated.

2. **Paulson (1989)** - examines the impact of monetary policy on Indian economy in the pre-reform period. The study reveals that the single important factor that influences the money supply in the economy is the reserve money. He points out a positive correlation between inflationary pressures and administered prices, and what is required, he suggests, to achieve price stability, is a cordial and symbiotic relationship between monetary policy and fiscal policy.

3. **Prof. S. L. N. Sinha (1995)** – This study stated that a high level of exchange reserves on a continuing basis, means many things, it can create the problems like shoot up of exchange rates, adverse consequences on exports, domestic output and employment. Out of these problems the major problem is of reserves adequacy, which should be based on objective criteria. For this the components, which need to take account of, are volume of country’s commodity exports and imports, the position regarding transactions in invincible, which together make up the current account of the country’s balance of payments. The study further elaborated the relationship of balance of payments, foreign exchange reserves and volatility of exchange rates.

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4. R. R. Krishna and V.S. Ganesamurthy (1996)\textsuperscript{16} - It was found that the government’s efforts to curb the imports in 1991-92, 1992-93 and 1993-94 had a bad impact industrial production. In 1994-95 imports curbs were largely removed. It results into increase of imports by 21.7\% as against an increase of 18.3\% in exports in 1994-95. Due to this the trade imbalance almost doubled.

5. Reddy (1997)\textsuperscript{17} - Since the mid-1980s, transnational corporations (TNCs) have started performing some of their strategic research and development (R&D) in some developing countries. The primary driving forces behind such a move by TNCs are technology-related, i.e. to gain access to science and technology (S&T) resources and cost-related, i.e. to exploit the cost differentials. R&D activities related to product development for regional/global markets and generic technologies by TNCs are diffusing skills and knowledge to the host countries. By establishing linkages between the local innovation systems and TNCs’ worldwide R&D network, such R&D helps to integrate some developing countries into global technology development activities.

6. R. Nagraj (1997)\textsuperscript{18} - FDI in India were only about a fifth of the approved amount at Rs. 95960 crore during 1992-96. However, it has shown significant jump in the decade of 1986-96. This study further finds out that the FDI’s share in fixed asset formation in corporate sector remained a mere 10\% in the 1990s.\textsuperscript{19}

7. C. Rajendran (1998)\textsuperscript{20} – This paper has discussed about certain facts related to India’s economic condition of 1990-91 came out, which could be summarized as follows:
   - High inflation rate of 16.7\% per cent in August 1991.
   - Fiscal deficit of 8.4\% per cent of GDP.
   - Interest rate of 19\% per cent.

\textsuperscript{19} CMIE 1993.
• Tariff rate for imports were high ranging from 75per cent to 350per cent.
• Subsidy rate was high.
• Deficit of 2.6per cent of GDP in current account balance and
• Internal liability of 53.3per cent of GDP and external liability of 12.5per cent of GDP.

All the above mentioned problems lead the Indian economy towards the globalisation.

8. Pathasarthi Shome and Hiranya Mukhopadhyay (1998)\textsuperscript{21} - This study observed that after the 5 years of introduction of liberalization, exports have declined sharply to 4per cent in FY 1996-97 and less than 3per cent in FY 1997-98. However during this period India’s capital account position has improved. Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII) comprised the main source of foreign exchange reserves.

9. L. P. Singh (1999) - It was found that the foreign exchange reserves have witnessed a slump from more than US $ 20 billion in March 1995 to around US $ 17.5 billion in January 1996. It happened because of the depreciation of Indian rupee against the US $. The depreciation of Indian rupee raises the question that whether the bountiful reserves in the country are stable or not?

10. S. Sundari (2000)\textsuperscript{22} - Utilization rate of loans in India is showing a downward trend since the fourth five year plan. This fall in utilization of loans and the diversion of external loans for debt servicing has raised fears among the economists that India would land up in a situation like Latin America countries whose external debts have been converted into equity and thus liquidating the assets of the nation.

11. Arjun Sen Gupta (2000)\textsuperscript{23} - Capital that come in either in the form of direct

investment or in the form of long term or medium term loans may be withdrawn from the country attendant by the additional flight, depending upon the degree of capital convertibility of the country. This situation can raise a crisis situation in economy. Because in a situation of reversal of capital flows, it may be very difficult to readjust the production and payments system.

12. **Renu Kohli (2000)**\(^\text{24}\) - analyzes the exchange rate behavior and its management in India. A scrutiny of the exchange rate management strategy of the RBI reveals a strong commitment to exchange rate stability and keeping the exchange rate aligned to one of its fundamentals, i.e., the price level. It was found a positive response of direct intervention activity, to a rise in exchange rate volatility. It was also found that intervention activity adjustments appear to be tied to the price level. The implications for intervention activity are even more significant in a situation where the capital account is liberalized. A rise in the scale of future intervention would therefore imply a significant build-up of reserves.

13. **Ashok V. Desai (2001)**\(^\text{25}\) - In his article has assessed the decade of economic reforms and to access the situation certain questions has been raised which are:

- The splendid industrial boom of early 1990’s was cut short by a credit squeeze in 1996: industry has never recovered momentum since. Could a softer landing have been devised?
- Precisely those industries that boomed in the early 1990’s are doing badly: in this sense, the investment in those years was misguided. Could it have been guided better?
- The momentum has slackened so much by now that the economy looks ready to lapse back into the Hindu rate of growth 3.5 per cent. Is that not the ultimate failure of the reforms? Why has growth slumped? How it can be raised again?


14. **Kantha Krishnan & J.D. Steward Jones (2003)** - The FDI inflows have removed the obstacles like shortage of financial resources, technology and skills etc. These flows increased considerably from Rs. 3514.3 million in 1991 to a peak of US $ 3551 million in 1997. India's share among developing countries reached a peak of 1.9per cent in 1997. However, it has decreased 1.5per cent in 2002 in comparison to 2001.

15. **Davesh Kapur and Urjit R. Patel (2003)** - In this paper, it was found that Indian govt. has been able to build a good reserve of foreign exchange in comparison to the situation of 1991, the year in which reforms were initiated. This situation of reserves has situated Indian economy in a situation where we can avoid external shocks like fluctuating prices, sanctions, war like conditions etc. However this situation has its own opportunity cost that is of macroeconomic consequences or sterilization.

16. **C. P. Chandersekhar and Jyati Ghosh (2003)** - This study revealed that the position of India’s external balance of payments was extremely robust if we see this in relation with the accumulation of foreign exchange reserves. The reserves accumulation was more pronounced between March 2001 and Dec. 2002, external reserves increased by US $ 28 billion in that period. Major reason behind this increase is the appreciation of Indian rupee against US $. But this appreciation is considered threatening, as it would increase balance of trade deficit. Because no major export boom has been noticed during the post economic reform period.

17. **Ramana Ramaswamy (2003)** - In his review of the book ‘International Capital Markets: Systems in transition’ has revealed that the emerging markets like Mexico, Indonesia, korea, Thailand, Brazil, Russia, Argentina and Turkey all have

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already gone through string of dramatic crisis since the mid 1990’s. The reason behind
the crisis in most of these countries is significant capital account liberalization and the
combination of fixed exchange rate with open capital market.

18. **Looney and Frederiksen (2004)**\(^{30}\) - This paper uses factor and discriminant
analyses to generate indices of globalization. The first part of the paper describes the
technique and we find that the Netherlands is the most globalized and Sierra Leone the
least. In the second part of the paper, comparisons are made between South Asian, East
Asian and Middle East countries to see if relative globalization process is proceeding at
a faster or slower pace. Although the analysis is mostly regional, we introduce evidence
for several countries, including Sri Lanka, Pakistan, the Philippines, Thailand, India
and Malaysia to compare globalization and openness. Based on our findings, several
conclusions are drawn concerning progress made and the economic implications of that
progress. Because of the poor showing of Pakistan’s globalization efforts, special
attention has been focused on that country. The main finding is that Pakistan appears to
have fallen into a vicious cycle of low and declining globalization leading to low
productivity causing low rates of return on investment. The result is low investment
and technology transfer which only reinforces the drift towards an increasing
globalization gap with the country’s main international competitors.

19. **T. Singh (2004)**\(^{31}\) - This study estimates the inter temporal optimizing model of
the balance of trade in India. The theoretical model is first developed and tested without
government consumption and then the model is extended to include government
consumption. Both versions of the model provide strong evidence for the presence of
long run co integrating relationship among the model variables. The model estimated
without government consumption performs better compared with the model estimated
with government consumption. An increase in prices relative to user cost of capital and
the real wealth lead to deterioration, while the rise in real capital stock results in an
improvement in trade balance. The study suggests the need for continuation of
economic reforms, further reduction in costs, and rationalization of relative prices and
removal of capital controls. The study also suggests the need to strengthen


infrastructure, encourage foreign investment and increase domestic saving to accelerate investment and capital accumulation in India.

20. **Cuenca-Esteban (2005)**\(^{32}\) - The East India Company’s “regulated” trade monopoly more effectively served Britain’s national interest during the French wars than might be inferred from contemporary complaints and recent scholarship. The Board of Control’s assessment of India’s importance to the British balance of payments in the 1780s was well informed and was borne out by subsequent developments. British net inflows from India remained substantial through 1765–1812 and were arguably least dispensable. British trade with Asia most frequently outgrew the worldwide totals and retained some of the acquired gains to the end of the period. The real constraints faced by private traders should be weighed against the external economies and scale advantages rendered by the East India Company to a wider range of British interests.

21. **Derne (2005)**\(^{33}\) - Since 1991, India has witnessed an explosion of new media. Between 1990 and 1999, access to television grew from 10 per cent of the urban population to 75 per cent of the urban population. Cable television and foreign movies became widely available for the first time. Despite being heavy users of this new media, nonelite urban middle-class men continue to be attached to previous family arrangements. The striking continuity of nonelite men’s gender culture in the face of new meanings introduced by foreign media suggests that institutions are fundamentally important in rooting the fit between cultural orientations and institutional structures. Social theorists today often emphasize the mutually reinforcing nature of culture – meanings, norms, values – and structure – the way society is organized. But contemporary theorists too often sidestep consideration of the relative causal importance of cultural and structural factors. This paper confirms Swidler’s argument that cultural “consistencies across individuals come less from common inculcation by cultural authorities than from the common dilemmas institutional life poses in a given society.” Changes resulting from globalization are, then, more likely to follow from changed structural realities than the introduction of new cultural meanings.


22. **Terada-Hagiwara (2005)**\(^{34}\) – This paper is keen to outline the issues or concerns that come from foreign exchange reserve accumulations in Asia. A lot of attention is paid to the People’s Republic of China and India in order to signify the accumulation that is borne by capital inflow surges. This research paper examines the fact that sterilization interventions by the two economies look as if they are able to hold the credit growth from increasing. However, the impact looks as if it is limited and momentary. In this context, the adjustments of exchange rate policies are considered for increased freedom in policy options although the incentives to live with it are very limited. Thus, according to this paper, while maintaining the current exchange rate practices with capital account convertibility and better exchange rate flexibility in the long run.

23. **Chakrabarti (2006)**\(^{35}\) – The average monthly turnover in the Indian forex market was about 175$ USD billion in 2003-04. When compared with the monthly trading volume of about 120$ USD billion USD for all cash, derivatives as well as debt instruments in the country and the size of the entire forex market is seen clearly. Foreign exchange forms the biggest financial market. A country’s foreign exchange market constitutes the strongest in a particular country, whether India or any other in the world. Indian forex sector has been majorly changed by way of the liberalization process. It has been since 1991 that the rigid, forty year old, fixed exchange rate system that is replete with major import and foreign exchange controls along with the huge and thriving black market that is replaced with a less regulated ‘market-driven’ arrangement. Because of an overabundance of foreign exchange reserves, one does not perceive imports with fear.

24. **Dossani and Kenney (2006)**\(^{36}\) Services offshoring to India has grown dramatically in the last 10 years. It is linked to the earlier expansion of Indian software services exports, but has its own dynamic and workforce. Although domestic firms were early entrants, MNCs are central actors. Already, some work done in India resembles that done in developed countries. To explain the dynamism and complexity


of offshoring, a taxonomy of market participants is presented. Offshoring by small entrepreneurial US firms is highlighted as an emerging phenomenon. The conclusion argues that market entry by other developing countries is possible.

25. **Goyal (2006)** – International economics has been studied in great detail over the past few years with specific focus on the increasing integration of economies and societies worldwide. Increasing growth and reducing poverty in countries like China, India, and the like that experienced huge poverty about a couple of decades back are now enjoying the fruits of liberalization, privatization and globalization as well (LPG). However, these processes have also created much international opposition over certain issues that have actually increased the inequality and environmental degradation. It is also important to study the kind of impact globalization has had on developing countries from the perspective of inward FDI’s. One has to also focus on the role that some developing countries play especially from certain parts of Asia and Latin America who are more of initiators of the process of globalization via their own MNC’s. After having experienced a major crisis in the early 90’s, India took the decision of opening up the economy. What happened because of that was a slew of domestic as well as external sector policy measures taken mainly because of immediate requirements and a little because of the demands of several multilateral organizations. The regime of the new policy majorly pushed ahead the option of keeping an open and a market-oriented economy. What this research study explores are the nuances of an existing process of globalization, liberalization and privatization. There are also certain comments made on what LPG has caused by way of its impact on developing countries.

26. **Shukla (2006)** – This special issue aims to present India as one of the world’s most promising and fastest growing economies, with multinational companies eager to invest. Examines the eight articles and the contribution of each to an important aspect of marketing in the region. The issue provides insights from both organizational and consumer perspectives; provides various methodological insights in researching the Indian marketplace; being specifically focused on India, the findings are applicable in

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the Indian market context which has a need for customized tools and marketing strategies.

27. **Singh (2006)**[^39] – The high rise in Foreign Exchange Reserves (FER) in a few Asian nations create a concern with regard to the appropriate size and utilization. This has been the case in India too especially about financing infrastructure. The Indian government want to utilize a part of its reserves into infrastructure financing and has even announced a scheme that is to be implemented in the February 2005 Annual Budget. The FER that India has is not much when compared with that of what some other nations have. It could also be argued that probably the proposed plan could lead to greater potential problems than expected benefits.

28. **Badar Alam Equal (2006)**[^40] - India’s FDI need is stood at US $ 15 billion per year, whereas actually FDI were amounted to only US $ 5.3 billion in year 2004.[^41] This situation is not suitable for attaining a growth rate of 7-8 per cent.

29. **A. Vasudevan (2006)**[^42] - This study has found that portfolio flows has created two sides in the economy. On one side it’s adding to the country’s foreign exchange reserves and on the other side generated concerns about the stability of the financial sector. Moreover, these sharp changes in net inflows would affect the foreign exchange rate, which leads toward instability or volatility of exchange rates.

30. **RBI (2006)**[^43] - In its report on foreign exchange reserves, has stated that the foreign exchange reserves have emerged as a good tool for measuring the ability to absorb the external shocks. Various parameters like ability to pay for imports, size, composition and profile of various types of capital flows, payment obligations, liquidity risk in terms of exchange rates, commodity prices etc. should take notice of while judging adequacy of reserves.

[^41]: The Economic Times; 28 June 2005.
31. Patnaik & Amaresh Samantarya (2006) - Indian economy underwent a severe economic crisis in 1991, mainly due to the problem of balance of payments and manifestation of underlying imbalances amounting from an adverse impact of high fiscal and current account deficits of the 1980s. In 1991 economic growth was 1.3 per cent and the foreign currency reserves were around US $ 1 billion, which were very insufficient. With the available resources the country could have financed only two weeks of imports. In view of this position, reforms were introduced by the govt., covering various sectors of the economy.

32. Chandra (2007) – When studying the fiscal issue, we start with the tax-GDP ratios. In the recent official discourse, credit has been claimed so as to register better overall tax-GDP ratios. From the Chart D1, the ratio has recovered from the 1991-2001, crossing earlier peaks in the late 80’s and in 2005 and 2006. Because of the high oil prices in the global market, the oil PSUs contributed in 2006-07 an amount of Rs 93,800 crore by way of direct and indirect taxes (BL 5/12/07) which amounts to than 28 per cent of the total tax revenues of Rs 345, 972 crore.

33. EPW Research Foundation (2007) - Issues related to foreign currency inflows, sterilization & liquidity control and exchange rate management has come into picture once again. It has happened because of the appreciation of Indian rupee in comparison to US $ from Rs. 45.15 on March 22 to Rs. 43.39 on March 31(RBI mid day rate) an appreciation by 4.1per cent in six working days. It has been found that all this happened because of the capital amount side of balance of payments. The reserves were increased during that period whereas trade deficit remained in deficit with imports rising at a faster rate than exports.

34. Michelson (2008) - The field of nanotechnology offers the possibility of transforming the international science and technology (S&T) policy landscape and

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47 RBI bulletin, April 2004.
making a significant impact on the direction of research and development for a wide range of nations and companies. Nanotechnology endeavors in the United States, China, and India remain some of the most interesting because of the opportunities and challenges this field poses for future competition and collaboration between these three nations. This paper examines how nanotechnology will raise new science and policy questions—and lead to new strategic linkages—that will have a major impact on the futures of these nations for decades to come. Then the paper analyzes and compares the current state of nanotechnology in these three countries, discusses some of the main drivers of collaboration, investigates current and potential uncertainties associated with nanotechnology, and offers policy suggestions on ways that these difficulties may be addressed.

35. **Ravi (2009)**⁴⁹ – When India achieved its independence from the clutches of the British rule, it stood on unsteady ground with regard to running a country ridden with a multitude of problems – social, economic and political as well. Policy makers who inherited these difficult times decided to initiate wide economic reforms. Impediments to growth initiated a transition of the state-controlled rule to a more market-friendly period.

36. **Mihir Rakshit (2009)**⁵⁰ - This paper has discussed about the problems like inflation, growing foreign indebtedness and worsening balance of payments situation in the country. The paper critically evaluated the long terms plans undertaken by the govt. to promote efficiency and enterprise through de-licensining of industries, liberalization of the financial markets, decontrol of foreign trade and free entry of foreign capital.

37. **Arunachalam (2010)**⁵¹ – It has been identified that India as well as China would be the frontrunners as the world largest economies of the 21st century. This has been researched by Professor Irma Glicman Adelman, an Irish economist in California

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⁵⁰ Mihir Rakshit(2009), Macroeconomics of post-reform India, Oxford University Press, New Delhi, India.

University at Berkeley in her research study ‘Development Over Two Centuries’ that was published in the Journal of Evolutionary Economics, 1995. According to her, the period 1700 – 1820 was that of the Netherlands, the period 1820 – 1890 is the period of England, the period 1890 – 2000 is the period of America and the existing period – the 21st century is that of China and India. It has also been forecasted that India will be considered as one of the leading players of this century. The World Bank has also regarded India as one of the leading players of this century and will be the third-largest economy after American and China. India has been slated to challenge the Global Economic Order in the next 15 years, overtaking Italy in 2015, England in 2020, the Japanese economy in 2025 and the USA in 2050. The Japan economy will be overtaken China in 2016 and the US economy in 2027. There are some advantages that India enjoys as compared to with other economies:

India’s is the 4th largest GDP worldwide with regard to purchasing power. It is also the third-fastest growing in the world after China and Vietnam. The service sector contributes about 57 per cent of GDP while that of agriculture is about 17 per cent and manufacture is 16 per cent as in 2005-06. This is how a developed country works. The expected growth rate of GDP is about 10 per cent very soon (since it has slipped from 9.2 per cent to 6.2 per cent within 2 years from 2006-07 to 2008-09 because of recession which would be only a temporary phase). India has about $284 billion as foreign exchange reserves as of today. It did not have more than $1 billion as Foreign Exchange reserve when it opened the economy in 1991. This research paper works towards studying two booming economies globally with regard to their foreign exchange reserves. This study is founded on secondary data that has been published by the respective governments and different studies done in this regard.

38. **Das (2010)**[^52] - In the background of the global economic and financial crisis, one hears and reads nothing but excoriation and denunciation of globalization. The purpose of this paper is to provide an honest and objective analysis of the contemporary global economic scenario, which reveals numerous challenges that globalization engendered in different countries, country groups as well as in the global economy. This paper asserts that globalization has a positive side as well. The trauma of the

continuing crisis is vitiating the enormous constructive contribution made by economic and financial globalization in the contemporary period. The paper looks at: globalization as a welfare-enhancing force; some front runners of globalization and particularly the ascent and economic integration of East Asia, China, India, the BRICS, etc. and latecomers to globalization. The essential findings of this paper are that country groups like East Asia in the past and China and India at present have benefited immensely from economic and financial globalization. Rapid group in the sub-group of economies referred to as the emerging-market economies is made possible by economic and financial globalization. The ascent of these economic groups is changing the contours of the global economy. The newest achievement of economic and financial globalization is a favourable impact over the former non-market economies and Africa. Both of these are regarded as challenging cases in the past.

39. Dongre (2011)\textsuperscript{53} - Serious budgetary and fiscal deficit of the government and perilous balance of payment crises occurred in 1991, which put India into a dangerous economic and financial chasm. Therefore in 1991 India was on the threshold of bankruptcy for international payments. Consequently series of reforms were undertaken with respect to industrial sector, trade and for financial sector, to make Indian economy more competent in 1991. The year 1991 witnessed the era of new regulatory, liberalized and globalized economic time in power. This paper discus the various policy changes in terms of the FDI, Foreign Exchange, Industrial Sector, Merger and Acquisition and Foreign Trade of in tune with globalization.

40. Joseph et al. (2011)\textsuperscript{54} – This research paper attempts to develop tools that study only certain issues that are a part of the Indian economy. It also traces the potential growth rate of the economy and the agricultural sector as well while extending the study of the fiscal stimulus and its impact. It also estimates the short and long run elasticities of the country’s trade. There is a definite need to bring about structural reforms in order to improve the potential growth rate of the economy as well as that of the agri sector to achieve a non-inflationary and high growth move for the country. The fiscal stimulus effects show how important the fiscal consolidation efforts so as to keep


up the high growth movement. Moreover, the trade elasticities also buttress the situation needed to acquire the correct and real effective exchange rate.

41. Ana Mar (1997)\textsuperscript{55} reviews the recent evidence on the scale of FDI to low-income countries over the period 1970-96 and major factors determining foreign companies’ decision to invest in a particular country. The study concludes that large market size, low labor costs and high return in natural resources are amongst the major determinants in decision to invest in low income.

42. Mucchielli and Soubaya (2000)\textsuperscript{56} investigated the determinants of the volume of trade of the French Multinational Corporations (MNCs). The major findings suggest that inward FDI has a positive influence on Foreign trade (including exports and imports), and this positive influence is stronger for exports compared with imports.

43. Charkraborty and Basu (2002)\textsuperscript{57} explore the co-integration relationship between net inflows of FDI, real GDP, unit cost of labor and the proportion of import duties in tax revenue for India with the method developed by Johansen (1990). They find two long-run equilibrium relationships. The first relationship is between net inflow of FDI, real GDP and the proportion of import duties in tax revenue and the second is between real GDP and unit cost of labor. They find unidirectional Granger Causality from real GDP to net inflow of FDI.

44. Naga Raj (2003)\textsuperscript{58} discusses the trends in FDI in India in the 1990s and compare them with china. The study raises some issues on the effects of the recent investments on the domestic economy. Based on the analytical discussion and comparative experience, the study concludes by suggesting a realistic foreign investment policy.


45. **Salisu A.A. fees (2004)**

examined the determinants and impact of FDI on economic growth in developing countries using Nigeria as a case study. The study observed that inflation, debt burden, and exchange rate significantly influence FDI inflows into Nigeria. The contribution of FDI to economic growth in Nigeria was very low even though it was perceived to be a significant factor influencing the level of economic growth in Nigeria.

46. **Kulwinder Singh (2005)**

analyzed the developments (economic and political) in India relating to the trends in two sectors: Industry and Infrastructure. The study concludes that the impact of the reforms in India on the policy environment for FDI presents a mixed picture. The industrial reforms have gone far, though they need to be supplemented by more infrastructure reforms, which are a critical missing link.

47. **Nirupam Bajpai and Jeffrey D. Sachs (2006)**

attempted to identify the issues and problems associated with India’s current FDI regimes, and more importantly the other associated factors responsible for India’s unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labor costs, and a well working democracy, her performance in attracting FDI flows have been far from satisfactory. The conclusion of the study is that a restricted FDI regime, high import tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision making processes, and a very limited scale of export processing zones make India an unattractive investment location.


examined the effects of international trade and investment related macro-economic variables, namely, exports, imports and FDI inflows and the outflows of FDI from India over 1970 through 2005. Unidirectional Granger Causality was found from export and import to FDI outflows, but no such causality exists from FDI inflows to the corresponding outflows from India.

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49. **Burak Camurdan and Ismail Cevis (2009)** developed an empirical framework to estimate the economic determinants of FDI inflows by employing a panel data set of 17 developing countries and transition economies for the period of 1989-2006. Seven independent variables were taken for this research namely, the previous period FDI, GDP growth rate, wage, trade rate, inflation rate and economic investment. The empirical results conclude that the previous period FDI is important as an economic determinant. Besides, it is also understood that the main determinants of FDI inflows are Inflation rate, the interest rate and trade (openness) rate.

50. **Sapna Hooda (2011)** analyzed the impact of FDI on economic growth of Indian economy for the period 1991-92 to 2008-09. She Used OLS method for this purpose. The empirical results found that foreign Direct Investment (FDI) is a vital and Significant factor influencing the level of growth in Indian economy. She also estimated the determinants of FDI inflows and found that trade GDP, Research and Development GDP, Financial position, exchange rate, Reserves GDP are the important macroeconomic determinants of FDI Inflows in India.

1.9. **Research Methodology**

1.9.1. **Sampling Design of Research**

For this study, the selected research design is of *convenience sampling*. As per Reason (2006) convenience sampling gets counted as a process of non probability sampling. Here, relevant sample gets marked primarily as per convenience that attains the advantage related to relatively easy kind of sample selection and collection of data thereby. However, it gets impossible to initiate the mode of evaluating goodness over sample as per its representatives marked within the population. For convenience sample, there is the scope for good results or might not have statistically accepted procedure. This analyses probability and inference is meant for quality related to sample results. There are cases when researchers applied statistical design related to probability samples for the convenience sample. The logic was that convenience

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sample can get treated as probability sample. Here, cost as well as convenience related to real assumptions must have final factors managed after deliberating the way information related to utility gets marked strategically. This is noted from limited cases that get sampled. Convenience sampling is not strategic or is purposeful (Anderson, Sweeney and Williams, 2008). Riley M (2000) declared it as the weakest in the list of sampling procedures that are integral as per determined cases. These are very least expensive and consume least time for sampling and get considered as a convenience sample that is under any process for the selection of sampling. The limitation as noted with convenience sampling is related to its inability towards the understanding of a sample that represent at target population. As the convenience sampling follows the domain of being non pre-designated, process, the sampling error never gets calculated. Thus, there is the precision as well as level of confidence that cannot be estimated. Thus, this approach is related to exploratory research in particular.

1.9.2. Method of Data Collection

Research data is meant for the observations related to the argument or the relevant test. Data remains indispensable in terms of carrying any research. This particular research uses secondary sources for the study of the data.

Loewy and Guffey (2009) declare secondary data as a kind of information that appear in some form or with other, yet never get gathered on the primary basis as per the demand of the data present in hand. Modes of secondary data are relevant at the beginning in the process of collecting data as the same is implied for the data relevant to the first type. Basic limitation of the secondary data depends on the collected process that differs from current problem of the research. These kinds of data might not address determined topic under the relevant question or can just offer partial information, which can turn inaccurate or outdated. Secondary data can get examined first as the same can offer invaluable mode of background information, which is subject to get used for defining the project. It also participates in developing objectives under apt methodology. Secondary data can be comprised of published as well as raw summaries. There are various data stored by many organizations to support determined operations. Secondary data is subject to save costs along with time and demands careful
representation for enhancing data that are found by the researcher as useful and
important.

The methodology that we chose arose out of the need to address our research problem, i.e., to study the meaning of globalization in terms of its genesis, evolution and characteristics of globalization with reference to India. In the existing literature, the meaning of globalization with respect to India is not fully explored.

First, the issue has not been directly studied; at best it has been discussed in passing. Second, studies that have dealt with this issue have focused only on some specific periods of the time and there is no continuity among the various studies during the history of India's effort to integrate with the rest of the world economy in the last about 30 years.

Third, the past studies have engaged in single or fewer variables in their respective studies. However, we think that in order to explain the concept of globalization, a wider set of dimensions including the concerns of the host country and that of the foreign companies, foreign governments and world bodies have to be looked into.

Historical Analysis of the several parameters of the globalization during the last three decades is the approach that we adopted so that the meaning of globalization with respect to India could be explained in the proper perspective. The following variables have been taken into account while conducting this research work: (Included in Appendices)

**Balance of payments**

GDP

Consumption

Physical investment

Government spending

Nominal money supply

Price level

Nominal interest rate

Liquidity preference (Real money demand)
Taxes

**Foreign exchange reserves**

Reserves excluding gold
Period average exchange rate
Nominal daily effective exchange rate
Exports
GDP Deflator