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REVIEW ARTICLE

INDICATORS OF THE EXTENT OF INTEGRATION OF THE INDIAN ECONOMY IN THE WORLD MARKET FOR GOODS AND SERVICES

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Indicators of the Extent of Integration of the Indian Economy in the World Market for Goods and Services

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FDI may be defined as an investment involving a lasting interest and control by an investor who is a resident of another economy, other than that of the host economy. In the simple sense, FDI implied that the investor has a significant degree of influence on the management. Foreign Direct Investments are investments made by residents of one economy with the objective of establishing a lasting interest in a company located in another economy (host economy).

FDI refersto the purchase by the citizens of one country of non-financial assets in another country. Foreign direct investment involves the acquisition or establishment of a firm, company or enterprise in a country outside of the registered corporate home country. FDI in real estate involves acquisition of land or building across all commercial, residential and retail segments. Any construction activity is also included in FDI.

The year 2006 witnessed robust growth in the world economy and vigorous trade expansion. According to data available in (UNCIAD 2007), global GDP growth accelerated to 3.7 percent, the second best performance since 2000. All major regions recorded GDP growth in excess of population growth. Economic growth in the least-developed countries continued to exceed 6 percent for the third year in a row. A large part of the stronger global economy is attributable to the recovery in Europe in early 2006, which turned out to be stronger than expected. The United States economy maintained its overall expansion as weaker domestic demand was balanced by a reduction in the external deficit, mainly due to a faster export growth. In Japan somewhat faster economic growth was achieved despite weaker domestic demand reflected in a widening of its external surplus. China and India continued to report outstandingly high economic and trade growth.

The more favourable investment climate is also reflected in a sharp rise in global foreign direct investment flows in 2006, which approached the record levels of the past. UNCTAD reports that global FDI inflows surged by one-third to US$ 1.23 trillion, the second highest level ever. The high growth of global FDI flows can be attributed partly to increased mergers and acquisitions activity and higher share prices.

Integration of the domestic economy with the world market can be indicated by the extent of international trade in the domestic economy as measured by the share of exports and imports in GOP and in the global economy as measured by the share of country's exports and imports in global exports and imports.

The relevant data are given below in the table:

Table : Measures of Integration of the Indian Economy with the World Economy (percent total)

Measures of Integration	1994	2004
Share in GDP of Exports of Goods and Services	10	18
Share in GDP of imports of Goods and Services	10	20
Share in World Merchandise Exports	0.6	0.8
Share in World Merchandise Imports	0.6	1.1
Country Share in World Exports of Commercial Services	0.6	1.9
Country share in World Imports of Commercial Services	0.8	2.0

Sources: World Bank 2006 and WTO, 2005

It is evident from above that India has become increasingly integrated with the world economy. During the period 1990-2004 the share of exports and imports in India's GDP almost doubled, but the increase in India's share in its world merchandise exports was proportionately far less. However, because of the success in the IT service sector, India's share in world exports of commercial services tripled during the same period. This would imply that excluding the services sector, the effect of greater integration is mostly domestic. This is because of rising share of trade in domestic GDP, rather than India's GOP growth, affecting the global GDP growth.

Table : Share of India in Global GDP and its Growth

Share in Global GDP (Percent)		Share in GOP of Low and Middle Income Countries (Percent)		Growth Rate of GOP (percent)		Share in Growth World GDP (percent)		Share in Growth Rate of Low and Middle income countries (percent)	
1990	2004	1990	2004	1990	2004	1990	2004	1990	2004
1.46	1.67	7.92	8.25	6.0	6.2	3.58	4.14	12.66	10.63
						(3.12)	(3.62)	(12.18)	(10.23)

Source: Srinivasan (2006)

Note: Using shares of the two countries in global and low and middle income countries' GDP of 2004 respectively as weights. Figures in parenthesis use corresponding shares in GDP of 1990 as weights.

The share of India in global and low income countries' GDP respectively has increased over time. And India's share of GDP among low and middle income countries is naturally higher than in global GDP and its contribution to GDP growth in low and middle income countries is even higher.

The IMF (2005) recognizes that policy makers in India are actively seeking to strengthen India's global linkages and to accelerate its integration with the world economy. Success in these efforts would increase the role of India in the world economy.

The stock of foreign direct investment in India soared from less than US$ 2 billion in 1991, when the country undertook major reforms to open up the economy to world markets, to almost US$ 51 billion in 2006. Reforms are being done to deregulate FDI restrictions further, e.g., by allowing FDI in retail trade. Policymakers in India as well as external observers attach high expectations to FDI. According to the Minister of Finance, Mr. P. Chidambaram, "FDI worked wonders in China and can do so in India" (Indian Express, November 11, 2005). The Deputy Secretary General of the OECD reckoned at the OECD India Investment Roundtable in 2004 that the improved investment climate has not only resulted in more FDI inflows but also in higher GDP growth (OECD India Investment Roundtable 2004). This implicitly means that higher FDI has caused higher growth.[i]Bajpai and Sachs (2000) advice policymakers in India to throw wide open the doors to FDI which is supposed to bring "huge advantages with little or no downside."

SIZE AND MAGNITUDE OF INWARD FDI

Table : FDI Inward Stock (US$ billion)

Year	World	Developing Economics	India
1992-97	2662.8	694.92	5.4
1998	4166.21	1224.05	14.06
1999	4939.44	1558.68	15.42
2000	5810.18	1707.63	17.51
2001	6210.76	1786.91	20.32
2002	6789.2	1727.49	25.4
2003	8185.38	1978.06	30.82
2004	9570.52	2287.69	38.67
2005	10048.01	2621.61	44.01
2006	11998.83	3155.85	50.68

Source: World Investment Report,

At the first impression it appears that India is an underperformer in attracting FDI. However, FDI flows are not easy to analyse because they are generally low and fluctuating. Data relating to FDI inflows are underestimated because of their national definition and interpretation. The RBI and SPA, which officially publishes statistics on foreign investment, have, since 1991, only reported the equity component of FDI. And reinvested earnings[ii] have not been taken into consideration, though the IMF guidelines estimate that they are a part of FDI inflows. The Indian data on FDI include neither the proceeds of foreign equity listings nor foreign subordinated loans to domestic subsidiaries. Overseas commercial borrowing as well as some depository receipts over 10 percent of the equity coming from the foreign institutional investors are also disregarded (Srivastava, 2003). Hence, there is a lot of scope to bring India's statistics in line with the international standards.

At the end of 2006, India's stock of inward FDI amounted to US$50.6 billion which is only 0.4 percent of the world stocks, and 1.6 percent of the investments received by the developing countries. It can be seen, however, that Indian stocks were 2.6 times greater in 2006 than in 1998.

Table : Inward FDI Flows (US$ Billion)

Year	World	Developing Economics	India
1992-97	312.23	114.65	1.67
1998	709.3	189.64	2.63
1999	1098.89	228.46	2.16
2000	1411.36	256.08	3.58
2001	832.56	212.01	5.47
2002	621.99	166.31	5.62
2003	564.07	178.69	4.32
2004	742.13	283.03	5.77
2005	945.79	314.31	6.67
2006	1305.79	379.07	16.88

Source: World Investment Report, 2007

Indian inward FDI flows surged to US$ 6.67 billion in 2005 and US$ 16.88 billion in 2006, which is a record level. It represented 01 percent of the world FDI flows and 2:12 percent of the developing economies flows in 2005. However, the ratios improved to 1.29 percent and 4.45 percent in 2006 respectively, which shows marked progress. In 2004, FDI reached a record level of US$ 5.7 billion, and India held the 7th rank among developing countries to attract foreign investors. (WIR, 2005)

Table : FDI Inflows in selected Asian developing countries (1990-2004) (US$ billion)

Country	1990	2004
China	3.48 (1.72)	60.63 (8.16)
Hong Kong	3.27 (1.62)	34.03 (4.58)
India	0.23 (0.11)	5.77 (0.77)
Indonesia	1.09 (0.54)	1.89 (0.25)
Korea	0.759 (0.37)	8.98 (1.2)
Malaysia	2.61 (1.29)	4.62 (0.62)
Phillppines	0.55 (2.76)	19.82 (2.67)
Singapore	5.57 (2.76)	19.82 (2.67)
Srilanka	.043 (0.02)	0.23 (0.03)
Thailand	2.57 (1.27)	5.86 (0.78)
Developing Economics	35.89 (17.80)	283.03 (38.13)
World	201.59	742.13

Source: DIP & P, Ministry or commerce, 2005

(Figures in the parenthesis are % share of the World total)

The above table shows that the share of world investment received by India remains weak (0.11 percent in 1990 and 0.8 percent in 2004), however, it is gradually increasing. However, if the distortions in FDI data measurement, as previously mentioned, are taken into consideration, then the actual FDI will be higher than the official figures. If reinvested earnings by foreign firms are added, FDI inflows have to be increased by about US$ 1.8 billion in 2003 and 2004. So, India would have received about US$ 7 billion of FDI in 2004. (RBI bulletin, 2005)

The growing trend in FDI inflows is also pushed by Greenfield investments. The amount of Greenfield investment has risen by 82.8 percent in 2003 with 457 projects, and by 50 percent in 2004 with 685 projects (WIR, 2005). As far as Mergers and Acquisitions by the foreign firms, they amounted to US$ 949 million in 2003 and US$ 1760 million in 2004. (WIR 2005)

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