

India's financial openness and integration with Southeast Asian countries: an analytical perspective

Chandan Sinha and Narayan Chandra Pradhan¹

I. Introduction

At present, most developed economies have open capital accounts coupled with liberalised domestic financial sectors. Following the trend, developing and transition economies have opened up mostly between the late 1980s and the mid-1990s. *The Economist* recently carried an article proclaiming that emerging economies are driving global growth and making a big impact on developed countries as these newcomers integrate with the global economy. In several Indian cities, one can come across stores sporting the name China Bazaar, which essentially sell “made in China” goods for price-conscious Indian consumers. This is the effect of globalisation, which opens up the Indian economy to a world of opportunities for ordinary people to reap benefits. Nobel laureate Joseph Stiglitz, in his book *Making Globalization Work* (2006), pointed out that China and India are growing at historically unprecedented rates, largely because of globalisation, new technologies, and financial integration.

In a way, the trade openness and financial integration between developed and developing countries have become much stronger in recent years. A number of developing economies have been transformed into emerging economies by growing at an extraordinary pace while rapidly integrating into the regional and global economies. Moreover, some of these developing economies have become increasingly important players in the global economy, as they have begun to account for a substantial share of world output (Akin and Kose, 2007). While there are divided opinions on the advantages and disadvantages of global financial market integration, most would agree that globalisation has been positive, at least to the extent of imposing market discipline on policymakers.

The conceptual analytics behind the trade openness and financial integration of an economy relate to cross-border movement of goods, services and factors of production. Historically, the approach towards openness has varied widely in different economies, as well as under separate regimes within the same country. Since 1950, there has been a gradual liberalisation of world trade under the banner of the General Agreement on Tariffs and Trade (GATT) and, since 1995, under the aegis of the World Trade Organisation (WTO). A slow but definite break from inward-looking approaches started during the late 1970s when some of the East Asian economies embarked on the path of export-led growth and succeeded in attaining higher economic growth. As a consequence, while world output has expanded

¹ The authors are Chief General Manager and Research Officer, respectively, in the Financial Markets Department, Reserve Bank of India, Mumbai – 400001, India.

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fivefold since 1950, the volume of world trade has grown 16 times, that is, at an annual compound growth rate of about 7 per cent. It has been documented that exports have tended to grow steadily in countries with more liberal trade regimes and these countries have experienced faster growth of output and living standards (Thirlwall, 2002). The emerging market and developing countries weathered the recent financial storm and are providing the basis for strong global growth in 2008. For the first time, China and India are making the largest country-level contributions to world growth. These two countries together now account for one fifth of world purchasing power parity-adjusted GDP, up from 10 per cent in 1990 (IMF, 2007). The output paths of China and India have broadly followed the output paths of other economies that experienced rapid expansions earlier.

Against this backdrop, several issues have come into sharp focus: Where does India stand in the evolving global trade pattern? Does global experience suggest that trade liberalisation/openness move in tandem with financial integration as well as higher growth? What is the link between international trade and financial openness? Other aspects that are relevant to India's trade openness and financial integration with Southeast Asian countries are discussed with analytical rigour in the following sections. Schematically, Section II deals with the recent trend in world trade, followed by that in finance, in the context of the financial turmoil that shook the world economy, and with the consequent growth prospects. Section III delves into the analytics of openness as a prelude to reviewing the literature in order to analyse various indicators of trade openness and financial integration. Section IV analyses India's domestic, regional and global openness with a special focus on Southeast Asian economies, including China. Section V concludes with some observations from the ensuing analysis and random thoughts on the future deeper economic integration of India with the East Asian region.

II. Recent trends in world trade vis-à-vis Asia's trade and finance

World trade in recent years was buoyant despite the lack-lustre economic performance of several industrialised countries, especially those of the European Union and Japan. Although the Southeast Asian crisis did cause a major disruption in international trade in 1997, the crisis-affected countries have recovered in recent years, and have growing trade volumes. According to the WTO's *World trade report 2007 and prospects for 2008*, real merchandise export growth slide to 5.5 per cent in 2007 from 8.5 per cent in 2006, and may grow even more slowly in 2008 – at about 4.5 per cent – as sharp economic deceleration in key developed countries is only partially offset by continuing strong growth in emerging economies. World commercial services exports also rose by 18 per cent to USD 3.3 trillion in 2007.

The recent financial market turbulence, which has considerably reduced economic growth projections for some major developed markets, has clouded the prospects for world trade in 2008. Real merchandise export growth in 2007, while nearly 3 percentage points lower than in 2006, according to provisional estimates, was still close to the average rate of trade expansion over the past decade (1997–2007). Exports from Asia rose by 11.5 per cent in real terms, again exceeding significantly the region's import growth (8.5 per cent). Within the Asian region, very large variations could be observed on the import side. While China and India recorded double digit import growth, the comparable figure for Japan was practically stagnant (1 per cent). The trade performance of the four newly industrialised economies (Hong Kong SAR, Korea, Singapore and Taiwan, China) continued to be less dynamic than that of the region as a whole, but still recorded an excess of export growth over import growth (8.5 per cent and 7.0 per cent, respectively), indicating the importance of the Asian region in the world trade picture (Table 1).

The most important phenomenon to emerge from the recent trade and finance scenario is the increased interdependency among the economies of Southeast Asia and specifically in the trade between China and the rest of the region. This intraregional trade is spurred by the

integration of the regional production network and supply chain. Financial integration in the form of cross-border investment flows, such as foreign direct investment (FDI), portfolio investment and bank lending, is also on the rise. The Asian Bond Market Initiative under ASEAN + 3 (China, Japan and Korea), the launching of the Asian Bond Funds, I and II, under the EMEAP,² and the road map for monetary and financial integration undertaken by ASEAN³ are important government policy measures behind the recent expansion in trade and financial flows in the region.

Table 1
Growth in world GDP and merchandise trade by region
Annual percentage change at constant prices

Region	GDP			Exports			Imports		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
World	3.3	3.7	3.4	6.5	8.5	5.5	6.5	8.0	5.5
Asia	4.2	4.7	4.7	11.0	13.0	11.5	8.0	8.5	8.5
China	10.4	11.1	11.4	25.0	22.0	19.5	11.5	16.5	13.5
Japan	1.9	2.4	2.1	5.0	10.0	9.0	2.5	2.5	1.0
India	9.0	9.7	9.1	21.5	11.0	10.5	28.5	9.5	13.0
USA	3.1	2.9	2.2	7.0	10.5	7.0	5.5	5.5	1.0
Europe	1.9	2.9	2.8	4.0	7.5	3.5	4.5	7.5	3.5
EU (27)	1.8	3.0	2.7	4.5	7.5	3.0	4.0	7.0	3.0
S&CA	5.6	6.0	6.3	8.0	4.0	5.0	14.0	15.0	20.0
CIS	6.7	7.5	8.4	3.5	6.5	6.0	18.0	21.5	18.0
AME	5.6	5.5	5.5	4.5	1.5	0.5	14.5	6.5	12.5

Note: EU (27) stands for the 27 European Union economies; S&CA for South and Central America, including the Caribbean; CIS for the Commonwealth of Independent States; and AME for Africa and the Middle East.

Source: WTO, *World trade report 2007 and prospects for 2008*.

According to the UNCTAD⁴ *World investment report 2007*, FDI inflows to southern, East and Southeast Asia maintained their upward trend in 2006, rising by about 19 per cent to reach a new high of USD 200 billion. At the subregional level, southern and Southeast Asia saw a sustained increase in flows, while their growth in East Asia was slower. However, FDI in the latter subregion is shifting towards more knowledge-intensive and high value-added activities. China and Hong Kong retained their positions as the largest FDI recipients in the region, followed by Singapore and India. Resource-seeking FDI from China and India continued to increase. The emergence of China and India as important sources of FDI, coupled with active mergers and acquisitions (M & A) by investors based in the Asian NIEs⁵ (particularly Singapore), has led to increased FDI flows from Asia to developed countries.

² Executive Meeting of East Asia-Pacific Central Banks.

³ Association of Southeast Asian Nations.

⁴ United Nations Conference on Trade and Development.

⁵ Newly industrialised economies – Hong Kong SAR, Korea, Singapore and Taiwan, China.

Resource-seeking FDI from southern, East and Southeast Asia rose again in 2006, driven by large M & A involving oil and gas companies from China and India. With strengthening relationships between countries within the same region, and the emergence of many developing countries as sizeable investor economies, geographical proximity is becoming increasingly important in bilateral FDI relations.

III. Analytics of openness

A. Indicators of trade openness

The proportion of a country's gross domestic product (GDP) involved in international trade (exports and imports) has been recognised in the literature as a good indicator for levels of trade openness. Academics and policymakers have devoted enormous energy to the question of whether openness is good for growth. Most of the evidence is based either on case studies or on regression analysis. The main objections to such studies are that the case studies are always hard to replicate and are affected heavily by country idiosyncrasies, while regression analysis is plagued with endogeneity issues (Lee et al, 2004).

The trade openness of an economy has two distinct dimensions – ex ante and ex post openness. While these dimensions are separate, they are often interrelated. The ex ante trade openness of an economy relates to the permissiveness of its policy positions on exports and imports. The levels of tariff and non-tariff measures (such as quantitative restrictions) applied by the country to cross-border trade flows are the most important indicator of the ex ante trade openness of the economy. The ex post trade openness of an economy, on the other hand, refers to the actual outflow of exports and inflow of imports. Despite low levels of ex ante openness, the ex post openness of the country may be high owing to its large dependence on certain crucial and high-value imported products. The relative “size of the domestic economy” is another crucial factor, owing to which, even with similar ex ante openness, the ex post openness generally becomes higher for smaller economies (for example, the ratio of exports to GDP of Hong Kong and Singapore is more than 200 per cent). Thus, the major problem in the analysis of trade openness is that openness is neither directly observable, nor does it have an accepted definition derived from theory.

As a result, a large body of literature proposing and evaluating alternative measures of trade openness has grown up. The *World development report 1987* constructed an “outward orientation” index for 41 countries in accordance with their trade policies. The distinction between an inward-oriented and an outward-oriented strategy is made on the basis of: (1) effective rate of protection; (2) use of direct controls, such as quotas and import licensing schemes; (3) use of export incentives; and (4) degree of exchange rate overvaluation. On the basis of these data for 41 countries at two points in time, the countries were divided into four broad categories, viz, “strongly outward-oriented”, “moderately outward-oriented”, “strongly inward-oriented” and “moderately inward-oriented” economies.

Sachs and Warner (1995) used a series of trade-related indicators – tariffs, quota coverage, black market premia, social organisation and the existence of export marketing boards – to construct a composite openness index. These indicators provide only a binary classification – a country is either open or closed. As a result, countries with different degrees of trade intervention are equally classified as open. Also, many of the underlying data used by Sachs and Warner to construct their index are only available at one point in time. Most researchers have examined the relationship between economic growth and trade volumes, not policies, because of the difficulties in measuring policy. Second, it is sometimes difficult to interpret the observed correlation between trade policies and growth. Third, most of the literature uses cross-sectional averages or starting values for time-series data (Edwards, 1997).

The indicators of trade openness used by researchers in many cases are problematic as the trade barriers are highly correlated with other sources of poor economic performance. In other cases, the empirical techniques used to ascertain the link between trade policy and growth suffers from serious shortcomings, the removal of which weakens the findings significantly (Rodriguez and Rodrik, 1999). To sum up, the nature of the relationship between trade openness and economic growth remains an open question and the issue is far from having been settled on empirical grounds.

At present, a key aspect of the global economy is the mushrooming of regional trade agreements (RTAs), as multilateral efforts have faced not only economic bottlenecks but also political obstacles. The difficulties encountered in reaching agreement on sensitive issues like agriculture and services (more specifically, on Singapore issues) under the Doha Development Agenda, and the complex and slow negotiation process, have stalled the process of globalisation and paved the way for open regionalism. In this context, RTAs hold advantages for the global trading system. A pertinent issue arising from the current trend in regionalism is how it can be reconciled with increasing globalisation. The debate over whether RTAs are building blocks or stumbling blocks is characterised by two schools of thought. One provides a pessimistic prognosis of the effects of regionalism on multilateral liberalisation, while the other predicts benign effects. Systematic and anecdotal evidence can be found to support both views. Recent work has stressed that the network of overlapping RTAs, including trade-diverting RTAs, may act as a positive force for the multilateral trading system by generating a need to rationalise the system.

B. Indicators of financial integration

Apart from trade, the openness of an economy can have other dimensions as well, most notably, openness in allowing cross-border capital flows (Virmani, 2001). In economics literature, “financial integration” and “financial openness” have often been used interchangeably. The problems associated with capital mobility or financial openness are ascribed to the “costs” of financial integration. If the costs are too high in net terms, financial integration would induce welfare reduction. An economy pursuing capital account liberalisation is said to be seeking financial integration with the international financial markets through financial openness. In this sense, financial openness is the means, while financial integration is the goal. Although financial openness is a necessary condition for financial integration, it is not a sufficient condition.

The growth of international financial flows in recent years has overshadowed that of trade resulting from the rapid liberalisation of capital account regimes. In addition, several pull⁶ and push⁷ factors have changed the composition of financial linkages between developed and developing countries during the process of globalisation. Regional financial integration occurs due to ties between a given region and the major financial centres serving that region. It has been widely believed that economic integration might be easier to achieve at a regional level due to network externalities and the tendency of market-makers to concentrate in a certain geographical proximity to one another.

The gravity models that take into account the economic size and the distance between two countries explain bilateral trade and investment flows. Furthermore, regional financial integration can be an important means of developing local financial markets, for instance,

⁶ Privatisation of state-owned enterprises, removal of restrictions on the acquisition of assets by foreigners, liberalisation of domestic banking systems and stock markets, and gradual establishment of liberal capital account regimes have attracted international capital flows towards the developing countries.

⁷ Demographic changes in the developed economies have resulted in a search for higher returns from emerging markets.

through peer pressure to strengthen institutions and upgrade local practices (BIS, 2006). As a consequence, the composition of capital flows, in particular to emerging economies, has rapidly changed, and portfolio equity and foreign direct investment inflows have become more prominent. Accumulation of official international reserves has recently accounted for a significant portion of the increase in the gross foreign assets of emerging and developing economies (Kose et al, 2006).

In practice, financial openness is a situation in which existing administrative and market-based restrictions on capital movement across borders have been removed. In some countries it also includes the introduction of measures to attract foreign capital and reduce discrimination against foreign financial institutions operating in domestic markets. When a country implements capital account liberalisation, it should first ensure openness, and then financial integration will be achieved gradually. Ideally, that country will eventually have a financial market structure and products similar to those of overseas markets. Domestic financial markets effectively become part of the world market, synchronising interest rate movements, saving and investment activities, and the accumulation of physical capital stocks.

Since the 1997 financial crisis in East Asia, the economics literature has sought to explain why financial integration has sometimes caused harm instead of providing the benefits predicted in theory. Among researchers, the answers to this question range from asymmetrical information problems, such as moral hazard and adverse selection (Eichengreen and Mussa, 1998; Roubini, 1998), to flawed financial fundamentals (Moreno et al, 1998). Certainly, all these issues are relevant and important, although they overlook the eventual and aggregate cause of these problems for the economy – the low level of financial integration. Instead of trying to identify all the inherited problems in the financial system, it is much simpler to look at the gap between openness and integration to appreciate the costs and benefits of the capital account liberalisation process.

The financial markets are, firstly, a market for channelling savings to investment; secondly, a market for risk; thirdly, a market for corporate control; and, finally, they provide an infrastructure for making payments. The market for savings is analysed by macroeconomics; the market for risk is analysed using the theory of finance; and the market for corporate control is analysed using the theory of industrial organisation. Finally, the intermediation of payments is usually analysed in the context of monetary theory. In many financial relationships, these different functions of financial markets appear intertwined, but nevertheless they are conceptually separate and their purposes and impact on financial integration are also different.

Furthermore, the issue of sequencing the process of capital account liberalisation has been widely addressed as a policy response to the ostensible costs or risks of financial openness (Eichengreen and Mussa, 1998). Although financial integration is not directly mentioned, what the sequencing in fact does is to harmonise openness and integration in an attempt to prevent a situation in which a country completely opens its capital account while its level of financial integration is still very low. There is, however, a shortcoming in sequencing studies – the lack of a simple timing index or indicator which would allow policymakers to decide when it is appropriate to move to the next step.

The classical view may, however, be too simplistic. As a result of the emergence of the so-called “new economic geography” advocated by Paul Krugman, the classical view is no longer seen as the whole story. New economic geography emphasises the importance of economies of scale in many industries. In those industries, the rate of return on capital is not necessarily a declining function of previous investment, but may well be an increasing function of the amount of capital. For these kinds of industries, market integration can lead to agglomeration and concentration in centres where the economies of large-scale operation can best be achieved.

The degree of financial openness can influence the extent of international trade in goods and services through two main channels. The first operates through risk-sharing and product

specialisation. Open and well integrated financial markets facilitate diversification of ownership. This, in turn, has two effects. First, if economic agents in one country hold debt and equity claims on the output of the other country, then the dividend, interest and rental income derived from these holdings contributes to smoothing shocks across countries. This is thus a form of ex ante international insurance. Second, to achieve consumption smoothing, households in each country will undertake ex post adjustment of their asset portfolios following the occurrence of shocks in the region. Again, this will lead to smoothing the income of all countries. Once insurance is available through international trade in financial assets, each country will have a stronger incentive to specialise in one form of production (or technology) in order to fully exploit economies of scale or technological competitive advantage. The specialisation in production will then create greater scope for international trade in goods and services, as predicted by standard neoclassical trade theory.

The second channel relies on the ability of the financial sector to divert savings to the private sector. When domestic financial intermediation is weak and inefficient, firms in export-oriented sectors are burdened by significant liquidity constraints; hence, they trade less. Financial openness can help to overcome those constraints by making more external finance available to domestic firms. An implication of this model is that international trade will tend to increase particularly in those sectors that are heavily reliant on external finance, such as projects in the manufacturing sector. A related argument is that financial openness, by eventually facilitating the development of financial intermediation and hence contributing to the establishment of efficient international payment systems, can work as a trade facilitation factor.

IV. Openness of the Indian economy

Specifically in the Indian context, the paradigm shift towards liberalisation started in 1991 following the balance-of-payments crisis, and was carried forward by several policy measures undertaken in response to the crisis (Box 1 and Annex 1). The broad approach to external sector reform was laid out in the report of the High-level Committee on Balance of Payments, headed by C. Rangarajan, in 1993. The devaluation of the rupee in July 1991 and the subsequent transition to the market-based exchange rate regime constituted an important aspect of the open trade policy regime. The reform also sought the elimination of quantitative restrictions on imports (barring a few sensitive items) and a drastic reduction in customs duties. With a distinct change in the overall policy stance, the reform marked a shift in emphasis from import substitution to export promotion, moving away from direct subsidies to indirect promotional measures. Apart from deregulation of the domestic economy, the objective was to increasingly integrate the Indian economy with the world economy, that is, to globalise the Indian economy (Nayar, 2001).

The setting up of a road map for capital account liberalisation in India (RBI, 2006), sequenced with other institutional policy measures, resulted in significant trade and financial flows in conjunction with other emerging market economies of Southeast Asia (Tables 2 and 3). India's economic performance has continued to be impressive since 2001–02⁸ and real GDP growth has been particularly rapid since 2003–04, averaging 7.2 per cent during 2000–08, with 9.6 per cent and 8.7 per cent growth in 2006–07 and 2007–08, respectively. This performance is largely due to unilateral trade and structural reforms, in particular in services, according to a WTO Secretariat report on Indian trade policies and practices. Rapid economic growth has also resulted in an improvement in social indicators such as poverty and infant mortality (WTO, 2007a). It has been observed that trade openness is correlated with financial market

⁸ The financial year runs from 1 April to 31 March.

development, especially when cross-border capital flows are free and changes in openness are correlated with changes in the size of financial markets (Rajan and Zingales, 1998).

Box 1

Liberalisation of the external sector in India since 1991

The external payment crisis that India witnessed in 1991 called for management of the external sector reforms. These included a market-based exchange rate system, introduction of convertibility of the rupee for external transactions on the current account, and a compositional shift in cross-border capital inflows from debt-creating to non-debt-creating flows. A cautious approach was followed in respect of debt-creating external capital inflows, especially those with short-term maturity, in addition to reducing the volatile component of non-resident Indian (NRI) deposits and the flow of external assistance. In the 1990s, for the first time, a strategic external debt management policy was put in place, emphasising compositional aspects, cost, maturity, end use, transparency and risk management. The overall prudential approach was integrated into the process of growing openness and financial liberalisation, which were basic elements of the package of structural reforms. Quantitative annual ceilings on external commercial borrowing (ECB), along with maturity and end-use restrictions, broadly shaped the ECB policy. FDI is encouraged through a very liberal but dual route: a progressively expanding automatic route and a case-by-case route. Portfolio investments are restricted to selected players, particularly approved institutional investors and NRIs. Indian companies are also permitted to access international markets through Global Depository Receipts/American Depository Receipts (GDRs/ADRs) under an automatic route, subject to specified guidelines. Foreign investment in the form of Indian joint ventures abroad is also permitted.

Restrictions on outflows involving Indian corporates, banks and those who earn foreign exchange (like exporters) have also been liberalised over time, subject to certain prudential guidelines. As a result of pursuing the above approach, India has attracted considerable private flows, primarily in the form of FDI, portfolio investment, ECB and NRI deposits. Consequently, managing the surplus also became a challenge in the management of the capital account. The policy for reserve management is built upon a host of identifiable factors and other contingencies. Similarly, the Indian securities market is increasingly integrated with the rest of the world. Indian companies have been permitted to raise resources from abroad through the issue of ADRs, GDRs, Foreign Currency Convertible Bonds (FCCBs) and ECBs. Foreign companies are also allowed to tap the domestic stock markets. FIIs have been permitted to invest in all types of securities including government securities. The Indian stock exchanges have been allowed to set up trading terminals abroad. The trading platforms of Indian exchanges are now accessed through the internet from anywhere in the world. The Reserve Bank of India (RBI) permitted two-way fungibility for ADRs/GDRs, which meant that investors (foreign institutional or domestic) who hold ADRs/GDRs can cancel them with the depository and sell the underlying shares in the market.

Source: RBI, Report on currency and finance.

Table 2
India's trade and financial openness

In per cent

Year	Trade		Invisibles			Current account			Capital account		Import cover of reserves (number of months)
	Exports/GDP	Imports/GDP	Receipts/GDP	Payments/GDP	Net/GDP	Current receipts/GDP	Current receipts/ current payments	CAD/GDP	Foreign investment/GDP	Foreign investment/exports	
1992-93	7.3	9.6	3.6	3.0	0.6	10.8	87.7	-1.7	0.2	3.0	4.9
1993-94	8.3	9.8	4.1	3.1	1.0	12.3	95.6	-0.4	1.5	18.7	8.6
1994-95	8.3	11.1	4.8	3.1	1.8	13.0	91.7	-1.0	1.5	18.3	8.4
1995-96	9.1	12.3	5.0	3.5	1.6	14.0	88.8	-1.7	1.4	14.9	6.0
1996-97	8.9	12.7	5.6	2.9	2.7	14.3	91.6	-1.2	1.6	18.0	6.5
1997-98	8.7	12.5	5.7	3.2	2.4	14.3	90.9	-1.4	1.3	15.1	6.9
1998-99	8.3	11.5	6.2	4.0	2.2	14.5	93.2	-1.0	0.6	7.0	8.2
1999-2000	8.3	12.3	6.7	3.8	2.9	14.9	93.0	-1.0	1.2	13.8	8.2
2000-01	9.9	12.6	7.0	4.9	2.1	16.8	96.4	-0.6	1.5	14.9	8.8
2001-02	9.4	11.8	7.7	4.5	3.1	16.9	103.8	0.7	1.7	18.2	11.5
2002-03	10.6	12.7	8.3	4.9	3.4	18.8	106.6	1.3	1.2	11.2	14.2
2003-04	11.0	13.3	8.9	4.3	4.6	19.8	112.8	2.3	2.6	23.7	16.9
2004-05	12.2	17.1	10.3	5.5	4.5	22.1	98.0	-0.4	2.2	18.0	14.3
2005-06	13.1	19.5	11.5	6.2	5.3	24.4	95.2	-1.1	2.5	19.2	11.6
2006-07	13.9	21.1	13.0	7.0	6.0	26.9	96.0	-1.1	2.9	20.8	12.4

Source: RBI, *Handbook of statistics on the Indian economy 2006-07*.

Table 3
Exports to GDP and FDI to GDP of selected SEA economies
In per cent

Economy	Indicator	2001	2002	2003	2004	2005	2006
China	Export/GDP	22.6	25.1	29.6	34.0	37.3	36.8
	FDI/GDP	3.3	3.4	2.9	2.8	3.5	...
Hong Kong SAR	Export/GDP	138.7	149.6	171.1	190.2	198.7	205.7
	FDI/GDP	14.3	5.9	8.6	20.5	20.2	...
India	Export/GDP	12.7	14.5	14.7	18.2	20.3	...
	FDI/GDP	1.1	1.1	0.8	0.8	0.8	...
Indonesia	Export/GDP	39.0	32.7	30.5	31.8	32.9	30.2
	FDI/GDP	-1.9	0.1	-0.3	0.7	1.8	...
Japan	Export/GDP	10.6	11.4	12.0	13.4
	FDI/GDP	0.2	0.2	0.1	0.2	0.1	...
Korea	Export/GDP	37.8	35.3	37.9	44.0	42.3	43.2
	FDI/GDP	0.7	0.4	0.6	1.4	0.5	...
Malaysia	Export/GDP	116.4	114.8	113.3	121.1	123.4	117.1
	FDI/GDP	0.6	3.4	2.4	3.9	3.0	...
Philippines	Export/GDP	49.2	50.2	49.6	50.8	47.3	43.1
	FDI/GDP	0.3	2.0	0.6	0.8	1.2	...
Singapore	Export/GDP	191.8	193.2	214.3	230.6	244.3	252.6
	FDI/GDP	18.3	8.2	11.2	13.8	17.2	...
Thailand	Export/GDP	65.9	64.2	65.7	70.7	73.8	71.4
	FDI/GDP	3.4	0.8	1.4	1.1	2.6	...
Vietnam	Export/GDP	54.6	56.0	59.2	67.5	70.0	...
	FDI/GDP	4.0	4.0	3.7	3.6	3.7	...

Note: Exports: both goods and services in current US dollars; FDI: net inflows basis; ...: not available.

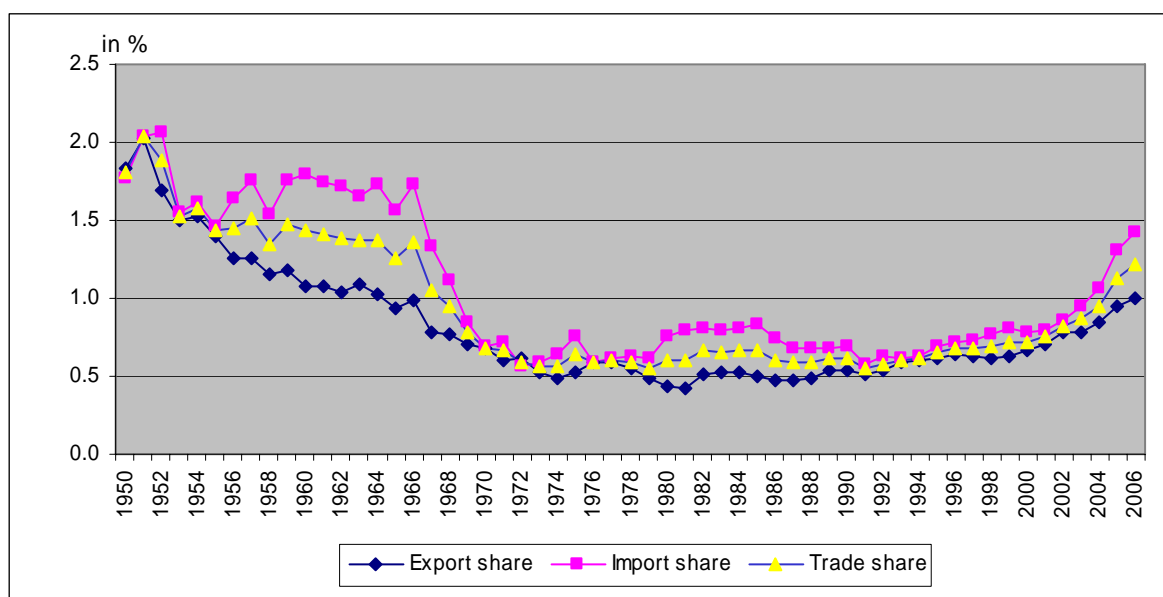
Source: World Bank online database.

A. Perspective on current account openness

From the beginning of the planning process in the 1950s, India adopted an inward-looking development strategy. The essence of this strategy lies in production for the domestic market behind higher tariff barriers, and a higher degree of effective protection for domestic industry. Besides tariffs, quantitative restrictions were used to provide automatic as well as custom-made protection to almost all domestic import substitution activities. It has been argued by many analysts that inward-looking policies and import-substituting industrialisation, coupled with the system of controls, led to inefficiencies in resource allocation and landed the economy in a high-cost industrial structure with "technology lag" (Chopra et al, 1995; Joshi and Little, 1996; Nayar, 2001; Virmani, 2001). Trade performance was also hampered by restrictive industrial and foreign investment policies. This can be ascertained from India's share of world merchandise exports, which declined from about 2 per cent in 1951 to less than 1 per cent in 1965, and hovered around 0.5 per cent in the 1980s, reaching 1 per cent only in 2006 (Graph 1).

Graph 1

India's share of world exports and imports



B. India's trade with East Asia and China

Under India's "focus area" approach (as a part of its overall trade strategy), trade with East Asian countries focused specifically on catering to the rising demand from this region. As a result, during the 1990s, the average growth of India's exports to Asian countries, and especially China, Singapore, Korea and Thailand, far exceeded its overall export growth (Table 4). Since 2004–05, China has emerged as the third major export destination for India after the United States and the United Arab Emirates. However, its share of exports to the Asian region as a whole remains sluggish and below the expected level (Table 5).

Table 4

Growth in India's exports to selected Asian economies

In per cent

Region/economy	1993–97	1998–2002	2003	2004	2005	2006
Asia	20.2	10.8	34.0	27.6	33.7	27.6
China	66.0	27.6	57.6	54.2	54.2	47.7
Hong Kong SAR	23.4	7.3	21.5	14.7	20.0	1.1
Indonesia	32.2	17.4	39.7	18.8	8.8	23.5
Japan	5.2	-1.1	-1.6	9.3	24.4	57.5
Korea	20.6	16.4	22.2	24.3	77.9	81.2
Malaysia	18.5	11.0	13.4	13.3	16.9	6.8
Philippines	32.1	19.9	-13.7	4.6	25.2	-22.6
Singapore	11.4	12.2	48.9	73.3	53.3	-14.3
Thailand	10.3	14.3	15.9	6.0	20.2	44.6
India's exports growth	12.7	8.1	21.0	23.3	29.9	25.4

Source: Calculated from IMF, *Direction of trade statistics*.

Table 5
Share of India's exports with selected Asian economies

In per cent

Region/economy	1993–97	1998–2002	2003	2004	2005	2006
Asia	21.7	21.7	27.1	28.0	28.9	28.5
China	1.4	2.3	4.4	5.5	6.6	7.8
Hong Kong SAR	5.6	5.6	5.1	4.7	4.4	3.5
Indonesia	1.4	1.0	1.7	1.7	1.4	1.4
Japan	7.0	4.4	2.9	2.5	2.4	3.0
Korea	1.3	1.3	1.2	1.2	1.7	2.4
Malaysia	1.2	1.3	1.4	1.3	1.2	1.0
Philippines	0.4	0.5	0.6	0.5	0.5	0.3
Singapore	2.9	2.1	3.2	4.5	5.3	3.6
Thailand	1.4	1.2	1.3	1.1	1.0	1.2
India	100.0	100.0	100.0	100.0	100.0	100.0

Source: Calculated from IMF, *Direction of trade statistics*.

A similar trend was noticeable vis-à-vis the ASEAN 5 (Indonesia, Malaysia, the Philippines, Singapore and Thailand). The surge in India's trade with East Asian countries has emanated mainly from product specialisation and the natural comparative advantage of the respective countries. Engineering goods, chemicals and related products, crude petroleum and related products, gems and jewellery, and iron ore are India's major exports to East Asian countries.

China is the major source of India's imports, comprising about 9 per cent of total imports during 2006–07 (Table 6). Major imports from this region are electronic goods and edible oil. It may be pertinent to mention that the increase in India's degree of openness compared to that of Asian countries is the result of aggressive industrialisation policies based on export-driven growth strategies. These developments have been accompanied by a substantial reallocation of resources from agriculture to industry and services. These two sectors have been the driving forces of the growth in the emerging South. The share of manufacturing imports has also expanded simultaneously with the growth of manufacturing exports. One of the factors underlying this trend has been the rising intra-industry trade between India and Asian countries during the process of achieving openness and integration. In recognition of the growing importance of Asian countries to India's foreign trade, a series of nominal and real effective exchange rate indices released by the RBI were revised recently to include the renminbi and the Hong Kong dollar in the weighting scheme. With Japan already a part of the indices, the representation of Asian economies has increased to three in the six-country real effective exchange rate index.

The modalities of a free trade agreement (FTA) between India and China are on the way, against the backdrop of a report by the joint task force entrusted with studying the pros and cons and making recommendations. Considering the larger perspective of India's "look east" policy on free trade, an agreement with ASEAN would in the long run lead to a reduction in costs, resulting in a better standard of living for the people of Asian countries. There would also be a rational allocation of resources between the economies concerned, leading to higher productivity and efficiency. An FTA with China would enhance India's business interests in the region, despite the apprehension that the unregulated opening up of the Indian market will lead to a flood of low-priced Chinese products. The fear is understandable, given the prowess of Chinese manufacturers in churning out low-priced manufactured goods which have had a "tsunami effect" on markets the world over. There is also the issue of

granting “market economy” status to China, a step that will make way for the establishment of anti-dumping charges under the WTO rules.

Table 6
Share of India’s imports from Asian economies

In per cent

	1993–97	1998–2002	2003	2004	2005	2006
Asia	13.8	19.1	21.5	21.3	21.5	26.5
China	2.1	3.2	5.0	6.1	7.3	8.7
Hong Kong SAR	0.8	1.6	1.8	1.7	1.5	1.8
Indonesia	1.2	2.0	2.6	2.4	2.1	1.9
Japan	6.3	4.4	3.3	2.9	2.6	2.7
Korea	2.2	2.6	3.4	3.1	3.1	3.0
Malaysia	2.1	3.1	2.6	2.2	1.8	3.0
Philippines	0.0	0.1	0.2	0.2	0.1	0.1
Singapore	2.8	3.3	2.6	2.5	2.3	4.6
Thailand	0.5	0.7	0.7	0.8	0.8	1.1
India	100.0	100.0	100.0	100.0	100.0	100.0

Source: Calculated from IMF, *Direction of trade statistics*.

C. Perspective on capital account openness

As a result of calibrated and gradual capital account openness, the financial markets in India have also become increasingly integrated with the global network. In horizontal integration, interlinkages occur among domestic financial market segments, while vertical integration occurs between domestic markets and international/regional financial markets. Global integration refers to the opening up of domestic markets and institutions to the free cross-border flow of capital and financial services by removing barriers, such as capital controls and withholding taxes. A deeper dimension of global integration entails removing obstacles to the movement of people, technology and market participants across borders (BIS, 2006). Regional financial integration occurs through ties between a given region and the major financial centre serving that region. It is perceived that economic integration might be easier to achieve at a regional level due to network externalities and the tendency of market-makers to concentrate in certain geographical centres. Furthermore, regional financial integration can be an important means of developing local financial markets, for instance, through peer pressure to strengthen institutions and upgrade local practices.

The number of international investment agreements (IIAs) has continued to grow, reaching a total of almost 5,500 at the end of 2006, of which 2,573 are bilateral investment treaties, 2,651 are double taxation treaties and 241 are free trade agreements and economic cooperation arrangements containing investment provisions. The number of preferential trade agreements with investment provisions has almost doubled in the past five years. Developing countries are becoming increasingly important participants in international investment rulemaking, partly reflecting growing South-South FDI (UNCTAD, 2007). Rapid economic growth in southern, East and Southeast Asia should continue to fuel growing market-seeking FDI to the region. The region will also become more attractive to efficiency-seeking FDI, as countries such as China, India, Indonesia and Vietnam plan to significantly improve their infrastructure.

(i) India's domestic financial integration

Until the early 1990s, India's financial sector was tightly controlled. Interest rates in all market segments were administered. The flow of funds between various market segments was restricted by extensive regulations. There were also restrictions on participants operating in different market segments. Banks remained captive subscribers to government securities under statutory arrangements. The secondary market of government securities was dormant. In the equity market, new equity issues were governed by several complex regulations and restrictions. The secondary market trading of such equities lacked transparency and depth. The foreign exchange market remained extremely shallow as most transactions were governed by inflexible and low limits under exchange regulation and prior approval requirements. The exchange rate was linked to a basket of currencies. In this environment, the financial sector grew at a lower level of efficiency. Financial market reforms initiated in the early 1990s focused on removal of structural bottlenecks, introduction of new players/instruments, free pricing of financial assets, relaxation of quantitative restrictions, improvement in trading, clearing and settlement practices and greater transparency (Mohan, 2004).

Other policy initiatives in the money, foreign exchange, government securities and equity markets were aimed at strengthening institutions, fostering greater transparency, encouraging good market practices, establishing effective payment and settlement mechanisms, rationalising tax structures and enabling legislative frameworks. Dismantling of various price and non-price controls in the financial system has facilitated the integration of financial markets. The 2006 report of the Committee on Fuller Capital Account Convertibility observed that in order to make a move towards fuller capital account convertibility, it must be ensured that different market segments are not only well developed, but also well integrated. In the sphere of finance, the traditional postulate that capital flows from the capital-surplus developed countries to the capital-scarce developing countries seems to have been disproved in recent years (Reddy, 2006).

(ii) India's regional financial integration

With growing financial globalisation, an emerging market economy (EME) like India also needs to develop its financial markets to manage the risks associated with large capital flows. In a globalised world, the importance of a strong and well regulated financial sector, in order to deal with capital flows that can be very large and might reverse quickly, can hardly be overemphasised. The East and Southeast Asian economies, in particular, have achieved significant integration due to liberalisation of foreign direct investment (FDI) regimes. The resulting expansion of trade and FDI has become the engine of economic growth and development in the region. The underlying surge in capital flows to developing and emerging market economies in recent years is led by the strong demand for emerging market debt and equities, supported by sharp improvement in fundamentals in many EMEs and investors' search for higher yields in an environment where long-term interest rates remain low in major industrial countries (World Bank, 2006).

India's capital account has witnessed a structural transformation, with a shift in the composition from official flows to market-oriented private sector flows. Following the shift in emphasis from debt to non-debt flows in the reform period, foreign investment comprising direct investment and portfolio flows emerged as the main capital account component (Box 2).

Box 2

Framework for regional economic integration in Asia

The East Asian economies have embarked upon various initiatives for regional monetary and financial cooperation. The major initiatives for regional cooperation in Asia include ASEAN + 3, the Chiang Mai Initiative, the Executive Meeting of East Asia-Pacific Central Banks (EMEAP), the Asian Bond Market Initiative and the Asian Bond Fund (ABF). The countries of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) and India have entered into a framework agreement on comprehensive economic cooperation. ASEAN has embarked on a process to expand economic cooperation with its neighbours to the north, namely China, Japan and Korea (ASEAN + 3). As far as India's association with the ASEAN community is concerned, India currently is not a full-fledged member of the ASEAN network, but holds a regular summit with ASEAN. However, in the years ahead, it is envisaged that the ASEAN + 3 + 3 (India, Australia and New Zealand) network would help India to share and cooperate on various financial issues, in the same way as the present network of ASEAN + 3 has consistently engaged in an economic policy dialogue of unprecedented scope and depth.

Another instance of central banking cooperation in Asia consists of reciprocal currency or swap arrangements under the Chiang Mai Initiative. The ASEAN Swap Arrangement (ASA) was created primarily to provide liquidity support to countries experiencing balance-of-payments difficulties. The Finance Ministers of ASEAN + 3 announced this initiative in May 2000 with the intention of cooperating in four major areas, viz, monitoring capital flows, regional surveillance, swap networks and personnel training. The informal meeting organised by the Asia Cooperation Dialogue (ACD) is, however, attended by participant central banks, including that of India, to discuss promotion of the supply of Asian Bonds. The government of India has given a commitment on participation in the ABF-2 to the tune of USD 1 billion. SEANZA (Southeast Asia, Australia and New Zealand) and SEACEN (Southeast Asian Central Banks Research and Training Centre) are the oldest initiatives in central bank cooperation in Asia. SEANZA, formed in 1956, promotes cooperation among central banks by conducting intensive training courses for higher central banking executive positions with the objective of building up knowledge of central banking and fostering technical cooperation among central banks in the SEANZA region. The SEACEN provides a forum for member central bank governors to become acquainted with one another and to gain a deeper understanding of the economic conditions of the individual SEACEN countries. It initiates and facilitates cooperation in research and training relating to the policy and operational aspects of central banking, ie, monetary policy, banking supervision and payments and settlement systems. The Asian Clearing Union (ACU), an arrangement for central banking cooperation, has functioned successfully since 1974, providing multilateral settlement of payments to promote trade and monetary cooperation among the member countries. Since 1989, the ACU has also included a currency swap arrangement among its operational objectives. The SAARCFINANCE, established in September 1998, is a regional network of the South Asian Association for Regional Cooperation (SAARC) Central Bank Governors and Finance Secretaries, which aims to strengthen the SAARC with specific emphasis on international finance and monetary issues. India has participated very actively in SAARCFINANCE activities. The clearest evidence of Asian countries' desire to forge closer economic relationships is the proliferation of free trade agreements (FTAs). By 2006, there were more than 30 FTAs under negotiation in East Asia alone. Increasingly, these agreements are also deepening, extending to areas beyond mere tariff reduction. One example is the recently signed India-Singapore comprehensive economic cooperation agreement, which covers not only trade in goods, but also trade in services, investments and cooperation in technology, education, air services and human resources.

Source: RBI, Report on currency and finance.

India's FDI openness, as measured by the FDI stock-to-GDP ratio, increased from 3.8 per cent in 2000 to 5.8 per cent in 2006. However, this is still much lower than in other emerging countries in Asia, including China (Table 7). India has emerged as a major destination for global portfolio equity flows since the late 1990s. On average, India's share was 24 per cent of total portfolio flows to all developing countries during the period 1999–2006. The geographical sources of portfolio investment inflows show a country's global and regional

financial linkages. Singapore appears among one of the top sources of India's portfolio stock investment.

Table 7
Indicators of FDI openness in selected Asian economies

As a percentage of GDP

Economy	2000	2001	2002	2003	2004	2005	2006
China	16.1	15.3	14.9	13.9	12.7	12.1	11.1
Hong Kong SAR	269.9	251.8	205.4	240.6	273.2	294.3	405.2
Korea	7.4	8.8	8.3	8.2	8.7	8.3	8.0
Taiwan, China	5.5	13.0	9.5	11.8	12.0	12.1	13.8
India	3.8	4.3	5.1	5.4	5.8	5.7	5.8
Indonesia	15.0	9.5	3.6	4.4	6.2	4.7	5.2
Malaysia	58.4	38.6	39.4	39.6	36.8	36.3	36.0
Philippines	16.9	15.0	15.7	14.8	14.9	15.0	14.6
Singapore	121.5	140.5	153.7	160.2	159.6	159.3	159.0
Thailand	24.4	28.8	30.3	34.3	33.0	33.1	33.0

Source: UNCTAD online statistics.

According to the Indian Ministry of Commerce and Industry, Mauritius accounts for the largest share of cumulative FDI inflows to India from 1991 to 2006 – nearly 40 per cent. Given the size of an economy like Mauritius, this is simply implausible. The companies operating outside India utilise Mauritian holding companies to take advantage of the India-Mauritius Double Taxation Avoidance Agreement (DTAA). The DTAA allows foreign firms to bypass Indian capital gains taxes and may allow some India-based firms to avoid paying certain taxes through a process known as round-tripping. In round-tripping, a company operating in India registers a subsidiary in Mauritius and then routes profits through the subsidiary in order to avoid paying capital gains taxes on its profits in India. Although it is a matter of tax concern to the government of India, the extent of round-tripping by Indian companies through Mauritius is not yet known.

Financial market integration has assumed added significance in the recent period as capital has become more mobile across countries with the reduction in capital controls and improvement in technological infrastructure. This is reflected in increasing co-movements in interest rates, bond yields and stock indices. The bond yield differential in Asia has narrowed in an environment of improved macroeconomic fundamentals and lower inflation in these economies. Evidence from price-based measures of financial integration suggests increasing financial market integration in Asia. In general, money and bond market segments in Asia showed a lower degree of correlation as compared with stock markets. Within countries, bond and money market correlation was negative in many countries, implying that these markets remain segmented in the region (RBI, 2007).

(iii) Trade in services

According to the World Bank publication *Handbook of international trade in services*, India's services exports rose 15 times, from around USD 5 billion in 1990 to nearly USD 74 billion in 2006. Over the past decade, India's exports of business services have grown at a rate of

25 per cent per annum, which is faster than that of any other country in the world, barring Ireland. More than a third of India's aggregate exports are services, a proportion unmatched by any developing country and by only a handful of advanced countries. As a result, India today is confronted with contrasting challenges abroad: uncertainty of access for cross-border exports of services, and barriers to exports through the movement of people. Advances in information and telecommunication technologies have expanded the scope of services that can be traded across borders.

Many countries now allow foreign investment in newly privatised and competitive markets for key infrastructure services, such as energy, telecommunications and transport. More and more people are travelling abroad to consume tourism, education and medical services, and to supply services ranging from construction to software development. In fact, services are the fastest-growing components of the global economy, and trade and FDI have grown faster in services than in goods over the past decade and a half. International transactions, however, continue to be impeded by policy barriers, especially to foreign investment and the movement of service-providing individuals. Developing countries in particular are likely to benefit significantly from further domestic liberalisation and the elimination of barriers to their exports. In many instances, income gains from a reduction in protection of services may be far greater than from trade liberalisation in goods. The openness to trade could not be taken for granted because, as services outsourcing grows, adjustment costs in importing countries could unleash protectionist pressures. Now the political climate in many advanced countries has become more resistant to external service providers. But India has much to gain, probably more than any other country in the world, by bringing services to centre stage.

V. Concluding observations

India has undertaken important growth-enhancing reforms over the past 15 years, placing considerable emphasis on achieving macroeconomic stability, liberalising trade, strengthening the financial sector and improving the business climate. Over the years, this has resulted in higher trade and investment growth, especially to and from the Asian countries. The growth impulse has emanated from product specialisation and natural comparative advantages arising from various geographical factors. Overall, China has emerged as India's major trading partner.

However, India's share of exports to the Asian region remained sluggish and below the expected level. India's FDI openness, despite an increase, is much lower than that of other Asian emerging economies. As India's services exports are increasing at a rapid pace, the country is confronting challenges emanating from the uncertainty of access to cross-border exports of services and barriers to the movement of people. The role of the private sector is crucial for raising investment and productivity in the economy. Higher private investment, including foreign direct investment, can contribute to higher productivity through learning by doing and technology transfer. Public-private partnership is a key factor for boosting investment. The coming together of public and private sector representatives can be a catalyst for developing new regional initiatives in Asia aimed at expanding the private sector and thereby strengthening its positive impact on economic growth. The new sources of competitive advantage will be in technology and human skills, not necessarily in low wages.

Recognising their complementary strengths, India is becoming increasingly linked to East Asian production networks. East Asian companies have begun to exploit India's strengths in research and development (R & D), software and design by locating their global R & D centres in India. Several Indian companies have also begun to take advantage of cheaper manufacturing costs for hardware in China and other East Asian countries by rationalising their production. This trend is likely to become more entrenched as the emerging free trade arrangements between India and Southeast Asian countries come into effect. It is important for India to forge a closer relationship for mutual trade and investment within the Asian region

and also to adopt a proactive role vis-à-vis the ASEAN economies. India has already demonstrated its strength in the services sector, especially software. If complemented by the hardware and manufacturing base of East Asia, India and the region can prosper together in the new global scenario. The rapid change that has taken place in Asia provides new opportunities that must be seized by each side.

After the Southeast Asian crisis in 1997, there has been increasing recognition in Asia of the importance of regional economic integration for generating growth impulses from within the region. Substantial complementarities exist among Asian economies that remain to be exploited for their mutual common benefit. For instance, while the region has economies that have surplus capital resources, there are also economies which have inadequate domestic savings for rapid development. The region is similarly characterised by complementarities in the demand and supply of other resources, such as technology and skilled manpower. By generating intraregional demand, regional cooperation could supplement external demand and reduce the region's vulnerability owing to overdependence on outside regions. Regional cooperation could also help in exploiting the existing regional capacities fully.

Trade and investment promotion within Asia will also be accelerated by a conscious move towards the adoption of common standards in both goods and delivery of services. The massive increase in infrastructure investment in areas such as power, telecommunications, airports, highways and so on all require a corresponding expansion in manufacturing of the equipment that will be required in these projects. Other similar ideas can be explored so that the Asian region can move towards the formation of a larger common market.

The lessons learned from European experience have three components. First, in the European trade and financial integration process, there has been macroeconomic and monetary instability in the context of a global downturn. Second, the disturbances appearing in these economies have had internal causes rather than being the result of contagion. Third, at times of crisis, the European economic authorities have established a common platform, provided unconditional credit to their partners and pursued policies based on prudence. Taking its cue from this experience, Asia's economic outlook has improved since the financial crisis a decade ago. But underlying financial policies and institutions in the region remain underdeveloped and untested. The emphasis on regional solutions to perceived challenges has contributed to a profound ambivalence about financial openness in the region.

Annex 1: Chronology of India's financial liberalisation since 1991

July 1991	The government abolished the industrial licensing system, with a few exceptions, and approval for the expansion of large firms, including foreign firms, was no longer necessary. Foreign firms were allowed major shareholding in joint ventures, and foreign investment up to 51 per cent of equity in 35 priority industries received automatic approval. The new investment policy also spelled more incentives to attract FDI from non-resident Indians, including 100 per cent ownership shares in many sectors and full repatriation of profits.
1992	The Security and Exchange Board of India (SEBI) Act was passed, and the SEBI has since been an independent regulator.
September 1992	Foreign institutional investors (FIIs) were given permission to participate in the Indian market. One FII could own up to 5 per cent of a firm and all FIIs combined could own 24 per cent. FIIs had to have at least 50 investors.
1994	The National Stock Exchange (NSE) began trading bonds in June and equity in November. Different features of the NSE include: equal access for all traders in a vast geographical area, a competitive market in security intermediation, electronic matching of trades, anonymous trading followed by guaranteed settlement, and a more independent corporate governance structure.
November 1996	"100 per cent debt FIIs" were permitted. These were allowed to buy corporate bonds, but not government bonds.
April 1997	The ceiling upon total ownership by all FIIs of a firm was raised from 24 per cent to 30 per cent. A shareholder resolution was required.
April 1998	FIIs were permitted to invest in government bonds, with a ceiling of USD 1 billion on all FIIs in aggregate.
June 1998	The ceiling on ownership by one FII in one firm was raised from 5 per cent to 10 per cent. FIIs were permitted to partially hedge currency exposure risk using the forward market. FIIs were permitted to trade equity derivatives in a limited way.
August 1999	The requirement that FIIs must have at least 50 investors was eased to 20.
February 2000	Foreign firms and individuals were allowed to access the Indian market through FIIs as "subaccounts". Local fund managers were also permitted to manage funds for foreign firms and individuals through subaccounts. The requirement that no investor be allowed to own more than 5 per cent of an FII was eased to 10 per cent.
March 2000	The ceiling on total ownership by all FIIs of a firm was raised from 30 per cent to 40 per cent. A shareholder resolution was required.
March 2001	The ceiling on total ownership by all FIIs of a firm was raised from 40 per cent to 49 per cent. A shareholder resolution was required.
September 2001	The ceiling on total ownership by all FIIs of a firm was raised from 49 per cent to "the sectoral cap for the industry". A shareholder resolution was required.
January 2003	Limitations on FII hedging using the forward currency market were removed.
December 2003	Approvals for FIIs at both the SEBI and the RBI were replaced by single approval at the SEBI.
November 2004	A new ceiling on total ownership by all FIIs of corporate bonds was placed at USD 0.5 billion.
February 2006	The ceiling on ownership of government bonds by all FIIs was raised to USD 2 billion. The ceiling on ownership of corporate bonds by all FIIs was raised to USD 1.5 billion.

Source: Lane and Schmukler (2007).

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