International Journal of Research in Economics and Social Sciences(IJRESS)
Available online at: http://euroasiapub.org
Vol. 10 Issue 1, January- 2020
ISSN(o): 2249-7382 | Impact Factor: 6.939 |

EXTERNAL SECTOR REFORM AND ITS IMPACT ON THEGROWTH, COMPOSITION AND DETERMINANTS OF EXTERNAL DEBT

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ABSTRACT

This research aims to assess how reforming the external sector will affect the level of foreign debt and the external sector's economic health. As the name suggests, public debt is a country's debt. Internal debt and external debt are the two main categories of public debt. The sum of money a country owes institutions, organisations, and individuals is known as its domestic debt. The analysis's focal point, the external debt, can be defined as the sum of money a country owes institutions, organisations, and citizens across institutional boundaries. In actuality, there was no generally recognised or approved concept of external debt until 1988. The first time the term "external debt" was used was by the International Working Group in 1988. They stated that it "includes the amount of disbursed and outstanding contractual liabilities of the residents of a country to non-residents, to repay principal with or without interest." The external debts are separated into three categories: short-term, medium-term, and long-term.

KEY WORDS: External Sector, Reform, Growth, Composition and Determinants

1. INTRODUCTION

India's external payments position has been strained for years, with several catastrophic crisis moments during which the nation barely survived on handouts. The foreign sector is, in a way, the real success story of Indian economic reforms after the broad-based reforms implemented since 1991. The external sector is responsible for changes in policy relating to both current account and capital account operations, with a focus on foreign commerce, foreign investment inflows, forex reserves, external debt, and domestic investments abroad. Prior to the middle of 1991, India's overseas trade was hampered by stringent administrative and discretionary constraints. Similar to this, foreign exchange transactions were strictly regulated by the Indian government and reserve bank. The Indian government started to implement a number of changes in mid-1991 to liberalise and internationalise the Indian economy. India's external industry is being revitalised in an effort to better integrate it with the global economy. The statement "The process of globalisation is a reality which cannot be denied and also should not be avoided" is made in this context. However, it must be controlled in order for us to benefit as much as possible from global markets.

1.1 MEANING OF EXTERNAL SECTOR

Basic economic factors that affect economic growth and development are included in the external sector. These factors include: foreign direct investment, portfolio investment, current account, capital account, financial account, and balance of payments.

External debt, the average private external debt exchange rate, debt service, reserve assets, the international investment position, and the export and import price indices

1.2 EXTERNAL SECTOR REFORMS IN INDIA

The new Congress government, led by Dr. Manmohan Singh as finance minister, implemented a number of stabilisation measures and structural reforms to address the balance of payments crisis of 1991 and restore economic health to the external sector. Here is a small list of them:

1.3 DEVALUATION OF RUPEE

Prior to 1991, the Indian Rupee was excessively inflated against the US dollar and other significant currencies. Our exports were deterred by the overvaluation of the Indian rupee while imports were boosted. Therefore, this foreign exchange policy was biassed against exports. The rupee was devalued on July 1, 1991, and then again on July 3, 1991, to discourage imports and promote exports. The value of the rupee in a trade-weighted basket of foreign currencies decreased by an average of 22.8% over the course of the two devaluation rounds. Following the rupee's depreciation in July 1991, the cash compensating exporter subsidy that had previously been in place was eliminated. Devaluation was therefore anticipated to replace export subsidies because exporters would receive more rupees in exchange for foreign currencies.

1.4 TRADE LIBERALISATION AND REDUCTION IN CUSTOMS DUTIES

The opening of the Indian economy to international trade has been a key component of the external sector transformation. The adoption of an export-led growth strategy has replaced import substitution. Customs fees on non-agricultural imports have been lowered to that end, allowing domestic industries to purchase imported capital equipment and raw materials at lower prices in order to make items for export at lower prices. As a result, the highest customs tariff rate—which was over 300 percent in 1990—was gradually decreased from that level to 35 percent in the 2002–2003 budget, 15 percent in 2005–2006, and 12.5 percent in the 2006–2007 budget. In addition to improving the competitiveness of Indian exports, customs charges on imports were reduced for additional reasons. It curbed cost-push inflation that emerged as a result of the depreciation of the Indian rupee.

1.5 ASSISTANCE FROM IMF AND WORLD BANK

To solve the balance of payments issue, the IMF and World Bank were contacted urgently for financial assistance. IMF promised to give aid only if India met its requirements. Its requirements included devaluing the rupee, decreasing customs taxes on imports, implementing structural changes through various forms of domestic liberalisation, and opening up the Indian economy to foreign trade and investment. India received aid from the IMF after agreeing to these terms.

1.6 CUT IN FISCAL DEFICIT FOR MACROECONOMIC STABILISATION

An key factor in the balance of payments' deterioration in the 1980s was the growing budget deficit. Therefore, reducing the fiscal deficit was a crucial step in combating the balance of payments issue.

1.7 SWITCH-OVER TO MARKET-DETERMINED EXCHANGE RATE

After a two-year transition period, the exchange rate became market decided with effect from 1993, which was a significant step taken to address the balance of payments issue. As a result, the demand for and supply of Indian rupee and foreign currencies started to dictate the exchange rate. Current account transactions now allow for currency conversion for the Indian Rupee. This made currency exchange operations easier because market forces decided the exchange rate.

1.8 ELIMINATION OF ANTI-EXPORT BIAS

Modifying India's trade policy, which had an anti-export bias and a pro-import-substitution tilt, was a significant reform in the external sector. In order to eliminate protection for large-scale industries, the new trade strategy lowered customs duties. Protection eliminates international competition, which lowers production and efficiency. The peak custom duty on imports was lowered from 150 percent to 110 percent in 1992–1993 to remove the bias in favour of import substitution and liberalise imports. The maximum import tariff was further decreased from 100% to 85% in 1993–1994 to 65% in 1994–1995 to 50% in 1995–1996 to 45% in 1997. It has been further liberalised, and currently it is only about 10%.

2. BACKGROUND OF ECONOMIC CRISIS

India began to plan its economy in the 1950s. Our plan's goals were to reduce poverty, promote self-reliance, sustain economic growth, and improve income distribution. To achieve these goals, we developed a socialist economic strategy. The capital-intensive and significant industries were reserved for the public sector under the pursued strategy, while the remainder was made available to the private sector. When allocating resources, the public sector was given first priority. When granting licence to the private sector and foreign investors, our nation favoured the policy of regulations, licencing, and limits. The aforementioned strategy informed the framework of other policies such as taxes, fiscal and monetary policy, foreign exchange policy, and industrial policy. The "Closed Economy" strategy is what it is called. The aforementioned policies worked successfully in the early planning years. However, after then, their effectiveness was gone. Our issues grew because of a variety of factors, and our economy grew slowly. Things went awry because we held on to institutions and practises long after they were no longer necessary. Japan, China, Thailand, Korea, and Indonesia are examples of developing nations that opened their economies to foreign investment and competition as well as embraced international innovations. These nations had quicker economic growth and prosperity. India missed the chance for quicker growth because alternative policies were not implemented. A strategy with fewer barriers and restrictions can result in speedier industrialization, export growth, and sustainable economic growth, according to the experience of recent decades with global development.Rajiv Gandhi, the country's former prime minister, was the one to start economic changes in our nation, even though it was late and India had been searching for alternative economic strategies since the 1980s. These policies, however, lacked vigour, and only partial policy adjustments were made. Early in 1991, India endured a severe economic crisis that was, in the opinion of the majority of economists, the worst the nation has ever known since its independence. Despite all of the strong statements made by the government, this situation is still not over. The catastrophe did not arise out of nothing. It gathered over a number of years. In actuality, the 1992s' careless macro-economic management of the economy contributed to the huge and enduring macro-economic imbalances that were the root of the crisis. Despite its inadequacies, the development strategy cannot be held responsible for this problem. This crisis was caused by a number of factors. For instance, the government's fiscal deficit (excess of total receipts over total expenditures) and internal and external borrowing expanded significantly when the government's revenue deficit (excess of expenditure over revenue) increased. In addition, the economy's overall income and spending gap continued to widen, creating a significant current account imbalance in the balance of payments that required significant foreign borrowing to cover. Internal imbalance in the budgetary position and external imbalance in the balance of payments situation were two sorts of imbalances that the economy had to deal with as a result of the lack of sensible macroeconomic management. These inequalities caused the economy to enter a severe economic catastrophe. The late 1990s Gulf crisis further exacerbated the nation's macroeconomic issues. Additionally, there was political unrest at this time throughout the nation.

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The cumulative effect of all these events reduced global trust in the Indian economy, which led to a sharp decrease in the country's creditworthiness on the global capital market. It should be noted, nevertheless, that the economy's issues did not suddenly spiral into a major crisis. In actuality, these issues had built up over time, especially after 1980. Due to these issues, India's economy was essentially no longer able to withstand an internal or foreign shock. The Indian economy was robust enough to withstand even much larger shocks in the 1970s (i.e., from 1970 to 1979), but it was the 1980s (i.e., from 1980 to 1989) that saw the economy thrust into a severe crisis. By 1990, the situation had gotten so bad that the economy was unable to withstand even minor oil shocks, which had disproportionately large effects, and a macroeconomic crisis developed in the form of unsustainable fiscal and monetary policies. As a result, during 2012-2013 the crisis situation grew worse. The administration made the decision to implement economic changes with two strands—macroeconomic stabilisation and structural reforms—in response to this crisis. Stabilisation focuses on managing demand, whereas structural reforms address sectoral adjustments meant to address issues with the economy's supply side.

2.1 ECONOMIC REFORMS AND EXTERNAL VULNERABILITY

The success of the external sector directly influenced the liberalising economic changes of the 1990s. First of all, it is widely acknowledged that the balance of payments problem was the direct cause of the 1991-era push for significant economic liberalisation. Additionally, the economic reform program's explicit orientation has been mostly external, with a focus on seeking to make the Indian economy more "competitive" in terms of international commerce and luring quantitatively sizable inflows of foreign capital to supplement domestic savings.

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3. RESEARCH METHODOLOGY

3.1 DATA SOURCE

Since aggregate time series data spanning a period of time are required for this investigation, it is entirely relied on secondary sources. Multiple published and unpublished sources were used to get the secondary data.

3.2 NATIONAL SOURCES

The Reserve Bank of India Bulletin, RBI-Report on Currency and Finance, Economic Survey, Statistical office records, annual reports available on government and non-government websites, various books on Indian economy and econometrics, articles in Economic and Political Weekly, Southern Economist, Indian Economic Journal, and Third Concept have all been used to gather the data needed for the study.

3.3 WORLDWIDE SOURCES

The data needed for the study was also gathered from several issues of the International Monetary Fund's Balance of Payments Statistics, World Economic Prospects, and World Development Indicators. articles that have appeared in the Journal of Econometrics, Asian-African Journal of Economics and Econometrics, International Review of Applied Economic Research, and Journal of World Economic Review.

3.4 UTILISED DATA ANALYSIS TOOLS

For the purposes of data analysis and hypothesis testing, the acquired data have been processed both manually and with the aid of computer software programmes, Microsoft Excel and the Statistical Package for Social Sciences (SPSS). In this investigation, the following suitable statistical tools were applied.

The following is a quick presentation of the approach used to analyse the dynamics of foreign investment.

3.5 FACTORS AFFECTING FDI IN INDIA

The determinants are the elements that often determine the FDI flows to a specific nation or area.

In the case of India, it is hypothesised that the size of the market, the rate of market expansion, infrastructure development, domestic investment position, degree of economic openness, rate of foreign exchange, and fiscal deficit all play a role in determining foreign direct investment (FDI) flows into the nation.

4. RESULTS AND DISCUSSION

The Indian government first recognised the need to form a policy group to review the current system of categorising India's external debt in December 1991. On March 31, 1992, the report was turned in by the team that was led by Y. Venugopal Reddy, the then-joint secretary of the ministry of finance, and A. Seshan, the then-advisor of the department of economic policy analysis at the RBI. The Report was published by RBI in November 1992. This report's main objective was to ensure consistency and transparency in India's external debt per loan type. Multilateral, bilateral, bilateral, bilateral, IMF, commercial borrowings, NRI deposits up to one year, and export credits are only a few examples.

The increase in India's external debt is depicted in Table 4.1.

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TABLE 4.1: GROWTH OF EXTERNAL DEBT IN INDIA

Years	External Debt(US $ Billion)
1992-93	23.2
1993-94	25.5
1994-95	27.4
1995-96	32.0
1996-97	33.8
1997-98	40.9
1998-99	48.3
2011-12	55.7
2000-01	58.4
2001-02	73.4
2002-03	83.8
2003-04	85.3
2004-05	90.0
2005-06	92.7
2006-07	99.0
2007-08	93.7
2008-09	93.5
2009-10	93.5
2010-11	96.9
2011-12	98.3
2012-13	101.3
2013-14	98.8
2014-15	104.9
2015-16	111.6
2016-17	133.0
2017-18	138.1
2018-19	169.7
2019-20	221.2

Source: RBI Bulletin July 2020

The external debt climbed from 83.8 US billion in 2002-2003 to 221.2 billion in 2019-20, as shown in Table 4.1. The debt has significantly increased from 2002-2003 to 2019-20, according to a rough interpretation of the data. However, a closer examination of India's external debt shows some intriguing findings.

Table 4.2 shows the regression results for the growth in external debt from 2002-2003 to 2019-20.

TABLE 4.2: REGRESSION RESULTS OF GROWTH OF EXTERNAL DEBT(2002-03 TO 2019-20)

Items	a	b	andardError	t-Stat	R^2	CGR
Lin	63.2339	5.07069*	1.02976	4.924	0.60	---
Log-Lin	4.2982	0.0399	0.0065	0.8385	0.70	4.080

Significance at 5% level.

The external debt climbed at an absolute rate of US $ billion 5.07069 crore annually between 2002-2003 and 2019-2020, as shown by Table 4.2, while the slope for the post–reform period was 5.07069. At the 5% level, it is determined that the estimated regression co-efficient 't' of 4.924 is statistically significant. The simple linear regression line appeared to fit the data fairly well, as indicated by the R2 value of 0.60. The post-reform period's corresponding compound growth rate is discovered to be 4.080 percent.

4.1 EXTERNAL DEBT BY COMPONENTS

Since the liberalisation of the economic reform in 2002, India's external debt position has significantly changed. From over 51% in 2002, the proportion of bilateral and multilateral debt has decreased to about 33% in 2019. Since March 2015, NRI deposits have been the greatest single source of external debt. The rupee debt to the former Russia has decreased, with solely amortisation and no new loans being made. Table 3 lists the elements of the foreign debt.

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TABLE 4.3 : EXTERNAL DEBT BY COMPONENTS

(US $ Million)

Item / Year	End – March						
	2010	2011	2016	2017	2018	2019	2020
Multilateral	20,900	29,533	29,994	29,267	31,744	35,337	39,490
Bilateral	14,168	16.969	16,802	17,277	17,034	16,065	19,701
International Monetary Fund	2,623	664	0	0	0	0	0
Trade Credit	4,301	6,526	4,995	4,697	5,022	7,165	10,358
Commercial Borrowing	10,209	16,986	22,472	22,007	26,405	41,443	62,337
NRI & FC (B & O) deposits	10,209	11,913	23,160	31,216	32,743	41,240	43,672
Rupee debt	12,847	5,874	2,822	2,720	2,302	1,951	2,016
Total Long term debt (I to VII)	75,257	88,485	100,245	107,214	115,250	143,201	177,574
Short term debt	8,544	5,046	4,669	4,431	17,723	28,130	46,999
Gross total debt	83,801	93,531	104,914	111,645	132,973	171,331	224,573

Reserve Bank of India Annual Report 2020.

4.2 CURRENCY COMPOSITION

The currency mix is crucial for an analysis of an external debt. India's external debt may take the shape of US dollars, SDRs, Indian rupees, Japanese yen, euros, British pounds, and other currencies. As in the past, the US dollar accounted for the majority of India's external debt. From 41.4 percent in 2008 to 57.1 percent in 2020, its share has increased. 42.9 % of the total was made up of all other elements. Table 4 displays foreign debt by the composition of the used currencies.

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TABLE 4.4: EXTERNAL DEBT BY CURRENCY COMPOSITION

(Per cent)

Sl. No.		End-March							
	Currency	2008	2010	2011	2016	2017	2018	2019	2020
	1	2	3	4	5	6	7	8	9
1	US Dollar	41.4	54.3	46.6	40.5	48.0	49.2	52.0	57.1
2	SDRs	14.9	14.1	15.2	15.5	14.2	13.7	12.0	10.2
3	Indian Rupee	14.8	11.9	17.3	22.7	19.6	18.9	17.7	14.5
4	JapaneseYen	13.7	10.2	10.7	11.6	10.5	10.9	11.6	12.1
5	Euro	0	5.7	6.2	5.8	4.6	4.4	4.0	3.6
6	Pound Sterling	3.3	2.9	3.1	3.4	2.6	2.6	2.4	2.2
7	Others	11.9	0.9	0.9	0.5	0.5	0.3	0.3	0.3
	Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: India's External Debt, A Status Report, Government of India, August2007. Reserve Bank of India and RBI Annual Report, Various Issues.

4.3 INDICATORS OF DEBT SUSTAINABILITY

India's debt sustainability and debt ratios have been steadily improving, which reflects the consolidation of India's financial status. Key ratios include the debt to GDP ratio, the short-run debt to total debt, and the total debt to FERs are used to examine the sustainability of external obligations. A series of solvency and liquidity ratios are used to estimate the sustainable level of external debt for a nation. Over the years, indices of external debt have become more accurate.

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4.4 SOLVENCY INDICATORS

In terms of solvency indicators, the amount of export earnings utilised to pay debt service is shown by the ratio of debt service payments to exports of goods and services. When India's external debt became unmanageable and the nation had a serious BOPs problem in the early 2000s, the ratio for the country spiked dramatically. India's debt service ratio has been continuously becoming better. The ratio of external debt to current receipts, which includes worker remittances and exports of goods and services, decreased from 328.9% in 1992 to 130.8% in 2017. Similarly, the ratio of external debt to national revenue decreased from 28.7% in 2002 to 18.8% in 2019.

5. CONCLUSION

The new policy's objectives were to realign internal demand with the available resources, start adjustments in supply and production systems, and end the external imbalance. The economy was to be liberalized and gradually merged with the global economy through the removal of trade barriers, protection of foreign direct investment, and advancement of manufacturing technology in a number of industries. Financial stability, global policies, and market liberalization were the main focuses of the programs.

There were two parts to the reforms. The goal of the short-term, immediate stabilization actions was to restore equilibrium to the foreign exchange market by reducing demand, changing trade policy, reducing the fiscal deficit, and removing obstacles to unrestricted capital flow. Through a significant nominal depreciation of the currency rate, external competitiveness was to be increased.

Reforms in fiscal, currency rate, trade, and industrial policy, as well as in public, financial, and capital market policies, were implemented as part of the medium-term structural adjustment program. The liberalization of investments and pricing, the restructuring of taxation and public spending, the moderation of wage growth, the privatization of public businesses, and a deeper integration with the global economy were all components of these reforms.

The economy as a whole was affected by the adjustment policies that were implemented, not simply the agriculture sector. However, the macroeconomic and other changes implied in the stabilization and structural adjustment programme had a significant impact on the sector due to the importance and dominance of the agricultural sector in the Indian economy, both in terms of income generation and employment, as well as its close relationship with other sectors of the economy through input-output and consumption linkages.

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