

## **Increasing Economic Openness of India, the Purchasing Power Leakage and Exchange Rate Effect**

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*This study represents a modest attempt to examine to what extent the economic openness of India affected the purchasing power leakage from the Indian economy occurring through its economic transactions with the rest of the world. The study compares the experience of Indian economy during 1990s with that during the closed 1970s and the mildly liberal 1980s in respect of the net trade flows, net factor income flows and net capital account flows and a host of other related parameters. The conclusion emerging from the analysis is that there is continued net purchasing power leakage from the Indian economy in many years even during 1990s. However, the leakage is much moderated during 1990s mainly due to the increased net capital account flows. At the same time, 1990s also witnessed a worsening external debt service scenario. A comparative evaluation of the empirical results for different sub-periods reveals that the relationship of net trade and net capital account flows with foreign exchange rate and other explanatory factors became weaker during 1990s. While this causes some surprise, this may also imply the need for making a more in-depth analysis, by incorporating several other factors, for explaining the various inflows of Indian economy during 1990s.*

### **I Introduction**

The fact that economic openness provides scope for income leakage from the economy that opens up is a part of standard macroeconomic theory. Yet, economic openness is attractive for economies because leakage of one economy is infusion of others. Some analysts have argued in the context of services that openness is an important ingredient of economic growth and improvement in standard of living for both developed and developing economies (e.g., Broadman, 1994). It is true that in many cases the opening up is in response to the pressures from International Monetary Fund (IMF), the World Bank and the developed countries. Of late, many developing economies have been forced to open up much more than they desired or thought useful simply because these economies needed to honour their international commitments made under various multilateral agreements including that of World Trade Organisation (WTO). Still, economies that open up often feel that the increased import payments and factor income outflows immediately after opening-up are only temporary difficulties given the subsequent (anticipated) growth in exports and in investment inflows. For these economies, the literature emanating from different parts of the western world on the attractive benefits of economic liberalisation appears very reassuring in their expectations (e.g., Sefadi and Laird, 1996).

Financial resource (or purchasing power) flows between economies take place under three major heads: (i) Payments for imports; (ii) Payments for factor services; (iii) Transfer of funds for financial and physical investment (through debt, both official and

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