A Study on Balance of Payment in India: Trends and Challenges

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Abstracts

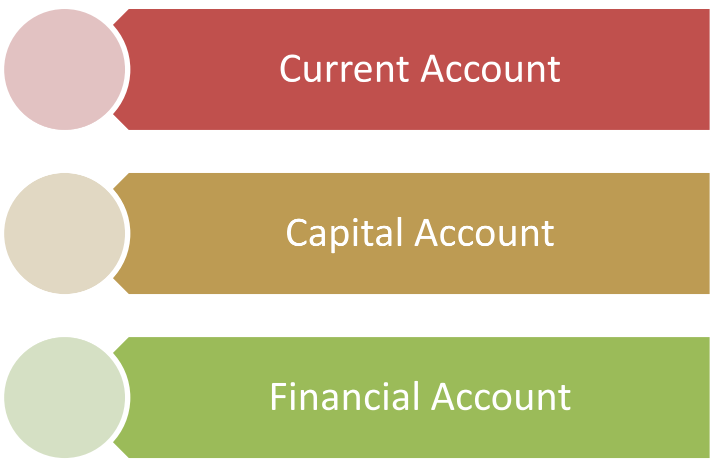
The "Balance of Payments" (Bop), which covers all debts and liabilities to foreigners as well as all payments and receipts from them, is a general summary of all financial transactions with the rest of the world over a specified time period. Therefore, one of the most important factors affecting a country's position in the global economy is its balance of payments. Since it significantly affects a government's economic policies and its capacity to compete internationally, every nation aspires to maintain a favourable balance of payments and long-term sustainability. When India first entered a regime of trade liberalisation, its position in the balance of payments was not very favourable. Over the past 20 years, economic reforms and free trade have opened up a lot of possibilities and improved the nation's "Balance of payments" performance. This essay offers a straightforward framework for comprehending the balance of payments and its constituent parts. This paper's main goal is to analyze the trend in India's position relative to its balance of payments and to identify the causes of that trend. The importance of the balance of payment statement is also covered in the essay. The difficulties that nations with balance of deficit problems must overcome are discussed in this portion of the article.

Keyword: Balance of Payment, Capital account, Current Account, Financial Account

Introduction

The "Balance of Payment" (BOP), which is accumulation of financial dealings with the rest of the world over a period of time, comprises all debts and liabilities to foreigners as well as all payments and receipts from them. In this sense, a nation's "balance of payment" is one of the major factors affecting its position in world commerce. To determine how much money is coming into and going out of a country, all transactions in the public and private sectors are recorded in the BOP. When a country receives money, it is considered to be in the positive and when it pays or transfers money, it is said to be in the negative. The BOP ought to be equal to zero, which shows that assets (credits) and obligations (debits) are equal and in balance. However, as this is rarely the case in reality, the BOP can tell observers whether a country is in deficit or surplus and which area of the economy is to blame for the variations. The BOP is divided into three main sections: current account, capital account, and financial account. These three groups are divided, and each one of them accounts for a specific type of international financial transaction. By emphasizing a country's competitive advantages and weaknesses, BOP accounting aids in the achievement of balanced economic growth. It has a significant effect on the economy and the economic policy of a government. Therefore, each country strives to keep a good balance of payments and long-term sustainability. India's balance of payments status was very unfavourable at the time the nation joined the liberalized trading regime. The success of the country's balance of payments demonstrated the prospects that two decades of economic reforms and free trade brought.

Components of Balance of Payment:



The current account shows the inflow and outflow of goods and services into a country as well as public and private investment earnings. It also shows the trade of goods, which includes goods like raw materials and manufactured goods that are bought, sold, or given away (possibly in the form of aid), as credits and debits. Services include revenue from the travel and tourism sector, transportation (like the tax that ships passing through Egypt's Suez Canal are required to pay), engineering, business service fees (like those from lawyers or management consulting, for example), and royalties from patents and copyrights. A country's balance of trade (BOT) consists of both goods and services. The BOT is sometimes the greatest part of a country's balance of payments because it takes into account all imports and exports. A country's trade balance determines whether it exports more goods than it imports or if it imports more goods than it exports. The current account also reflects dividend payments from income-producing assets like equities. The last component of the current account is unilateral transfers. The majority of these credits come from direct foreign aid as well as worker remittances, or the money that citizens who work abroad send home.

The Capital Account: The Capital Account is where all international capital transfers are reported. This is the buying or selling of non-financial assets like land and non-produced assets like diamond mines that are necessary for production but haven't yet been produced. The transfer of ownership of fixed capital assets (assets like apparatus used in the production procedure to create income), the assignment of funds received to the sale or purchase of tangible assets, souvenir and taxation on inheritance, death assessments, and, finally, uncovered damage to fixed assets are all included in the capital account.

The Financial Account: The Financial Account records the changes in the value of assets purchased through investments in bonds, equities, and real estate on a global scale. The list also includes government-owned assets including gold, foreign exchange reserves, special drawing rights (SDRs) held at the International Monetary Fund, privately held assets kept abroad, and foreign direct investment. The financial account also lists the personal and professional assets of foreigners.

Objectives of this Study

- To examine the trends and patterns of India's "Balance of payment"
- To investigate the importance of BOP in India
- To research the issues with India's balance of payments

India's Balance of Payment position:

Independent India's performance and trade with the outside world had frequently faced serious dangers. The one from 1991 was the most difficult. The enormous and growing budget deficits of the 1980s were a fundamental cause of the 1991 economic crisis. Due to a drop in investor confidence in 1990–1991 India's balance of payments had capital account problems. Due to increasing current account deficits, reserve losses, and low investor confidence, the foreign sector is in a difficult situation. In 1990–1991 the capital account margin was much lower at $– 7188 million while the current account shortfall expanded significantly to $–9680 million. India's Bop position saw an all-time high deficit as a result. India began making economic changes in an effort to address the growing issue. Structural policies initially focused on accelerating the process of industry and import delicensing before shifting to further trade liberalisation, banking sector reform, and tax reform. Prior to 1991, international aid, commercial borrowings, and deposits made by nonresident Indians were the main sources of capital flows to India. Foreign portfolio investment flowed almost exclusively into a small number of public sector bond issuances, direct investment was banned, and foreign equity stakes in Indian companies were outlawed (Chopra and colleagues, 1995). However, this growth model, which was strongly interventionist and inward-looking and included import protection, convoluted industrial licencing procedures, etc., experienced considerable changes with the liberalisation reforms of 1991. The post-reform period saw a significant improvement in India's issues with the foreign industry. This is made obvious by the RBI data that summarises the BOP in the current account and capital account. With the exception of the first three fiscal years, the current account, which keeps track of all transactions including exports and imports of goods and services, income owed to and payable to foreign parties, and current transfers to and from other countries, stayed practically negative during the post-reform period. Up until 2000–01, the current account deficit, which includes the trade balance and the invisible balance, stayed constant and was just under $5 billion. However, starting in 2001–02 and lasting for three consecutive fiscal years, the current account showed a surplus in its account for the first time since 1991. From 2004 to 2005, the current account deficit persisted while the growth rate was noticeably higher. Surprisingly, the current account deficit has increased consistently since the financial crisis of 2007–2008. India's current account balance during the 2011–12 fiscal year was $–78155 million, representing an eight-fold deficit over the 2007–08 data. This negative number in the current account was created by sizable negative debits and relatively small positive credits. The deficit was growing during the preceding years, which is another noteworthy aspect of current account balance. The invisibles and merchandise are the two main components of the current account. The value of the nation's current account balance is produced by these two components. Net merchandise has consistently been proven to have a significant negative figure. It was estimated to be $ - 189759 million in 2011–12. Our overall merchandise credit was $ 309774 million during that time, whereas our merchandise debit was $ 499533 million. This has consistently been a characteristic of India's merchandise figures over the years. The current crisis of 2008 significantly impacted India's trading performance. The Indian economy expanded rapidly from 2003–2004 to 2007–2008, averaging 8.8% yearly growth. Prior to the Lehman crisis, India's trade flows slowed as a result of Reserve Bank of India (RBI) raising interest rates in response to inflationary pressures (Kumar and Alex, 2009). The recent global financial crisis of 2008 had a significant impact on India through a number of crucial routes, including the trade flows, which began to collapse in late 2008. As a result of the exogenous external shock, commerce in goods, software exports, and remittances all experienced absolute declines.

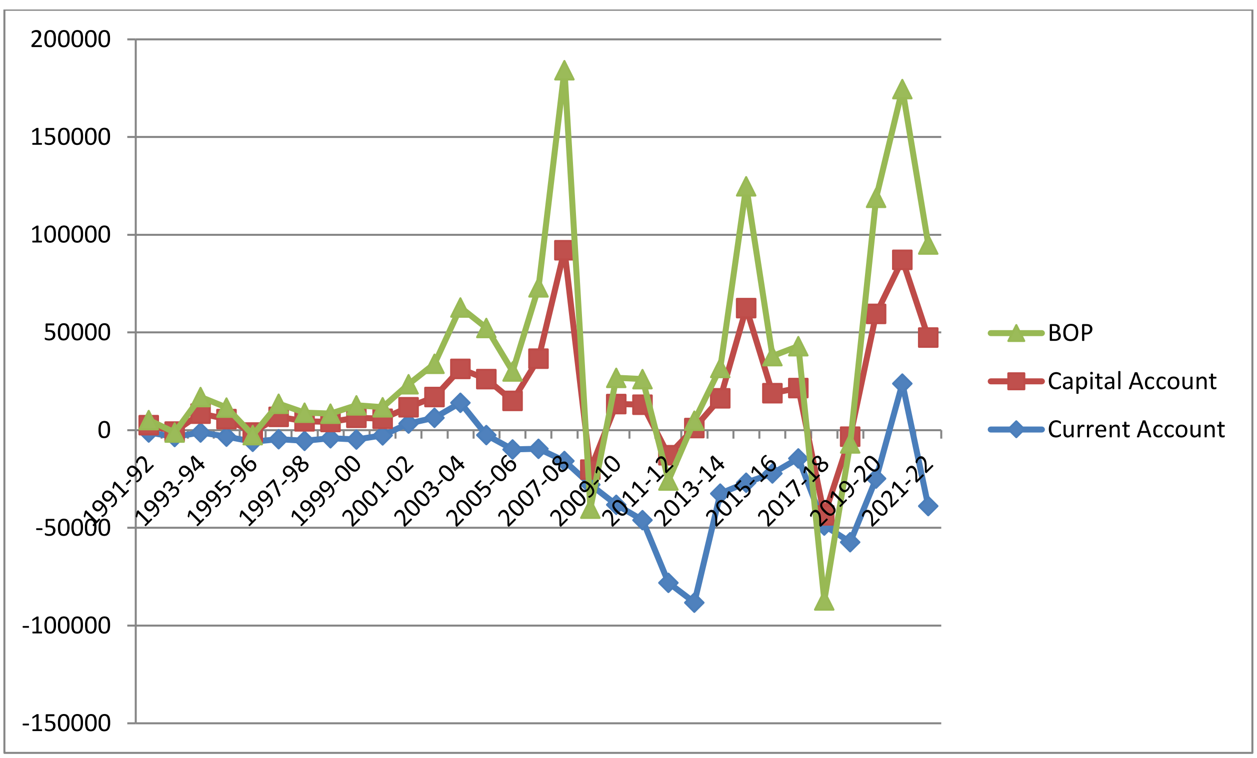
India's BOP during 1991-92 to 2021-22 (Values in US $ million)

Year	Current Account	Capital Account	BOP
1991-92	-1178	3777	2599
1992-93	-3526	2936	-590
1993-94	-1159	9694	8535
1994-95	-3369	9156	5787
1995-96	-5912	4690	-1222
1996-97	-4619	11412	6793
1997-98	-5499	10010	4511
1998-99	-4038	8260	4222
1999-00	-4698	11100	6402
2000-01	-2666	8535	5868
2001-02	3400	8357	11757
2002-03	6345	10640	16985
2003-04	14083	17338	31421

2004-05	-2470	28629	26159
2005-06	-9902	24954	15052
2006-07	-9565	46171	36606
2007-08	-15737	107901	92164
2008-09	-27915	7835	-20079
2009-10	-38180	51622	13441
2010-11	-45945	58996	13050
2011-12	-78155	65324	-12832
2012-13	-88163	89300	3826
2013-14	-32397	48787	15508
2014-15	-26859	89286	62427
2015-16	-22151	41128	18977
2016-17	-14417	35967	21550
2017-18	-48717	5143	-43574
2018-19	-57256	53917	-3339
2019-20	-24656	84154	59498
2020-21	23912	63374	87286
2021-22	-38766	86267	47501

Source: IMF, World Economic Outlook (https//imf.data.org.in)

Trends of India's BOP during 1991-92 to 2021-22



The "current account" shortfall increased significantly to \$ 9680 million in 1990–1991 while the "capital account" surplus was much lower at \$– 7188 million. This caused India's BoP position to experience an all-time high deficit. India started implementing economic changes to find a solution to the escalating issue. But starting in 2001–02, the current account showed a surplus in its account for three consecutive fiscal years for the first time since 1991. From 2004 to 2005, the "current account" deficit persisted while the growth rate was noticeably higher. Surprisingly, the "current account" shortfall has increased consistently since the financial crisis of 2007–2008. India's "current account" balance during the 2011–12 fiscal year was \$–78155 million, representing an eight-fold deficit over the 2007–08 data. This negative number in the current account was created by sizable negative debits and relatively small positive credits. The deficit was growing during the preceding years, which is another noteworthy aspect of current account balance. The invisibles and merchandise are the two main components of the current account. The value of the nation's current account balance is produced by these two components. Net merchandise has consistently been proven to have a significant negative figure. It was estimated to be \$ - 189759 million in 2011–12. Our overall merchandise credit was \$ 309774 million during that time, whereas our merchandise debit was \$ 499533 million. This has consistently been a characteristic of India's merchandise figures over the years. The current crisis of 2008 significantly impacted India's trading performance. From 2003-04 to 2007-08, the Indian economy grew rapidly at an average yearly rate of 8.8%. It was estimated to be \$ - 189759 million in 2011–12. Our overall merchandise credit was \$ 309774 million during that time, whereas our merchandise debit was \$ 499533 million. Finally, a good balance of payments was observed from 2019 to 2022.

Significance of BOP in India

Different facets of a country's foreign economic condition are shown by its balance of payments. It displays the nation's financial situation on a global scale. It assists the government in making decisions on, on the one hand, foreign trade and payment issues, as well as monetary and fiscal policy. An example of a developing country's balance of payments shows how significantly economic development depends on financial assistance from richer countries. The balance of payments is crucial because it acts as a barometer for a country's changing international economic status. The main economic indicator for evaluating a country's short-term international economic prospects, level of international solvency, and appropriateness of its currency exchange rate is the balance of payments. However, neither an economy's favourable balance of payments nor its adverse or even unfavourable balance of payments should be interpreted as a sign of insolvency. A country's competitive inferiority in international markets is not necessarily demonstrated by a "balance of payment" deficit. The more serious issues this economy presents, however, the longer the" balance of payments" shortfall persists. A nation shouldn't always become complacent just because its balance of payments is favourable. Due to the significant inflow of cash and loans from abroad, a poor country may have a favourable balance of payments. Due to significant help provided to underdeveloped nations, an advanced country may have a negative balance of payments. Therefore, a country's deficit or surplus on its balance of payments should not be interpreted as a sign of its economic health or prosperity. Only the transactions for the time period under evaluation are included in the balance of payments. It doesn't offer information on the assets and liabilities of another nation. Despite all of these shortcomings, the balance of payments is nevertheless significant since it supplies crucial information for evaluating a nation's financial transactions with the rest of the world.

Challenges of Balance of Payment

Unsustainable: A shortfall in the current account that is financed by borrowing is regarded as being more unsustainable. This is due to the fact that countries must pay high interest rates, and long-term borrowing is unsustainable. For instance, Russia was unable to pay its foreign debt in 1998. Similar problems with repayment have also affected other developing nations, such as Brazil and Africa. High interest-paying nations don't have much money left over for investment.

Risk of capital flight: A particularly high “balance of payment” imbalance could eventually lead to a loss of confidence on the part of foreign investors. As a result, there is always a possibility that investors will liquidate their holdings, which would cause your currency's value to drop dramatically. Living standards and investor confidence may drop as a result of this. The fact that countries ran substantial current-account deficits by luring capital (hot money) to finance the deficit was one of the causes of the Asian crisis in 1997. However, when confidence declined, these hot money flows stopped, precipitating a sharp devaluation and confidence crisis. A considerable degree of capital flight happened as foreign investors attempted to return assets when trust declined and the currency rate plummeted.

Foreign asset ownership: If your current account is negative, your capital account must be positive. This indicates that foreigners are claiming their assets more frequently, and they could decide to take them back at any point. For instance, foreign multinationals that invest in your nation or purchase assets may fund it if you have a current-account deficit. There is a chance that foreigners might purchase your most valuable assets, decreasing long-term income.

An sign of economic imbalance: A chronic current account deficit may indicate a dependence on consumer spending and an imbalance between short- and long-term investment and consumption. For instance, the UK has had strong consumer spending relative to GDP and low investment levels, particularly in the industrial sector. This focus on domestic consumption could have negative long-term effects due to lower productivity expenditures. Germany, which has a current account surplus and is generally regarded to have higher levels of economic investment, may have a different experience than the UK.

A non-competitive economy is indicated by: A current account deficit could indicate an uncompetitive economy and a comparatively overvalued exchange rate. • For countries with currency rates, like the United Kingdom, the Pound Sterling, this is not as significant because market forces will prompt a devaluation to reestablish competition. However, for countries in the eurozone who are unable to devalue their currencies in order to restore rivalry, a current account deficit could be a significant problem. For instance, in the countries of the southern eurozone, the gap in inflation rates between 2000 and 2007 resulted in very substantial current-account deficits. During the 2008–2013 recession in the eurozone, Greece, Portugal, and Spain's weak domestic demand was a result of this lack of competitiveness and low export demand.

Risk of depreciation: A country that has a significant current account deficit consistently runs the risk of seeing its currency decline. If insufficient capital inflows are made to cover the shortfall, the currency rate will decrease to reflect the imbalance in foreign flows. Consumers and businesses that depend on imported raw materials will experience imported inflation as a result of depreciation in the exchange rate.

Discussion and Conclusion

The Balance of Payments (Bop), which is a record of financial transactions with the rest of the world during a given time period, includes all payments and obligations made to and received from foreigners. In this regard, a country's balance of payments is one of the key determinants of its standing in international trade. Every nation aspires to have a favourable balance of payments and maintain its long-term sustainability since these factors have a substantial impact on the economic policies of a government and worldwide competitiveness. Because it is the foundation of numerous nations, like India, China, the United States, the United Kingdom, etc., the BOP has evolved into a gauge of the global economy. It aids in understanding their position on the global market and helps many nations create proper financial regulations for foreign currency rates and cross-border money transfers. The balance of payments is impacted by a number of factors, including inflation, national revenue, government reorganization, and exchange rates. A useful instrument for assessing both a country's economic prospects and the associated currency exchange rate is the historical trend of the BOP. This essay offers a straightforward framework for comprehending the balance of payments and its constituent parts. This paper's main goal is to analyze the trend in India's position relative to its balance of payments and to identify the causes of that trend. The importance of the balance of payment statement is also covered in the essay. The difficulties that nations with balance of deficit problems must overcome are discussed in this portion of the article. Data show that India has a significant balance of payments imbalance, and the government must act to fix this by enforcing exchange controls, lowering inflation, promoting exports, and devaluing the currency.

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