India's Balance of Payments: 1990-91 to 2014-15

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Abstract

The paper examines the trends in India's Balance of Payments since 1990-91.It examines the different items in invisibles account that have played significant role. The importance of surplus in capital account is analysed for financing current account deficit. The volatility of surplus in the capital account has been described.

Keywords: *Trade Deficit, Invisibles Account, Capital Account, Composition of Capital Surplus*

I. INTRODUCTION

India has undergone frequent balance of payments (BoP) crises since independence. Indian planners have recognised this from the beginning. In the first five year plan itself, it was stated while laying down the commercial policy to be followed with respect to the external sector in the following words, 'the deficits in the balance of payments must be kept within the foreign exchange resources at the disposal of the country in any given period' (Planning Commission, 1951) while stressing among other things, the necessity of maintaining a high level of exports. World macroeconomic developments as well as internal crises have often resulted in short run controls on trade and international movement of capital. In the heyday of planning, the commercial policy aimed at the external sector had to conform to the plan objectives and targets of production and consumption. However with the sudden fall of socialism in the late 1990s and the consequent spread of market economy all over the world, India had to re-orient the economy in the wake of foreign exchange crisis of 1991. Developments in the external sector since then have witnessed new turns. This paper examines the developments in the India's balance of payments in the post-reform period.

II. OBJECTIVES & DATA

This paper aims at examining the following two aspects of India's balance of payments since the launching of economic reforms in 1991.

1.developments in the balance of payments

2. actual patterns of financing balance of payments deficits

RBI, the central bank of India, publishes balance of payments accounts in its monthly publication, RBI Bulletin. These data are available as time series in its publication, Handbook of Statistics on Indian Economy. This publication is the main source of data. Other sources of data are Government of India publications, such as, Economic Surveys, Plan Documents and other reports. All data are annual time series in current US $ in billions.

Balance of payments of a country is a statement of its international transactions during a period. These occur mainly through two channels: foreign trade and international finance. The basic objective of India's integration with the world economy has been to facilitate growth and development of the country. It could be a severe constraint, if these transactions are not managed successfully. Besides posing problems for long term growth in the absence of foreign inputs, like critical capital goods, foreign capital and technology in the process of development, the entire financial system would be subject to serious currency crisis, if international movements of capital and finance are not properly monitored and regulated. A country's balance of payments reflects its health in its external sector. India's balance of payments has received critical examination from economists and policy makers, ever since the beginning of planning in 1951

India has seen stress in its BoP since 1956-57. The pre-reform period has been analysed particularly in the wake of the crisis of 1991 by several studies such as Jalan(1992), Joshi and Little (1994), and Rangarajan (2002) among others. Nayyar(1982), Sama(1989), and Ahluwalia (1986) have studied the BoP problems before the onset of 1991 crisis. Sathe (1996)up dates the analysis of Sama(1989) up to 193-94.All these studies have noted the special events such as droughts of 1965-66, oil price hikes of 1973 and 1979, the gulf war of 1989 as the proximate causes of deteriorating BoP situations. As the widening trade deficits has remained a persistent problem throughout, slow reforms in the trade sector has been cited as the cause behind continual balance of payments deficits. The attitude of protectionism dominated policy making until the late 1980s. It is only after the crisis of 1991 that major reforms have been undertaken encompassing the entire economy.

III. CONCEPTUAL FRAMEWORK

All transactions in the External Sector (ES) of an economy are divided into two main accounts:

Current Account (CA) and Capital Account (KA) as per the BPM- 5 of IMF. The CA comprises merchandise account and the account for invisibles. The Current Account Balance (CAB) shows the overall position in these two accounts. Any deficit in merchandise account is financed from surplus, if any, in the invisibles account. The current account may be in deficit if the total earnings from export of goods and services and receipt from transfers fall short of total payments arising from import of goods and services and payment for outward transfers. Any deficit in CAB must be financed by surplus in the KA. If the Capital Account Surplus (KAS) is less than the Current Account Deficit (CAD), it must be covered through depletion of International Reserves of Foreign Exchanges (IRFX). If the KAS is larger than the CAD, there is addition to IRFX. Briefly the relation is: $\Delta IRFX = CAB + KAB$, where ΔIRFX shows the change in IRFX. Obviously a country is interested in the overall balance in its External Sector. Improvement of External Sector Balance (ESB) over a period implies that ΣΔIRFX>0. Any analysis of ESB must examine the developments in the CAB and KAB over a period and the structure of relations between the two. And sinceeach of these accounts is composed of sub-accounts, the dynamics of ESB is revealed only when these sub- accounts are analysed

IV. OVBERALL BALANCE

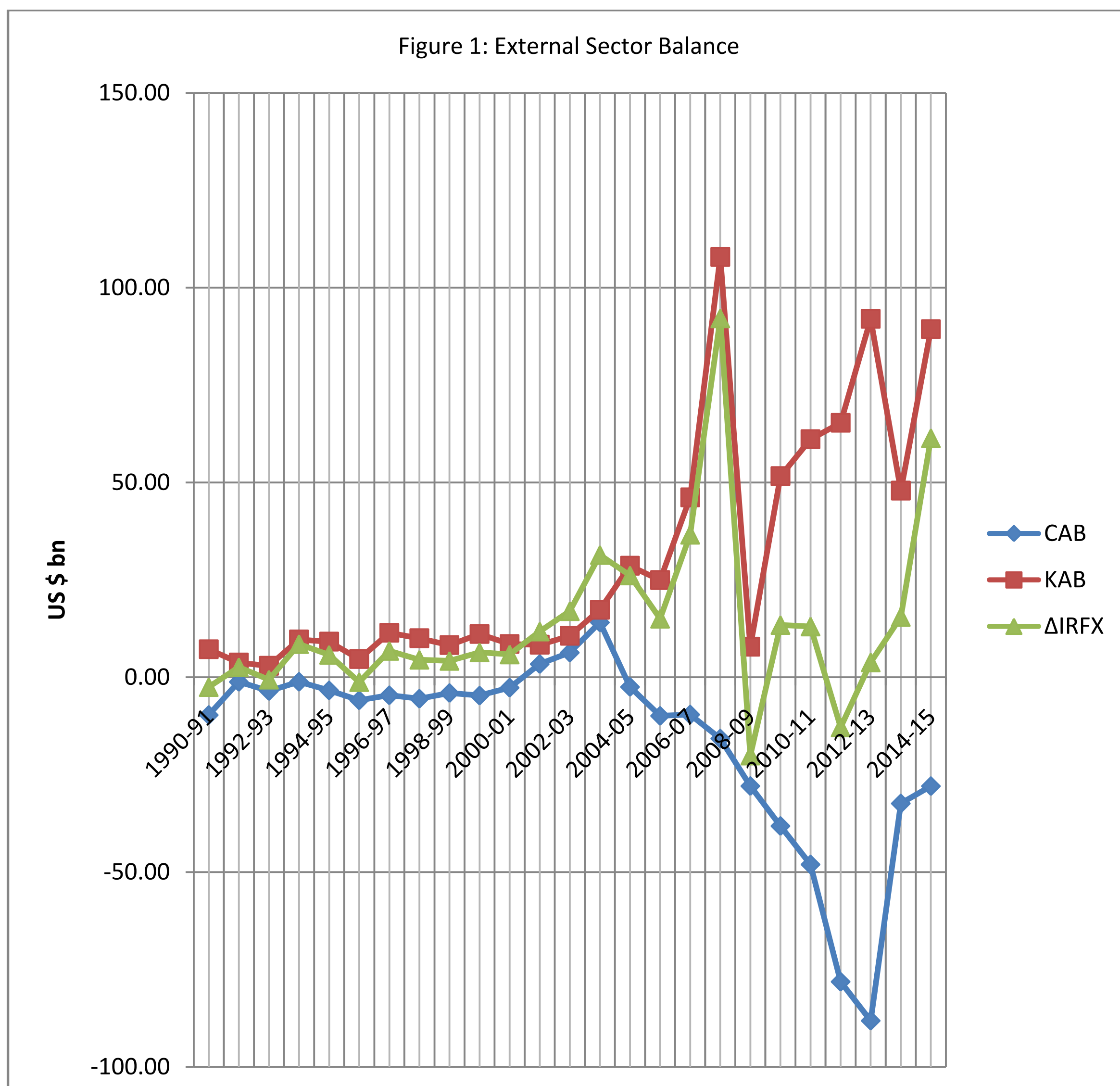
India's CAB has been negative from the days of independence except some years, and this has posed persistent problem in the maintenance of external balance. From 1991-92, it has shown increasing trend up to the year2012-13. The year 2013-14 seems to mark a reversal of this trend. After reaching a highest point of US$ 88.16 billion deficit in 2012-13, it has come down to US$32.40 billion in 2013-14 and US$ 27.94billion in 2014-15. Table1 and Figure 1 bring out the pattern of development in the overall balance. Only three consecutive years 2001-02, 2002-03 and 2004-05 have witnessed current account surplus. Except the years 1990-91, 1992-93, 1995-96, 2008-09and 2011-12, India's overall external sector balance has been in surplus, and boosted the international reserves of the country. This has been achieved through generating surplus in the capital account of BoP. While being a saviour, heavy dependence on capital account surplus for financing current account deficit raises sustainability questions in the highly integrated world of international finance.

Table1: Overall External Sector Balance (Us $ Bn)

Year	CAB	KAB	ΔIRFX
1990-91	-9.68	7.19	-2.49
1991-92	-1.18	3.78	2.60
1992-93	-3.53	2.94	-0.59
1993-94	-1.16	9.69	8.54
1994-95	-3.37	9.16	5.79
1995-96	-5.91	4.69	-1.22
1996-97	-4.62	11.41	6.79
1997-98	-5.50	10.01	4.51
1998-99	-4.04	8.26	4.22
1999-00	-4.70	11.10	6.40
2000-01	-2.67	8.54	5.87
2001-02	3.40	8.36	11.76
2002-03	6.35	10.64	16.99
2003-04	14.08	17.34	31.42
2004-05	-2.47	28.63	26.16
2005-06	-9.90	24.95	15.05
2006-07	-9.57	46.17	36.61
2007-08	-15.74	107.90	92.16
2008-09	-27.92	7.84	-20.08
2009-10	-38.18	51.62	13.44
2010-11	-48.05	61.10	13.05
2011-12	-78.16	65.32	-12.83
2012-13	-88.16	91.99	3.83

2013-14	-32.40	47.91	15.51
2014-15	-27.94	89.34	61.41

The exponential trend fitted to the KAB series is found to be $KAB = 3.379e^{0.12t}$ with R^2 =0.749 showing a growth rate of 12% per annum. Hence over the reform period the surplus in the capital account has grown at 12%, which has resulted in 18.2% rise in the reserves of foreign currency assets in US $ terms, besides financing the Current Account Deficit(CAD).



V. CURRENT ACCOUNT

The CAD in India reflects the deepening deficit in the merchandise account. The merchandise deficit has reached the highest point of US $195.66 bn in 2011-12. It has come down a little there after. From 2004-05, it has grown rapidly exceeding US$ 100 bn mark in 2008-09. The world financial crisis which surfaced in 2008 has its impact on the trade deficit up to 2012-13. From the very year of reform in 1991-92, the invisible account has shown surplus financing most part of trade deficit. Services and transfers have contributed almost in equal amount after 2004-05. From 1991-92 to 2004-05, the surplus from transfer category of invisibles dominated the surplus in the services category. Surplus in the services category was almost static up to 2002-03. For the year 1995-96, it was in fact negative at -0.20 billion. The income category in the invisibles has been running deficit over the entire period. The deficit has remained more or less static at about 3-8 billion US$ up to 2009-10. The deficit has grown rapidly thereafter. Growth of surplus in the services

and transfer category has reached a plateau after 2011-12. All these developments are illustrated in Table 2 and Figure 2. The growth of surplus in the invisibles account is found to be 18.8% per annum with equation $INVISISURPLUS = 2.055e^{0.188t}$

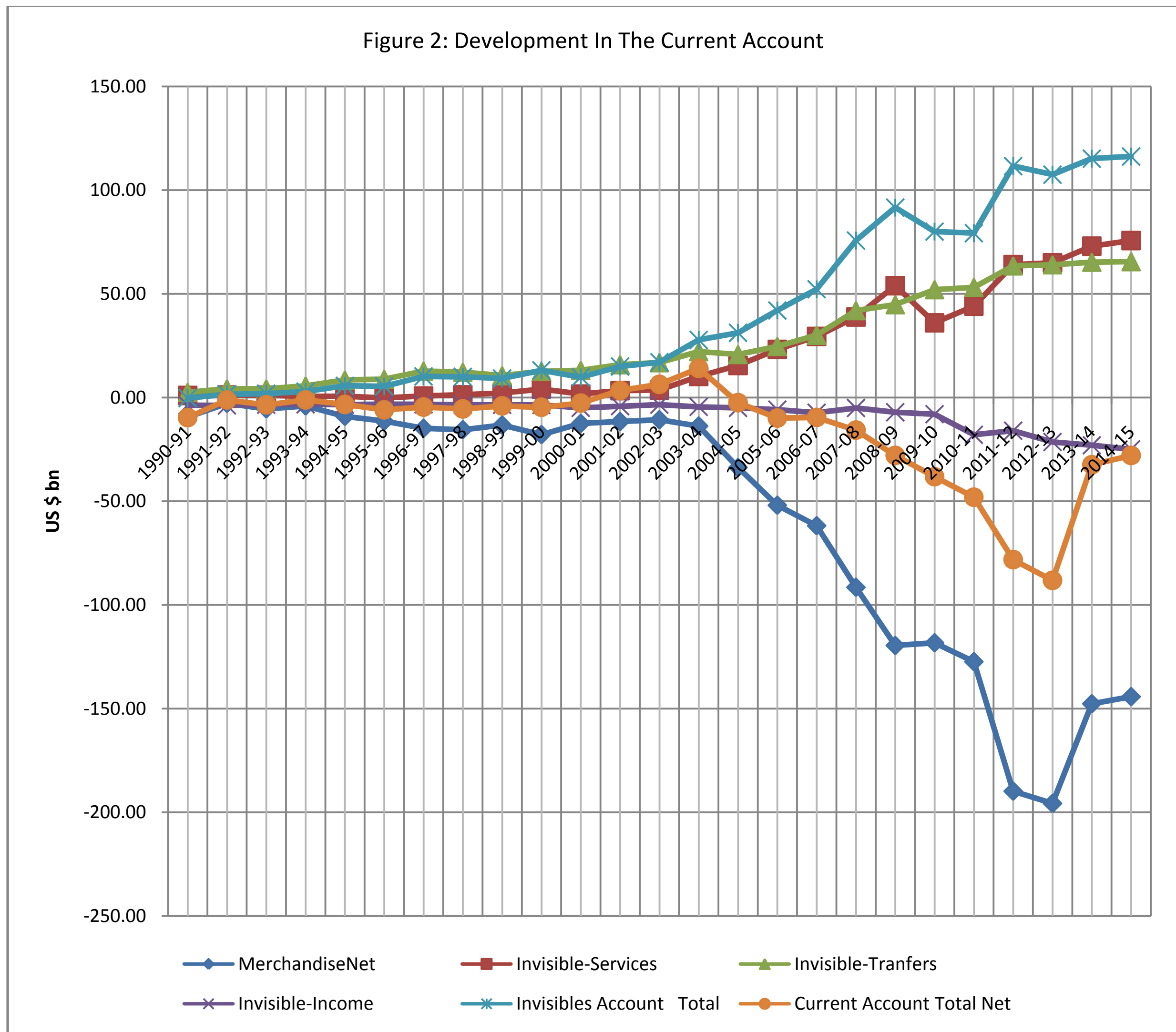


Table 2: Current Account Of Bop (Us $ Bn)

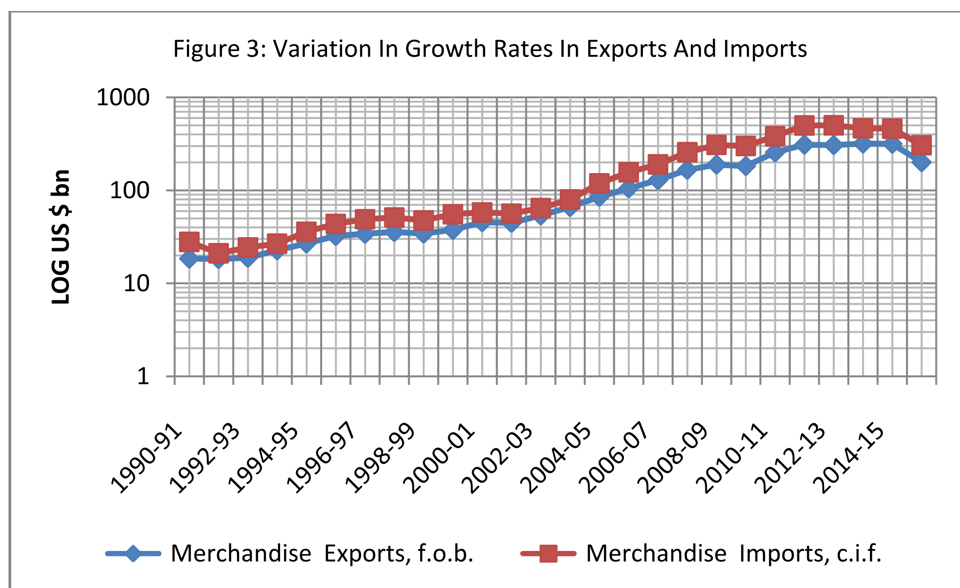
Year	Merchandise Net	Invisible-Services	Invisible-Transfers	Invisible-Income	Invisibles Account Total	Current Account Total Net
1990-91	-9.44	0.98	2.53	-3.75	-0.24	-9.68
1991-92	-2.80	1.21	4.24	-3.83	1.62	-1.18
1992-93	-5.45	1.13	4.22	-3.42	1.92	-3.53
1993-94	-4.06	0.53	5.63	-3.27	2.90	-1.16
1994-95	-9.05	0.60	8.51	-3.43	5.68	-3.37
1995-96	-11.36	-0.20	8.85	-3.21	5.45	-5.91
1996-97	-14.82	0.73	12.78	-3.31	10.20	-4.62
1997-98	-15.51	1.32	12.21	-3.52	10.01	-5.50
1998-99	-13.25	2.17	10.59	-3.54	9.21	-4.04
1999-00	-17.84	4.06	12.64	-3.56	13.14	-4.70
2000-01	-12.46	1.69	13.11	-5.00	9.79	-2.67

2001-02	-11.57	3.32	15.86	-4.21	14.97	3.40
2002-03	-10.69	3.64	16.84	-3.45	17.04	6.35
2003-04	-13.72	10.14	22.16	-4.51	27.80	14.08
2004-05	-33.70	15.43	20.79	-4.98	31.23	-2.47
2005-06	-51.90	23.17	24.69	-5.86	42.00	-9.90
2006-07	-61.78	29.47	30.08	-7.33	52.22	-9.57
2007-08	-91.47	38.85	41.95	-5.07	75.73	-15.74
2008-09	-119.52	53.92	44.80	-7.11	91.61	-27.92
2009-10	-118.20	36.02	52.05	-8.04	80.02	-38.18
2010-11	-127.32	44.08	53.14	-17.95	79.27	-48.05
2011-12	-189.76	64.10	63.49	-15.99	111.60	-78.16
2012-13	-195.66	64.92	64.03	-21.46	107.49	-88.16
2013-14	-147.61	72.97	65.28	-23.03	115.21	-32.40
2014-15	-144.18	75.68	65.54	-24.98	116.24	-27.94

VI. MERCHANDISE ACCOUNT

Merchandise account records receipts form export of merchandise and payments for merchandise imports. Balance on merchandise account is difference between the value of exports and the value of imports. All along, this trade balance has been negative for India. In the initial period of planning India followed an inward-looking policy up to late eighties, when export promotion replaced import substitution. It has been argued that this import substitution strategy resulted in distortion in resource allocation and led to high cost economy.

From a deficit of US $ 2.80 billion in 1991-92, it grew rapidly and crossed the US $ 100 billion mark in 2008-09. After reaching the highest point in 2012-13 at US $ 195.66 billion, it has come down below US $ 150 billion in2013-14 and 2014-15. The main cause of persistent deficit is the failure of export to grow sufficiently to pay for imports in a liberalised import atmosphere. The relative position of exports and imports is brought out in Figure 3. Exports have been consistently above imports, the difference being the trade deficit.



The exponential trends for export and import in

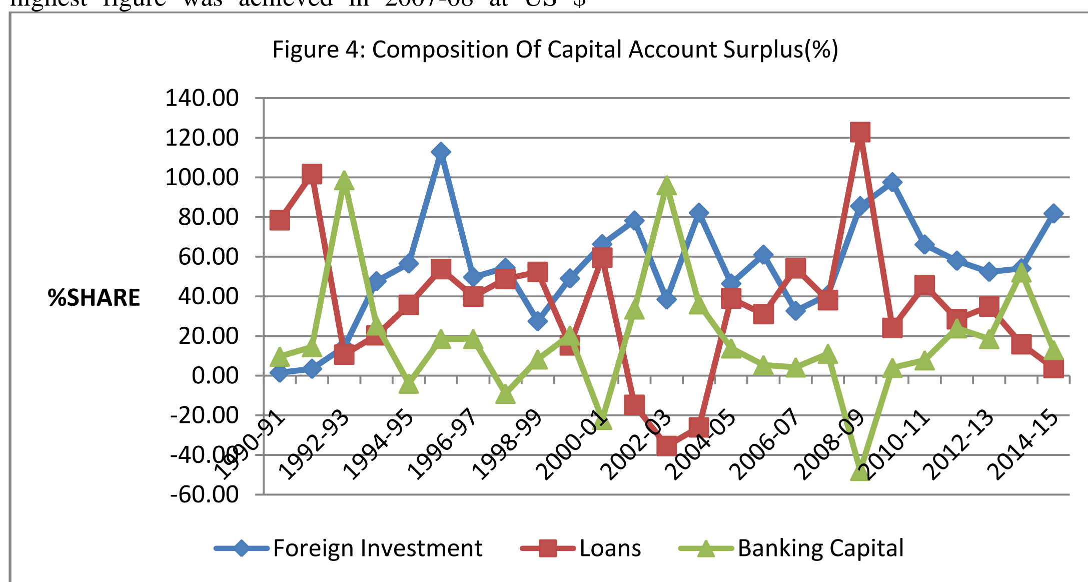
US $ bn are:

$XDL = 13.12e^{0.128t}$, R^2=0.955 for exports
$MDL = 15.60e^{0.143}$, R^2=0.954 for imports

Thus imports have grown at 14.3% per annum, where as the growth in exports is less at 12.8%. This variation in growth explains statistically the reason behind widening merchandise deficit. The oil import bill has grown a higher at 17.3% per annum compared to the non-oil import bill at 14.8%. This is despite the fact that oil export has been at a higher rate of 29.1% compared to the non-oil export growth of at 12.6% per annum during 1991-92 to 2014-15.

VII. CAPITAL ACCOUNT

Capital account has provided support to the financing of current account deficit. Starting with a surplus of US$ 3.78 billion in 1991-92, it has shown an upward trend, though with much volatility. The highest figure was achieved in 2007-08 at US $ 107.90 billion. The next year it recorded a mere surplus of US$ 7.84 billion chiefly because of the financial crisis of 2008. Over the period 1991-92 to 2014-15, the capital account surplus hasgrown at the rate of 12.5 %, the estimated exponential trend is: $KAB = 3.411e^{0.125t}$ with R^2=0.742. Foreign investment has played the critical role in generating surplus. Loans and banking capital have also been important. Surplus in foreign investment has witnessed increasing trend, loans and banking capital do not show anytrend in their behaviour. India has relied heavily on foreign investment for generation of surplus in thecapital account of BOP to cover the CAD. Net Foreign Investment has registered a growth rate of 19.5% much in excess of that of surplus in capital account as a whole at 12.5%.



The contributions of surplus in foreign investment, loans and banking capital to the capital account surplus in per cent are described in Figure 3. The average shares of foreign investment, loans and banking capital have been 54.30, 35.13 and 18.03 over the period 1990-91 to 2014-15.

VIII. CONCLUSION

The invisibles account and the capital account have been critical in avoiding BoP crisis. One of the goals of liberalising FDI is to boost exports, which does not seem to be happening. Given the liberal imports, the trade deficit remains a matter of concern. Investment, both FDI and FPI, may result in reversals taking the economy into payments and currency crisis. It seems prudent to rely on short terms selective controls on trade and capital flows for moderating short term volatility when the market mechanism fails to assist.

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