**E-ISSN:** 2708-4523
**P-ISSN:** 2708-4515
AJMC 2022; 3(2): 125-129
© 2022 AJMC
www.allcommercejournal.com
Received: 07-09-2022
Accepted: 09-10-2022

**Dr. TG Uma**
Associate Professor, School of Commerce Maharani Women's Arts, Commerce and Management College, Seshadri Road, Bengaluru, Karnataka, India

**Correspondence**
**Dr. TG Uma**
Associate Professor, School of Commerce Maharani Women's Arts, Commerce and Management College, Seshadri Road, Bengaluru, Karnataka, India

# An overview of balance of payments in India

**Dr. TG Uma**

**Abstract**
Balance of Payment is a statistical record of a business of country with rest of the world. India has been facing this deficit or disequilibrium in terms of BOP since 1947. In the modern-day context, international trade plays a key role in the economy of every country. Exporting goods & services that a country has surplus of or is good at and importing those which it needs is a driver behind the international trade. Balance of Payments is a good measure which indicates the surplus or deficit in a country's trade with other nations. The present article encapsulates the theoretical perspective on Balance of Payments in Indian context.

**Keywords:** Capital account, current account, monetary transactions

## Introduction
India's external sector exhibited resilience during the global financial crisis of 2008. The balance of payments however has been under increasing stress recently. Exports have declined while imports have not fallen significantly, resulting in increasing trade and current account deficits (Balance of Payments). Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should balance. But in practice this is rarely the case and, thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming. The BOP is divided into three main categories: the current account, the capital account and the financial account. Within these three categories are sub-divisions, each of which accounts for a different type of international monetary transaction (Sachin N. Mehta, 2013) [16].

## Definition
Balance of Payment (BoP) of a country can be defined as a systematic statement of all economic transactions of a country with the rest of the world during a specific period usually one year. It indicates whether the country has a surplus or a deficit on trade. When exports exceed imports, there is a trade surplus and when imports exceed exports there is a trade deficit.

## Purposes of calculation of Bop
- Reveals the financial and economic status of a country.
- Can be used as an indicator to determine whether the country's currency value is appreciating or depreciating.
- Helps the Government to decide on fiscal and trade policies. Provides important information to analyse and understand the economic dealings of a country with other countries.

## Components of BOP
For preparing BoP accounts, economic transactions between a country and rest of the world are grouped under-Current account, Capital account and Errors and Omissions. It also shows changes in Foreign Exchange Reserves. Current Account: It shows export and Import of visibles (also called merchandise or goods - represent trade balance) and invisibles (also called non-merchandise). Invisibles include services, transfers and income.

## Capital account
It shows a capital expenditure and income for a country. It gives a summary of the net flow of both private and public investment into an economy. External Commercial Borrowing

Foreign Direct Investment, Foreign Portfolio Investment, etc. form a part of capital account.

**Errors and omissions**

Sometimes the balance of payment does not balance. This imbalance is shown in the BoP as errors and omissions. It reflects the country's inability to record all international transactions accurately.

**Changes in foreign exchange reserves**

A movement in the reserves comprises changes in the foreign currency assets held by the Reserve Bank of India (RBI) and also in Special Drawing Rights (SDR) balances. Overall the BoP account can be a surplus or a deficit. If there is a deficit then it can be bridged by taking money from the Foreign Exchange (Forex) Account. If the reserves in the forex account are falling short then this scenario is referred to as BoP crisis.

Current Account + Financial Account + Capital Account + Balancing Item = 0

The IMF uses the term current account with the same meaning as that used by other organizations, although it has its own names for its three leading sub-divisions, which are:

- The goods and services account (the overall trade balance)
- The primary income account (factor income such as from loans and investments)
- The secondary income account (transfer payments) (Sandeep Patalay).

**Review of literature**

Shenti Kumar (2018) [18] propounds that Balance of Payment is a statistical record of a business of country with rest of the world. Balance of payment is one of the major indicators of country's progress. India has been facing this deficit or disequilibrium in terms of BOP. Restrictions on international trade were detached, foreign investments were allowed and a completely new Liberalized Exchange Management System was brought in to garner the benefits of competition. We opted for a very vigilant approach and at present after having surmounted the initial glitches of a newly liberalized economy. BOP shows strengths and weaknesses of country. It can notably affect the economic policies of a government and the economy itself (Shenti Kumar, 2018) [18].

Harendra Kumar Behera (2018-2019) [8] finds that India's CAD has widened in last few years mainly because of the rise in gold and oil imports, and increase in investment income payments in conjunction with fall in investment income receipts, despite a large comfort provided by services sector and private remittances. Given large demand in India, it is difficult to control import growth. However, policy makers should focus on achieving phenomenal export growth so that a sustainable current account is maintained. With rising working-age and skilled population, India could focus more on high-value product exports rather than low-value manufactured items. On the structural side, the widening CAD is contributed to a large extent by fall in household financial savings despite a fall in corporate investments, which raises concerns. Further investigation suggests that slowdown in household savings has been mainly led by acceleration in inflation. (Harendra Kumar Behera, 2018-2019) [8].

**Trend Analysis of Balance of Payments in India, (July-**December, 2021) reveal that during 1970-71 to 2019-20, this research attempted to investigate the impact of devaluation on the balance of payment in India. The change of the balance of payments from the pre-devaluation period to the post-devaluation period has been verified by the mean balance of payments measure. During the post-devaluation period 1991-92 to 2014-15, it accounts for an average of US$ 14473.71 million compared to US$ 68.95 million during the pre-devaluation period 1970-71 to 1990-91.

This increase in the balance of payments of the pre-devaluation and post-devaluation periods is important at the5 per cent level of significance the current account mean test indicated that the current account had changed from the pre- devaluation period to the post-devaluation period. It accounts for an average of US$ -16216.8 million during the 1991-92 to 2011-12 post-devaluation period, compared to US$ -2576.52 million during the 1970-71 to 1990-91 pre-devaluation period (Trend Analysis of Balance of Payments in India, (July-December, 2021)).

**Significance of balance of payment**

The balance of payments of a country reveals different aspects of the international economic position of a country. It presents the country's international financial position. It helps the government to take decisions on monetary and fiscal policies and on foreign trade and payment issues on the one hand. In the case of a developing country, the balance of payments shows how much economic development depends on the financial assistance provided by the developed countries. The greatest importance of the balance of payments lies in its service as an indicator of a country's changing international economic position.

The balance of payments is the economic barometer for assessing the short – term international economic prospects of a nation, assessing the degree of its international solvency and determining the appropriateness of the country's currency exchange rate. However, the favorable balance of payments in a country cannot be taken as an indicator of economic prosperity, nor does the adverse and even unfavorable balance of payments reflect bankruptcy. A balance of payments deficit in itself is not proof of a nation's competitive weakness in foreign markets.

However, the longer the balance of payments deficit continues, the more fundamental problems this economy presents. Nor should a favorable balance of payments always make a country complacent. A poor country may have a favorable balance of payments because of the large inflow of foreign loans and capital assets. An advanced country may have a negative balance of payments due to massive aid given to developing countries.

Therefore, a country's deficit or balance of payments surplus per se should not be taken as an index of economic bankruptcy or country's prosperity. The balance of payments concerns only transactions for the period under review. It does not provide data on assets and liabilities relating to

another country. Despite all these shortcomings, however, the importance of the balance of payments lies in the fact that it provides vital information to understand the economic relationship of a country with other countries (Sugandh Mittal, 2018) [19].

### Causes of disequilibrium in balance of payment

### Development programmes

Developing countries which have embarked upon planned development programmes require to import capital goods, some raw materials which are not available at home and highly skilled and specialized manpower. Since development is a continuous process, imports of these items continue for the long time landing these countries in a balance of payment deficit.

### Demonstration effect

When the people in the less developed countries imitate the consumption pattern of the people in the developed countries, their import will increase. Their export may remain constant or decline causing disequilibrium in the balance of payments.

### Natural factors

Natural calamities such as the failure of rains or the coming floods may easily cause disequilibrium in the balance of payments by adversely affecting agriculture and industrial production in the country. The exports may decline while the imports may go up causing a discrepancy in the country's balance of payments (Hymavathi and Kalpana, 2015) [9].

### India's balance of payments picture since 1991

Independent India's external trade and performance had faced severe threats many a times. The most challenging one was that of 1991.The economic crisis of 1991 was primarily due to the large and growing fiscal imbalances over the 1980s. India's balance of payments in 1990-91 also suffered from capital account problems due to a loss of investor confidence. The widening current account imbalances and reserve losses contributed to low investor confidence putting the external sector in deep dilemma. During 1990-91, the current account deficit steeply hiked to $- 9680 million while the capital account surplus was far below at $ 7188 million.

This led to an ever time high deficit in BoP position of India. India initiated economic reforms to find the way out of the growing crisis. Structural measures emphasized accelerating the process of industrial and import de licensing and then shifted to further trade liberalization, financial sector reform and tax reform. Prior to 1991, capital flows to India predominately consisted of aid flows, commercial borrowings, and nonresident Indian deposits. Direct investment was restricted, foreign portfolio investment was channeled almost exclusively into a small number of public sector bond issues, and foreign equity holdings in Indian companies were not permitted. However, this development strategy of both inward-looking and highly interventionist, consisting of import protection, complex industrial licensing requirements etc. underwent radical changes with the liberalization policies of 1991. The post reform period really eased India's struggles with regard to external sector.

This is evident from the RBI data summarizing the BOP in current account and capital account. The current account which measures all transactions including exports and imports of goods and services, income receivable and payable abroad, and current transfers from and to abroad remained almost negative throughout the post reform period except for the three financial years. Until 2000-01, the current account deficit that comprises both trade balance and the invisible balance, remained stagnant and stood around $ 5000 million. However, for the first time since 1991, the current account recorded surplus in its account during three consecutive financial years 2 from 2001-02. The deficit in current account continued to occur from 2004-05 onwards and the growth rate was comparatively faster. Surprisingly, the current account deficit grew like anything since 2007-08, the period witnessed financial crisis.

The current account balance of India during 2011-12 is recorded to be $ - 78155 million, signifying a deficit eight times that of the figures of 2007-08. Huge negative debits and comparatively low positive credits caused for this negative value in current account. Another notable feature of current account balance is that the deficit was mounting during the previous years. Two major items of current account are merchandise and the invisibles. These two items generate the value of current account balance of the country. The net merchandise has been always found to be huge negative figure. During 2011-12 it was recorded to be $ -189759 million. During the same period, our total merchandise credit was $ 309774 million while our merchandise debit was $ 499533 million. This is a common feature of India's merchandise figures during all the years.

The recent crisis of 2008 affected the trade performance of India in a large way. Indian economy had been growing robustly at an annual average rate of 8.8 per cent for the period 2003-04 to 2007-08. Concerned by the inflationary pressures, Reserve Bank of India (RBI) Increased the interest rates, which resulted in a slowdown of India's trade flows prior to the Lehman crisis. The trade flows, which are one of the important channels through which India was affected during the recent global crisis of 2008, started to collapse from late 2008. Merchandise trade, software exports and remittances declined in absolute terms in response to the exogenous external shock (Jomon Mathew, 2013) [10].

### Impacts of CAD

This section discusses the short term and long term effects of current account deficit on Indian economy.

### Short term effects

The following are the short term impacts of CAD:

1. A high negative CAD puts pressure of the domestic currency and leads to devaluation of the currency, in-turn making imports more costlier
2. The foreign investors pull out money from the country when domestic currency loses its value, this sets a chain reaction of money flowing out of the country and further eroding the value of the currency
3. The government has to finance the CAD through external borrowing and make interest payments leading to money getting sucked out of the domestic economy and in-turn leading to higher interest rates
4. Higher interest rates increases the cost of borrowing money and slows down the domestic economy
5. Slow growing economy leads to higher unemployment

rate and leads to social unrest in the country

**Long term effects**

The following are the long term impacts of CAD are:

1. In a country like India's where FDI is an important component, sustained CAD leads to loss of confidence with Foreign Investors
2. Sustained high levels of CAD will lead to Hyper Inflation in the domestic economy
3. High Interest rates for long periods of time will lead to economic contraction
4. Economic contraction will lead to unemployment and chaos in the society
5. Commodity prices will be out of reach of common man and will lead to famine in the country
6. Unemployment for a long time will lead to illiteracy and loss of knowledge
7. Foreign powers eyeing for a easy prey will invade India and will follow the well know pattern of Muslim rulers of the 10th century (Sandeep Patalay).

**BOP during 2020-21**

According to the Ministry of Commerce and Industry, India's Balance of Payments (BoP) in 2020-21 is going to be very strong.

**Strong BoP**

The BoP is going to be strong on the back of significant improvement in exports and a fall in imports. The exports in July 2020 is at about 91% export level of July 2019 figures. Imports are still at about 70-71% level as of July 2019.

**Trade surplus in June 2020**

India's trade has turned surplus for the first time in 18 years as imports dropped by 47.59% in June 2020 as compared to June 2019. The country posted a trade surplus of USD 0.79 billion in June 2020.

**Domestic manufacturing being boosted**

The government is taking steps to support and promote domestic manufacturing and industry.

It has increased curbs on imports of products and parts, especially from China, as part of its 'Atmanirbhar' Initiative. The government also reviewed all Free-Trade Agreements (FTA) done between 2009 and 2011 and found most of them to be asymmetrical. FTAs done earlier have permitted foreign goods to come easily into the country. But Indian goods have not been allowed reciprocal entry. E.g. European countries have opposed technical standards imposed by India on import of tyres, even as they have restricted export of tyres from India.

**Change in mode of manufacturing**

The government has also asked firms investing in the country to stop having an "assembly workshop" approach that has typically characterized Indian manufacturing. '

**Meaures to correct adverse balance of payments**

**Deflation**

Deflation refers to that monetary policy under which the volume of currency is reduced; consequently prices and monetary income of the people are brought down. In India, Reserve Bank of India, the Central Bank contracts the volume of credit in the economy by using quantitative and qualitative methods of credit control (Raising the Bank rate and open market operations).

**Devaluation**

Devaluation is that monetary measure under which government of a country lowers the value of its currency in terms of foreign currencies. Therefore, imports become dearer and exports cheaper. In this way adverse BOP is corrected (Shenti Kumar, 2018) [18].

**Measures adopted to solve the problem**

From the point of view of the measures adopted by the government to solve the problem of BOP deficits the whole period since 1950-51 can be divided in two parts, *viz*. (1) 1951-91 and (2) since 1991.

1) Till 1991, BOP deficits were sought to be controlled by measures like (i) promoting the growth of import substitution type of industries, (ii) putting physical restrictions on imports, (iii) extending assistance for export promotion, (iv) providing incentives for increasing foreign exchange earnings on account of invisibles. The fact that these measures could only moderately be successful is brought out clearly by the fact that the country was faced with BOP crisis of unprecedented dimensions.

2) Since 1991 India has put in practice a comprehensive strategy to overcome BOP deficits. The main elements of this strategy can be identified as follows:

**Fiscal and monetary discipline**

Strict fiscal and monetary discipline has been sought to be adopted to control aggregate demand. The central fiscal deficit stands reduced from 8.4 per cent of GDP in 1990-91 budget to 4.5 per cent in 1999-2000. Monetary policy has aimed at slowing down the growth of money supply. The rate of growth of money supply has been brought down from 18.5 per cent in 1991- 92 to 13.2 per cent in1995-96, and 17.8 per cent in 1998-99.

**Exchange rate policy and foreign trade policy reforms**

Till 1993, the exchange rate of the Indian rupee was fixed by Government. Since March 1, 1993, a new system of exchange rate determination has been introduced. This is known as the unified exchange rate system or UERS. Under this system, all payments and receipts of foreign exchange are converted in rupees at market rate of exchange. Further, Union Budget for 1994-95 introduced full convertibility on current account that makes many trade transactions relatively free of controls. As a part of foreign trade policy reforms, imports restrictions on capital goods, raw materials and components have been virtually eliminated. Thus, excess import demand will be reflected in a higher market exchange rate and self-correcting mechanism will operate to keep trade deficit in check. Along with this considerable reductions in peak tariffs, especially tariffs on capital goods, have been affected. Cash margins and interest surcharge on import credit have been abolished. Harmonised system of customs classification has been introduced.

**Structural reforms**

**Among these we may briefly mention as follows**

1. substantial deregulation of trade and industry;
2. De licensing of many industries;
3. Promotion of competition by the opening up of many areas previously reserved for the public sector to

private and foreign investment;
4. Policies put in place of attract foreign direct and port-folio investment;
5. Amendment of SICA to permit public enterprises to be examined by BIFR ;
6. Financial sector reformers including deregulation of interest rates, dismantling of directed credit, reforming the banking system, improving the functioning of the capital market including the government securities market, etc.

**Mobilization of exceptional financing**

Steps have been taken to mobilize exceptional finance from multilateral agencies and bilateral donors. (Exceptional financing need is defined as the requirement felt over and above the inflows of official project aid, commercial borrowings, and NRI deposits). Among other related measures are: stand-by arrangement with the IMF, structural adjustment and social safety net loans negotiated with Asian Development Bank, etc.
(Balance of payments).

**Conclusion**

In the modern world, there is hardly any country which is self-sufficient in the sense that it produces all the goods and services it needs. Population growth, Demonstration effect, cyclic fluctuations, Natural factors, Globalization and inflation are the factors which causes disequilibrium in balance of payments. BOP management still remains a tough walk for policy makers. The New Economic Policy of the nineties targeted for opening up of the economy, to permit free trade and competition and condense the role of government considerably in foreign trade issues. In line with efforts taken by governments and central banks all over the world, the Government and the Reserve Bank of India took aggressive countercyclical measures, sharply relaxing monetary policy and introducing a fiscal stimulus to boost domestic demand. India’s Merchandise exports had shown resilience despite continued disruptions caused by the pandemic. Merchandise exports gained momentum with the revival of domestic economic activity enthused by the receding second wave of COVID-19, fast-paced vaccinations along with the swift decisive steps taken by the Government.

**References**


1. Trend Analysis of Balance of Payments in India. ((July-December). Indian Journal of Economics and Business; c2021. p. 1933-1942.
2. Balance of Payments. (N. d.). 130-148.
3. Balance of Payments. (N.D.). 24-40.
4. Bery S. Global Imbalances, Spillover Effects and External Monitoring: Some Indian Perspectives. Think Tank 20: Macroeconomic Policy Interdependence and the G-20; c2012. p. 38-42
5. Calista Cheung DF. Structural and Cyclical Factors behind Current-Account Balances. Economics Department Working Paper No.775; c2010. p. 1-35.
6. Cheung Calista, Furceri Davide, Rusticelli Elena. Structural and Cyclical Factors behind Current-Account Balances. OECD, Economics Department, OECD Economics Department Working Papers. 21; c2010. 10.1111/roie.12080.
7. Disyatat CB. Global imbalances and the financial crisis: Link or no link. BIS Working Papers No. 346; c2011. p. 1-37.c
8. Harendra Kumar Behera. Explaining India’s current account deficit: a time series perspective; c2018-2019. p. 117-138.
9. Hymavathi, Kalpana. A Study on Analysis of Bop Trends with Reference to India; c2015. p. 630-634.
10. Jomon Mathew. Trends and Challenges of India’s Balance of Payments; c2013. p. 1-14.
11. Kuldeep Singh, Rana DK. Comparative Analysis of Balance of Payments: Indian Perspective. International Journal of Transformations in Business Management, 2011, 1(1).
12. Mathew J. Trends and Challenges of India’s Balance of Payments. Munich Personal RePEc Archive; c2013. p. 1-12.
13. Raschen M. The Problem of Balance of Payment Imbalances. KFW Economic Research. 2014;44:1-4.
14. Rogoff MO. Global Imbalances and the Financial Crisis: Products of Common Causes. Federal Reserve Bank of San Francisco Asia Economic Policy Conference; c2009. p. 1-69.
15. Reem Heakal. What is the balance of payment; c2022 Apr.
16. Sachin N Mehta. Analysis of Trends in the Balance of Payments in India; c2013. p. 80-83.
17. Sandeep Patalay. (N.D.). Financial Analysis of India's Balance of Payments (BOP). 1-53.
18. Shenti Kumar. Trend of India‘s Balance of Payment: An Analtical Study; c2018. p. 37-41.
19. Sugandh Mittal. Balance of Payment: An Indian Perspective; c2018. p. 20-24.
20. The JM. Trade Imbalances and Multilateral Trade Cooperation. Geneva: WTO Economic Research and Statistics Division; c2012.