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Trend Analysis of Balance of Payments in India

S. Suriaganth

Assistant Professor, Department of Economics, H.H. The Rajah's College (Autonomous), (Affiliated to Bharathidasan University), Pudukkottai, Tamil Nadu, India.

Dr. A. Mohamed Abdullah

Assistant Professor, Department of Economics, Periyar EVR College (Autonomous), (Affiliated to Bharathidasan University), Trichy, Tamil Nadu, India.

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Abstract: This paper tried to examine the trend pattern of the balance of payment during the pre and post devaluation period and the impact of devaluation on the balance of payment. The result indicates substantial improvement of balance of payments during the pre- to post-devaluation period.

Keywords: Balance of Payment, Current Account, Capital Account, Financial Account

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Introduction

The Balance of Payment (BOP) is the tool used by countries for tracking all international monetary transactions over a particular period. Currently, the BOP is calculated every quarter and calendar year. To determine how much money is going in and out of a country, all trades conducted by both the private and public sectors area counted for in the BOP. If a country has received money, this is known as a credit, and, if a country has paid or given money, the transaction is counted as a debit. Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debts) should balance. But this is rarely the case in practice and thus, the BOP will tell the observer whether 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, there are sub-divisions each of which accounts for a different type of international monetary transaction.

The Current Account

To mark the inflow and outflow of goods and services into a country, the current account is used. Investment earnings, both public and private, are put into the current account. Credits and debits on the trade of merchandise, which includes goods such as raw materials and manufactured goods that are bought, sold or given away (possibly in the form of aid) are included in the current account.

Services apply to tourism, transport, manufacturing, business service fees, and royalties from patents and copyrights. Goods and services to get her make up a country's balance of trade (BOT). The BOT is usually the largest proportion of a country's balance of payments as it accounts for total imports and exports. If a country has a trade deficit balance, it imports more than it exports, and if it has a trade surplus balance, it exports more than it imports. Receipts from income-generating assets, such as stocks (in the form of dividends) are also stated in the current account. Unilateral transactions are the last component of the current account. These are credits, mainly remittances from workers' salaries, which are sent back into the home country of a national working overseas, as well as foreign aid obtained directly.

The Capital Account

The capital account is where all the transfers of foreign capital are registered. This refers to the acquisition or disposal of non-financial assets (such as physical assets such as land) and non-generated assets that are needed but not generated for production, such as those used for diamond mining. The capital account is broken down into monetary flows resulting from the forgiveness of debts, the transfer of goods and financial assets by migrants leaving or entering a country, the transfer of ownership of fixed assets (e.g. assets used in the income-generating process of production), the transfer of funds received for the sale or acquisition of fixed assets, taxes on gifts and inheritance, etc.

The Financial Account

Foreign monetary flows related to the company, real estate, bond and stock transactions are documented in the financial account. Government assets such as foreign reserves, gold, special drawing rights (SDRs) owned by the International Monetary Fund, private assets held abroad, and foreign direct investment are also included. Private and official properties held by foreigners are also reported in the financial account.

Review of Literature

Nayyar (1982) had provided a systematic analysis of India's balance of payments since 1970 and evaluated the policies adopted by the government. The author observed that the overall comfortable position of India's BOP in the 1970s (especially in the second half of the 1970s) did not last long. At the end of the decade, there were serious BOP difficulties, in the form of a massive trade deficit in 1979-80 which increased further in 1980-81. The author concludes that the formulation of our economic policies in general, and trade policies in particular were based on short term crisis management, rather than long term planning. However, the policies adopted in the late 1970s of import liberalization with stress on export promotion represented the beginning of a new long term perspective about trade policies and industrialization.

Rangarajan (1990) has analysed the developments in India's balance of payments in the 1970s and 1980s. He pointed out that India's balance of payments remained comfortable in the 1970sdespitethefirstoil shockof1973-74.Theeconomywas able to adjust to the first oil shock in a remarkably short time because of strong growth in exports especially to oil-exporting countries, increase in world trade volume, large inward remittances from Indian workers in Middle-East, increase in private transfers, and increase in foreign aid. At the beginning of the 1980s, due to the second oil shock in 1979, the pressures on the BOP intensified. The author specifically remarks that while the current account turned into a surplus within two years after the first oil shock, the current account deficit increased substantially in the two years after the second oil shock. It was observed that from 1985-86 to 1989-90, that is, during the Seventh Plan period, there was a continuous strain on the BOP situation. The large current account deficit (CAD) was the result of (a) large trade deficits and the reduction in the surpluses on the invisible account and (b) large repayments to IMF also exerted pressures on the level of reserves. During this period, the CAD was mainly financed by costly measures such as commercial borrowings leading to an increase in the average cost of borrowing and a shortening of the maturity period.

Virmani (2001)paper focuses on the causes behind the crisis of 1990-91 and the impact of economic reforms for the period 1990-91 to 2000-01. It was observed that though the BOP crisis occurred in 1990-91, the prelude to the crisis was built up in the late eighties. The 1990-91 crises were the result of a combination of external and domestic shocks. The external shocks were: break up of Soviet Bloc, Iraq - Kuwait war, while domestic shocks were: political uncertainty and undermining confidence in the Indian economy. The main causes identified behind the crisis of 1990-91 were: fiscal profligacy, the decline in invisible surplus, rising external debt and an overvalued exchange rate. Although a series of reforms were undertaken to over come the BOP crisis, the external sector reforms were the most successful ones. There forms were successful in increasing India's trade to GDP ratio, improving net terms of trade, reducing thecurrentaccountdeficitandputtingitonasustainablepath.Besidesthis,therewas an increase in capital flows in the form of FDI and FII, an increase in foreign exchange reserves, a reduction in external debt, and an appreciation of REER. On the macroeconomic front, there was a reduction in fiscal deficit and primary deficit. Finally, the author concludes that further reforms are necessary to increase openness and strengthen the external sector and competitiveness of the Indian economy.

Holmes *et al* (2007) in their study have considered the sustainability of India's current account by covering the period from 1950 to 2003. According to them, a necessary condition for current account sustainability is that exports and imports are co-integrated. By employing parametric and non-parametric tests, they have identified two distinct regimes characterized by whether or not imports and exports are co-integrated. The regime of non - co-integration runs until the late 1990s and the second regime of co-integration is present after that. This latter regime coincides with the liberalization of the Indian economy. They concluded that there is evidence in favour of a sustainable current account that has emerged in the late 1990s.

Bose & Jha (2011) have examined the causal linkages between the government budget deficit and the current account deficit for India, by considering quarterly data from 1998Q1 to 2011Q1. They have used interest rates and exchange rates as the interlinking variables. The conventional hypothesis of causation running from the fiscal deficit to interest rates to exchange rates and then to the external deficit is only partially borne out by their results, while evidence in favour of reverse causation is very strong. Bringing at oil prices helps complete the chain of reverse causation in the twin deficit hypothesis for India, as the direction of causation is unambiguously seen to run from oil prices to the external deficit to the fiscal deficit. The two deficits were seen to run in the opposite direction since the mid - 1990s when the government started to significantly reduce its budget deficit by implementing FRBM Act 2003. The current account deficit, on the other hand, had been trending lower since the mid - 1990s till 2004-05, when it was again driven up by escalating global oil prices, as oil prices moved from theUS$29 per barrel to the US $ 124 per barrel between Q2 of 2003-04 and Q2 of 2007-08.

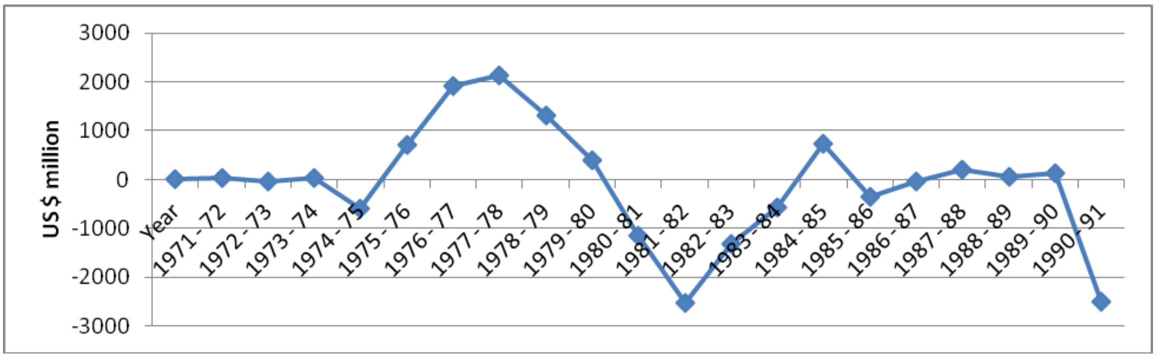
Materials and Methods

This study is mainly based on secondary sources which have been collected from Hand-Book of Statistics, RBI for the period 1970-71 to 2019-20. The basic methodology adopted in this study is the trend analysis.

Findings and Analysis

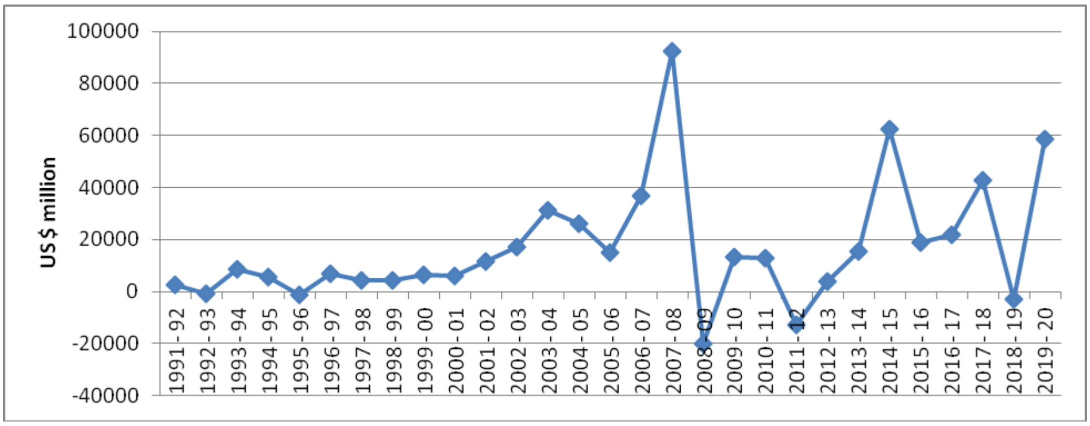
Table 1 shows that a fluctuation in BOP occurred before the devaluation of the currency. The balance of payments situation was acceptable in the 1970s. Owing to trade deficits, the balance of payments was negatively affected in the 1980s. Graph 1 shows that the balance of payments deteriorated sharply in 1990-91 because of domestic political developments that affected confidence in the Indian economy abroad.

Graph1: Trend of India's Balance of Payments during the Pre-Devaluation Period



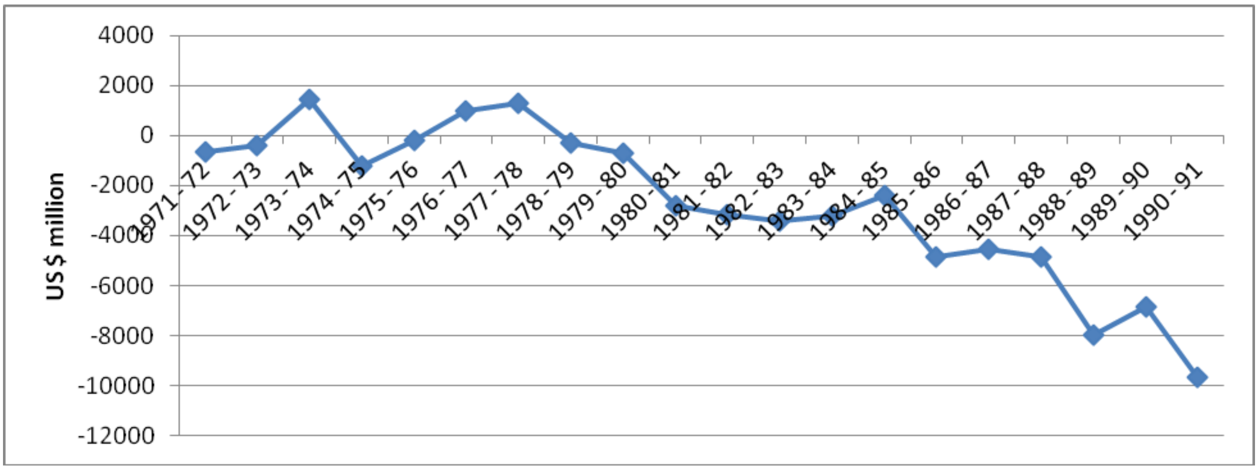
An analysis of the balance of payments trend shows that there was a substantial increase on average over the period. In 1991-92, it accounted for US dollars 2599 million to the US $58524 million in 2019-20. In 1992-93, 1995-96, 2008-09, 2011-2012 and 2018-19, there was a deficit in this account (Graph 2).

Graph2: Trend of India's Balance of Payments during the Post-Devaluation Period



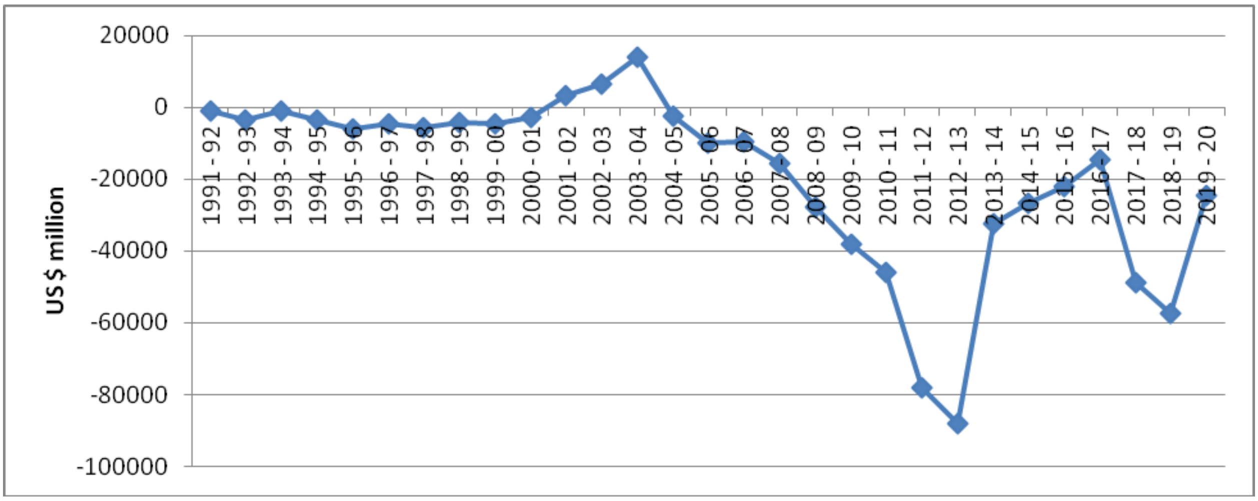
The study of the current account position trend of the Indian balance of payments shows that, during the pre-devaluation period, the deficit of this account increased significantly. It went from 290 million during 1978-79 to 9680 million during 1990-91 in absolute US dollar value. This is primarily due to the continuous decrease of the invisible account surplus during this time (Graph 3).

Graph3: Trend of India's Current Accounts during the Pre-Devaluation Period



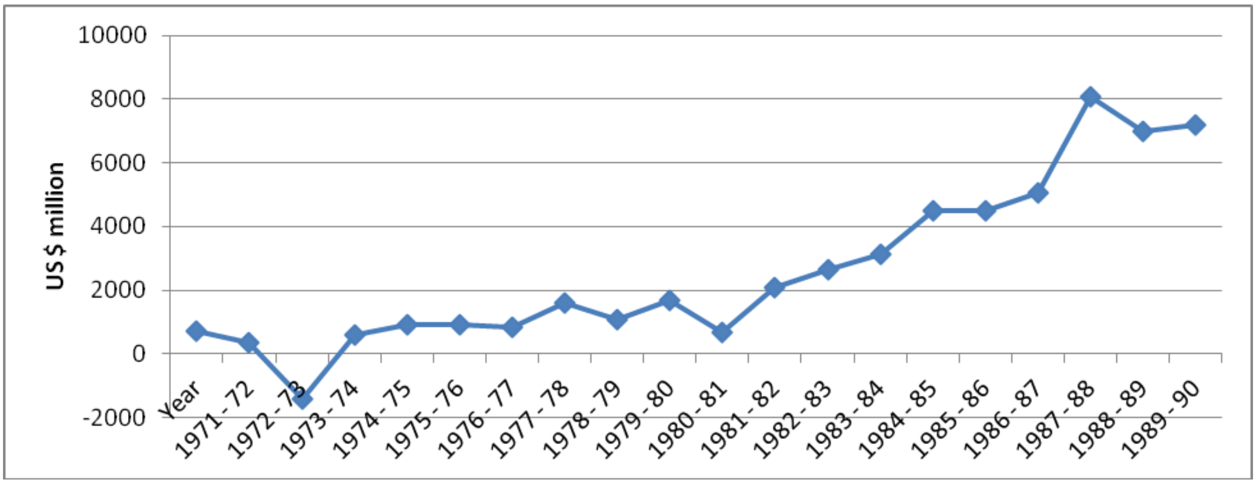
During the post-devaluation period, the current account status of India's balance of payments shows a growing pattern. The deficit of this account has risen from 1178 million in 1991-92 to 24656 million in 2019-20, in absolute terms. Graph 4 reveals that there was a current account surplus in the years 2001-02, 2002-03 and 2003-04. It is the first time that the current account surplus has existed for three consecutive years in the post-independent era.

Graph4: Trend of India's Current Accounts during the Post-Devaluation Period



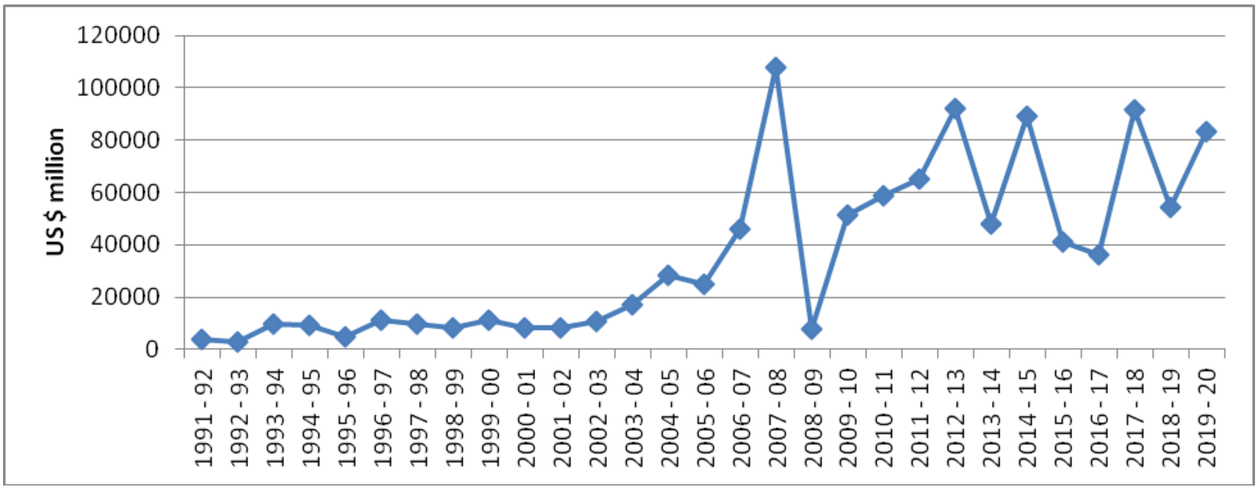
Graph 5 shows that the capital surplus has raised significantly. An upward movement during the time is shown by the overall trend of the account. The capital account rose from US $580 million in 1970-71 to the US $7188 million in 1990-1991. In contrast to the capital account growth rate of the balance of payments during the pre-evaluation period, the growth rate of the current account was high.

Graph5:Trend of India's Capital Accounts during the Pre-Devaluation Period



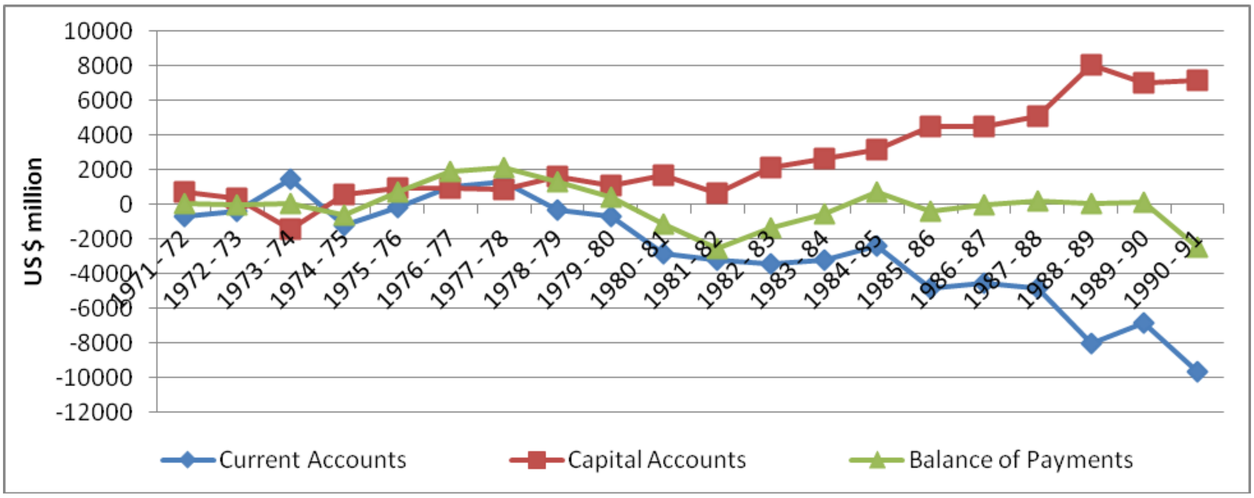
Graph 6 shows that there was a substantial increase on average during the time. The capital account has risen from the US $ 3777 million in 1990-91 to the US $ 83180 million in 2019-20,it can be noted. From the above graph, it can be observed that capital account inflows declined sharply in 2008-2009 due to the withdrawal of resources by recessionary foreign institutions.

Graph6:Trend of India's Capital Accounts during the Post-Devaluation Period

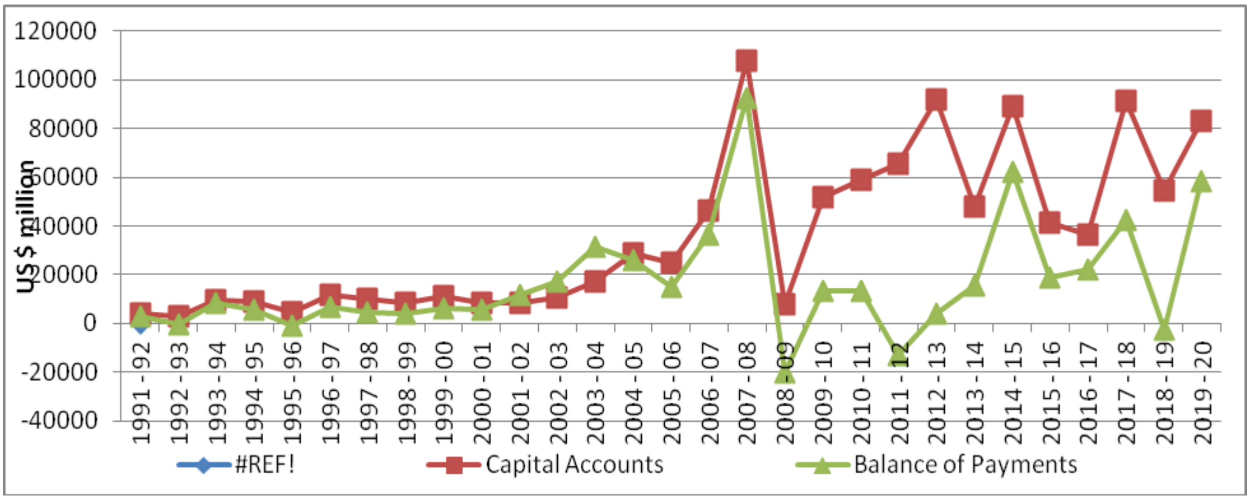


An overview of the balance of payment deficits in the pre-and post-devaluation periods indicates a rise from US$ 68.95 million in the pre-devaluation period to US$ 16819 million in the post-devaluation period. Furthermore, the study of the current account reveals that, on average, the account reveals an improvement in nominal terms from the pre-devaluation period to the post-devaluation period. In the post-devaluation period, it accounted for almost US$ - 19149 million as opposed to US$ -2576.52 million in the pre-devaluation period. The case of capital accounts was no different in that situation.

Graph7: Trend of India's Current Accounts, Capital Accounts and Balance of Payment during the Pre-Devaluation Period



Graph8:Trend of India's Current Accounts, Capital Accounts and Balance of Payment during the Post-Devaluation Period



Conclusion

During 1970-71 to 2019-20, this research attempted to investigate the impact of devaluation on the balance of payment in India. The trend pattern of different components of the payment balance, such as current account and capital account was also analyzed. The research draws the following inferences from the study of patterns.

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.

The capital account had changed from the pre-devaluation period to the post-devaluation period. During the post-devaluation period from 1991-92 to 2011-12, this represents an average of US$ 30690.67 million compared to US$ 2507.57 million during the pre-devaluation period from 1970-71 to 1990-91.

Table1:Trend of India's Current Account, Capital Account, and BOP Pre -Devaluation Period

Year	Current Accounts	Capital Accounts	Balance of Payments
1971-72	-669	697	28
1972-73	-403	360	-43
1973-74	1444	-1416	28
1974-75	-1198	600	-599
1975-76	-206	913	707
1976-77	1001	905	1905
1977-78	1313	828	2141
1978-79	-290	1597	1308
1979-80	-685	1090	405
1980-81	-2804	1665	-1140
1981-82	-3179	657	-2523
1982-83	-3407	2087	-1319
1983-84	-3216	2655	-561
1984-85	-2417	3147	730
1985-86	-4867	4506	-361
1986-87	-4560	4512	-47
1987-88	-4852	5047	195
1988-89	-7997	8064	68
1989-90	-6841	6977	136
1990-91	-9680	7188	-2492
Average 1970-71to 1990-91	**-2576.52**	**2507.57**	-68.95

Source: Handbook of Statistics on Indian Economy2014-15,Reserve Bank of India

Table2:Trend of India's Current Account, Capital Account, and BOP Post -Devaluation Period

Year	Current Accounts	Capital Accounts	Balance of Payments
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	5869
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	-20080
2009-10	-38180	51622	13442
2010-11	-45945	58996	13051
2011-12	-78155	65324	-12831
2012-13	-88163	91989	3826
2013-14	-32397	47906	15509
2014-15	-26859	89286	62427
2015-16	-22151	41128	18977
2016-17	-14417	36447	22030
2017-18	-48717	91390	42673
2018-19	-57256	54403	-2853
2019-20	-24656	83180	58524
Average 1991-92 to2019-20	**-19149**	**35968**	**16819**

Source: Handbook of Statistics on Indian Economy2019-20,ReserveBank of India

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