Trends in Major Balance of Payment Indicators of India

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Abstract
BOP is a very comprehensive and systematic monetary record of an economy's external transactions with the Rest of the World (RoW). For India, trends in BOP assume indomitable importance. In this background, this paper intends to present some exciting trends in valuable pointers of BOP of India. The study shows that the ratio of Imports to GDP in India (M/GDP) has still been higher than that of the Exports to GDP (X/GDP). Increasing CAD over the years especially in 2000s and 2010s also throws on the economic risks that has been facing. The growth in foreign investment albeit slow has turned out to be a positive indicator.
Keywords: BOP, Exports, Imports, Current Account Deficit, FDI, FIIs, BOP Equilibrium

Introduction

In an open economy movement in Balance of Payments (BOPs) matters a lot as it indicates the strengths and weakness of an economy, and its innate ability to be a shock absorber in times economic and financial turbulence. Theoretically speaking, BOP equilibrium is said to be automatically realized under the ambit of the flexible exchange rate system whereas in a fixed exchange rate system external factor causing disequilibrium in the BOP needs to be factored into as a policy variable and for that matter whatever happens externally will have its national reflections. India's external sector until the dawn of economic reforms was said to have been a regulated one thanks to which oscillations in BOP had been the order of the day. With the initiation of economic reforms and partial movements towards a flexible exchange rate system, discernible changes have been made apparent in the indicators of India's BOP, heralding the beginning of having equilibrium in BOP, which, of course, is likely to help the economy to focus solely on domestic economic affairs.

Many factors are decisive in building the statement of BOP of a country favorable to its long term economic outlook. Current account part of the BOP reflects the internal capability of the country to rise to the demand in the international market and its income backed capacity to purchase from the foreign countries. Exports as we now depend on domestic investment climate, capability of the economy to adapt to technology, the magnitude of labor used and their wages, government policies and other internal variables. On the other hand, Imports are directly affected by the domestic demand supported by an increasing income and purchasing power of people. Along with this income elasticity of demand for Imports also play an essential role in determining the import of the country. For India, a leading developing economy which shares 16 percent of world population, trends in BOP assumes indomitable importance.

In this background, this paper intends to present several fascinating trends in leading indicators of BOP of India. The present study relates itself to a pretty long period that is from 1979-80 to 2017-18 which covers both the pre-reform and post-reform period, thus enabling one to make incarnate comparison between the two periods.

A Note on Major Indicators of Balance of Payment

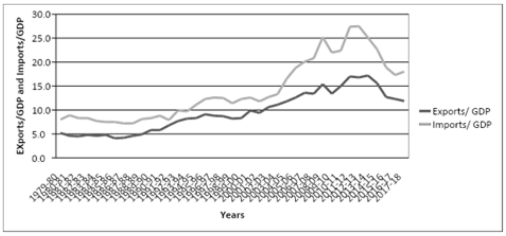
BOP is a very comprehensive and systematic monetary record of an economy's external transactions with the Rest of the World (RoW). Technically, BoP needs to be balanced, with outflows being equal to the inflows. BoP has both current account and capital account. New account mainly records exports and imports whereas capital account presents capital inflows and outflows. It is customary practice in all data analysis pertaining to BOP, ratio variables are extensively used to capture a prima facie picture of the trends in BOP. For instance, growth in Exports (X) is usually exposed as a ratio of Export to GDP. In this analysis, we use the same approach to examine the trends in the indicators of BOP. The following ratio variables are handled in this paper:

- Exports to GDP, X/GDP
- Imports to GDP, M/GDP
- Receipts to GDP and Payments to GDP (in the case invisibles)
- Current Account Deficit to GDP, CAD/GDP
- Foreign Investment to GDP

Trends in Export to GDP and Imports to GDP

During the period under this study that is from 1979-80 to 2017-18, Exports to GDP, which expresses Exports as a percentage of GDP and Imports to GDP, imports as a percentage of GDP, have registered an annual average growth rate of 9.5 per cent and 14.1 respectively, revealing that India has been more reliant on other countries in the case merchandise trade. A difference to the tune of 4.5 per cent between the two is normal of a developing economy but given the trade history of India this appears to be somewhat unwelcoming. As is evident from the Figure No.1 the difference was the narrower in 1991-92 and later got widened in 2008-09, the previous year being the year of an overhauling in the economic policy of India and then witnessed the spillover effects global financial meltdown. Further it is interesting to observe that the difference between these two ratios has been widening during the 2000s and 2010s with some room for a sigh starting with 2015-16.

Figure 1: Trends in the Ratio of Exports to GDP (X/GDP) and Ratio of Imports to GDP (M/GDP)

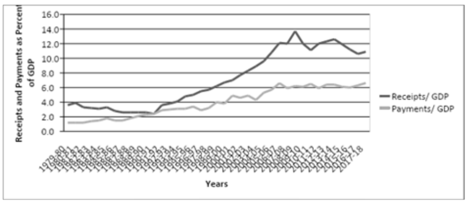


Source: Compiled from RBI Data Source

Trends in Invisibles

Turning to the Invisible account, we consider two ratios, the ratio of Receipts to GDP and Payments to GDP, the former shows inflows and the later outflows. As evident from the Figure No.2 during the period of this study, receipts as per cent of GDP has been quite higher than the Payment as per cent of GDP, barring 1990-1991, the year of severe economic crisis in India. Distant, it is interesting to note that the annual average growth rate of Receipts to GDP has hovered around 7.1 per cent whereas payments to GDP at 3.9 per cent per annum. Again a difference of 3.1 per cent between the two seems satisfying as it helps to partially offset the negative impact on account of the merchandise trade deficit. Like the trend in merchandise trades elucidated above, in the post reform period the difference between the Receipts to GDP and Payments to GDP has got widened in favour of Indian economy which is of course has been a matter a great relief.

Figure 2: Trends in the Invisibles as Percent of GDP



Source: Compiled from RBI Data Source

Trends in CAD (Current Account Deficit)

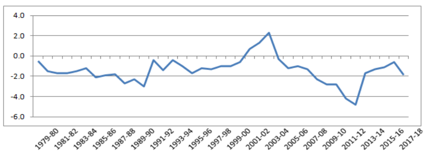
CAD assumes as much importance in judging the external risks of country as is fiscal deficit (FD/GDP) in the case of internal or domestic threats. CAD is said to occur when state spends relatively more on its imports than what it gets from its exports. At the outset it may be important to note that during the entire period under this study CAD/GDP has been negative except 2001-2002, 2002-03 and 2003-04 (Figure No3). In India, the average annual growth rate of CAD as per cent of GDP during the period 1979-80 to 2017-18 has been hovering around -1.4 per cent. In the immediate pre-reform period of 1980s CAD/GDP was at -1.7 per cent and it declined to -1.0 per cent in 1990s, the reform period in the immediate post reform period it further plummeted to a level as low as -0.5 per cent. But the most worrying is the fact that it again started increasing and touched -2.3 average annual growth rates in 2010s. Further it is quite interesting to note that since 2015-16, CAD has started decreasing, and in the fourth quarter ended March 31, 2019, CAD is reported to have been narrowed sharply to 0.7 per cent of GDP (Roy).

Table 1: Decadal Growth in CAD/GDP

Decades	Average Annual Growth Rate in CAD / GDP
1980s	-1.7
1990s	-1.0
2000s	-0.5
2010s	-2.3

Source: Compiled from RBI Data Source

Figure 3 Current Account Deficit as per cent of GDP

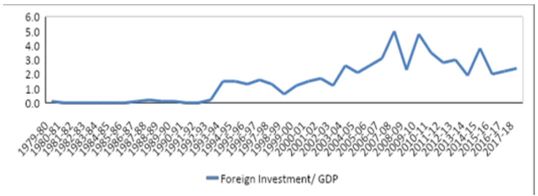


Source: Compiled from RBI Data Source

Foreign Investment to GDP

It has been rightly pointed out that reforms have made India a destination for investment unlike ever before. This is evident from the fact since 1991-92, foreign investment in India, comprised of Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII), has shown an upward shift (Figure No.4). With some oscillation especially on account of external shocks like the one which occurred in 2008-09 following the global financial meltdown, foreign investment as per cent of GDP has been growing in India. Prior to 1991-92 under this study, foreign investment as per cent of GDP did not show any growth as the average annual growth rate during this time hovered around zero whereas in the rest of the period since economic reforms the ratio of foreign Investment to GDP has registered a positive growth rate to the tune of 2.2 per cent per annum.

Figure 4 Trends in Foreign Investment to GDP



Source: Compiled from RBI Data Source

Summing Up

This paper has attempted to analyse the trends in significant indicators of BOP in India during the period 1979-80 to 2017-18. The study shows that the ratio of Imports to GDP in India (M/GDP) has still been higher than that of the Exports to GDP (X/GDP) which of course is a cause of worry. Increasing CAD over the years especially in 2000s and 2010s also causes discontent as far as Indian economy is concerned. The growth in foreign investment although slow has turned out to be a positive indicator. (Helpman) (Elhanan and Krugman) (Agarwal)

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