COMPARATIVE ANALYSIS OF BALANCE OF PAYMENTS: INDIAN PERSPECTIVE

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ABSTRACT

Uses of funds, such as for imports or to invest in foreign countries, are recorded as negative or deficit items. When all components of the BOP accounts are included they must sum to zero with no overall surplus or deficit. For example, if a country is importing more than it exports, its trade balance will be in deficit, but the shortfall will have to be counter-balanced in other ways – such as by funds earned from its foreign investments, by running down central bank reserves or by receiving loans from other countries. The balance of payments of a country is a systematic record of all transactions between the residents of a country and the rest of the world carried out in a specific period of time. The present paper scholar tried to focus of concept of BOP and comparative research on Indian balance of payment.

INTRODUCTION

The balance of payments of a country is a systematic record of all transactions between the residents of a country and the rest of the world carried out in a specific period of time. Balance of payments (BOP) accounts are an accounting record of all monetary transactions between a country and the rest of the world. These transactions include payments for the country's exports and imports of goods, services, financial capital, and financial transfers. The BOP accounts summarize international transactions for a specific period, usually a year, and are prepared in a single currency, typically the domestic currency for the country concerned. Sources of funds for a nation, such as exports or the receipts of loans and investments, are recorded as positive or surplus items. Uses of funds, such as for imports or to invest in foreign countries, are recorded as negative or deficit items. When all components of the BOP accounts are included they must sum to zero with no overall surplus or deficit. For example, if a country is importing more than it exports, its trade balance will be in deficit, but the shortfall will have to be counter-balanced in other ways – such as by funds earned from its foreign investments, by running down central bank reserves or by receiving loans from other countries.

While the overall BOP accounts will always balance when all types of payments are included, imbalances are possible on individual elements of the BOP, such as the current account, the capital account excluding the central bank's reserve account, or the sum of the two. Imbalances in the latter sum can result in surplus countries accumulating wealth, while deficit nations become increasingly indebted. The term "balance of payments" often refers to this sum: a country's balance of payments is said to be in surplus (equivalently, the balance of payments is positive) by a certain amount if sources of funds (such as export goods sold and bonds sold) exceed uses of funds (such as paying for imported goods and paying for foreign bonds purchased) by that amount. There is said to be a balance of payments deficit (the balance of payments is said to be negative) if the former are less than the latter.

Under a fixed exchange rate system, the central bank accommodates those flows by buying up any net inflow of funds into the country or by providing foreign currency funds to the foreign exchange market to match any international outflow of funds, thus preventing the funds flows from affecting the exchange rate between the country's currency and other currencies. Then the net change per year in the central bank's foreign exchange reserves is sometimes called the balance of payments surplus or deficit. Alternatives to a fixed exchange rate system include a managed float where some changes of exchange rates are allowed, or at the other extreme a purely floating exchange rate (also known as a purely flexible exchange rate). With a pure float the central bank does not intervene at all to protect or devalue its currency, allowing the rate to be set by the market, and the central bank's foreign exchange reserves do not change.

Historically there have been different approaches to the question of how or even whether to eliminate current account or trade imbalances. With record trade imbalances held up as one of the contributing factors to the financial crisis of 2007–2010, plans to address global imbalances have been high on the agenda of policy makers since 2009. India's balance of payment worsened in the early 1990's but now the situation is under control. In fact, India has a good foreign exchange reserves mainly due to capital inflows from foreign financial institutions orthe stock exchange.

CONCEPT OF BALANCE OF PAYMENT

The two principal parts of the BOP accounts are the current account and the capital account. The current account shows the net amount a country is earning if it is in surplus, or spending ifit is in deficit. It is the sum of the balance of trade (net earnings on exports minus payments for imports), factor income (earnings on foreign investments minus payments made to foreign investors) and cash transfers. It is called the current account as it covers transactions in the "here and now" - those that don't give rise to future claims. The capital account records the net change in ownership of foreign assets. It includes the reserve account (the foreign exchange market operations of a nation's central bank), along with loans and investments between the country and the rest of world (but not the future regular repayments/dividends that the loans andinvestments yield; those are earnings and will be recorded in the current account). The term "capital account" is also used in the narrower sense that excludes central bank foreign exchange market operations: Sometimes the reserve account is classified as "below the line" and so not reported as part of the capital account.

Expressed with the broader meaning for the capital account, the BOP identity assumes that any current account surplus will be balanced by a capital account deficit of equal size - or alternatively a current account deficit will be balanced by a corresponding capital account surplus: current account + broadly defined capital account +balancing item+0 . The balancing item which may be positive or negative is simply an amount that accounts for any statistical errors and assures that the current and capital accounts sum to zero. By the principles of double entry accounting, an entry in the current account gives rise to an entry in the capital account,and in aggregate the two accounts automatically balance. A balance isn't always reflected in reported figures for the current and capital accounts, which might, for example, report a surplus for both accounts, but when this happens it always means something has been missed most commonly, the operations of the country's central bank and what has been missed is recorded in the statistical discrepancy term (the balancing item).

The International Monetary Fund (IMF) use a particular set of definitions for the BOP accounts, which is also used by the Organisation for Economic Cooperation and Development (OECD), and the United Nations System of National Accounts (SNA). The main difference in the IMF's terminology is that it uses the term "financial account" to capture transactions that would under alternative definitions be recorded in the capital account. The IMF uses the term capital account to designate a subset of transactions that, according to other usage, form a small part of the overall capital account. The IMF separates these transactions out to form an additional top level division of the BOP accounts. 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)

REVIEW WORK ON INDIA’S BALANCE OF PAYMENTS

During the quarter of April-June 2011, the trade deficit rose by 9.7% to USD 35.4 billion, despite a sharp increase in exports relative to imports. Export goods recorded growth of 47.1% year-on-year (YOY), and imports registered a 33.2% YoY growth during the quarter. In absolute terms, the trade deficit increased by USD 3.1 billion from USD 32.3 billion in the corresponding quarter previous year. Meanwhile, net exports of services rose by 19.1% in the quarter, mainly due to higher growth in receipts led by the transportation, construction, insurance and pension, telecommunication, computer and information sectors. Driven by higher commodity prices, the current account deficit (CAD) widened by 17.4% YoY to USD 14.1 billion during the first quarter of the current fiscal year. This wider CAD was financed by an overall capital and financial accounts surplus in excess of USD 15.4 billion during the same period. Mainly due to increasing net foreign direct investment (FDI) inflows to India, net financial inflows increased 20.4% to USD 15.7 billion in the quarter compared to the previous year. FDI inflows increased to USD 7.2 billion during the first quarter of fiscal year 2011-2012 as compared to USD 2.9 billion last year. There was a net accretion to foreign exchange reserves to the tune of USD 5.4 billion reflecting depreciation of the U.S. dollar against major international currencies during the quarter.

The RBI’s latest presentation of the trade deficit patterns is decomposed into specific current account components with detailed breakdowns on trade of goods, services, and income transfers. In line with current international standards, the new BPM6 classifications enhance India’s BoP statistics with more detail and better cross-country comparisons. India could not insulate itself from the adverse developments in the international financial markets, despite having a banking and financial system that had little to do with investments in structured financial instruments carved out of subprime mortgages, whose failure had set off the chain of events culminating in a global crisis. Economic growth decelerated in 2008-09 to 6.7 percent. This represented a decline of 2.1 percent from the average growth rate of 8.8 percent in the previous five years (2003-04 to 2007-08). Per capita GDP growth grew by an estimated 4.6 percent in 2008-09. Though this represents a substantial slowdown from the average growth of 7.3 percent per annum during the previous five years, it is still significantly higher than the average 3.3 percent per annum income growth during 1998-99 to 2002-03. The effect of the crisis on the Indian economy was not significant in the beginning. The initial effect of the subprime crisis was, in fact, positive, as the country received accelerated Foreign Institutional Investment (FII) flows during September 2007 to January 2008. There was a general belief at this time that the emerging economies could remain largely insulated from the crisis and provide an alternative engine of growth to the world economy. The argument soon proved unfounded as the global crisis intensified and spread to the emerging economies through capital and current account of the balance of payments. The net portfolio flows to India soon turned negative as Foreign Institutional Investors rushed to sell equity stakes in a bid to replenish overseas cash balances. This had a knock-on effect on the stock market and the exchange rates through creating the supply demand imbalance in the foreign exchange market. The current account was affected mainly after September 2008 through slowdown in exports. Despitesetbacks, however, the BoP situation of the country continues to remain resilient. The challenges that confronted the Indian economy in 2008-09 and continue to do so in 2009- 10 fall into two categories - the short-term macroeconomic challenges of monetary and fiscal policyand the medium-term challenge of attaining and sustaining high rates of economic growth. The former covers issues such as the trade-off between inflation and growth, the use of monetary policy versus use of fiscal policy, their relative effectiveness and coordination between the two. The latter includes the tension between short- and long-term fiscal policy, the immediate longer term imperatives of monetary policy and the policy and institutional reforms necessary for restoring high growth.

India's balance of payments in 2008-09 captured the spread of the global crisis to India. The current account deficit during 2008-09 shot up to 2.6 percent of GDP from 1.5 percent of GDP in 2007-08 (Table 1). And this is the highest level of current account deficit for India since 1990-91. The capital account surplus dropped from a record high of 9.3 percent of GDP in 2007-08 to 0.9 percent of GDP. And this is lowest level of capital account surplus since 1981-82. The year ended with a decline in reserves of US$ 20.1 billion (inclusive of valuation changes) against a record rise in reserves of US$ 92.2 billion for 2007-08. The global financial crisis began to affect India from early 2008 through a withdrawal of capital from India's financial markets. This is shown in India's balance of payments as a substantial decline in net capital inflows in the first half of 2008-09 to US$ 19 billion from US$ 51.4 billion in the first half of 2007-08, a 63 percent decline. This is seen from a large outflow of portfolio investment (as equity disinvestment by foreign institutional investors); and lower external commercial borrowings, short-term trade credit, and short-term bank borrowings. Inflows under foreign direct investment, external assistance and NRI deposits, by contrast, surged during the first half of 2008-09.

IMBALANCES

While the BOP has to balance overall, surpluses or deficits on its individual elements can lead to imbalances between countries. In general there is concern over deficits in the current account. Countries with deficits in their current accounts will build up increasing debt and/or see increased foreign ownership of their assets. The types of deficits that typically raise concern are:

- A visible trade deficit where a nation is importing more physical goods than it exports (even if this is balanced by the other components of the current account.)
- An overall current account deficit.
- A basic deficit which is the current account plus foreign direct investment (but excluding other elements of the capital account like short terms loans and the reserve account.)

As discussed in the history section below, the Washington Consensus period saw a swing of opinion towards the view that there is no need to worry about imbalances. Opinion swung back in the opposite direction in the wake of financial crisis of 2007–2009. Mainstream opinion expressed by the leading financial press and economists, international bodies like the IMF—as well as leaders of surplus and deficit countries—has returned to the view that large current account imbalances do matter. Some economists do, however, remain relatively unconcerned about imbalances and there have been assertions, such as by Michael P. Dooley, David Folkerts-Landau and Peter Garber, that nations need to avoid temptation to switch to protectionism as a means to correct imbalances.

CAUSES OF BOP IMBALANCES

There are conflicting views as to the primary cause of BOP imbalances, with much attention on the US which currently has by far the biggest deficit. The conventional view is those current accounts factors are the primary causes these include the exchange rate, the government's fiscal deficit, business competitiveness, and private behaviour such as the willingness of consumers to go into debt to finance extra consumption. An alternative view, argued at length in a 2005 paper by Ben Bernanke, is that the primary driver is the capital account, where a global savings glut caused by savers in surplus countries, runs ahead of the available investment opportunities, and is pushed into the US resulting in excess consumption and asset price inflation.

IMPROVEMENT IN THE EXCHANGE RATE

The exchange rate policy in recent years has been guided by the broad principles of monitoring and management of exchange rates with flexibility, without a fixed or a preannounced target or As of April 2010 a band, while allowing the underlying demand and supply conditions to determine the exchange rate movements of the Indian rupee over a period in an orderly manner. Subject to this predominant objective, the RBI’s intervention in the foreign exchange market has been driven by the objectives of reducing excess volatility, maintaining adequate level of reserves, and developing an orderly foreign exchange market. The surge in the supply of foreign currency in the domestic market led inevitably to a rise in the price of the rupee. The rupee gradually appreciated from Rs. 46.54 per US dollar in August 2006 to Rs.39.37 in January 2008, a movement that had begun to affect profitability and competitiveness of the export sector. The global financial crisis however reversed the rupee appreciation and after the end of positive shock around January 2008, rupee began a slow decline.

A major factor, which affected the emerging economies almost simultaneously, was the unwinding of stock positions by the FIIs to replenish cash balances abroad. The decline in rupee became more pronounced after the fall of Lehman Brothers in September 2008, requiring RBI intervention to reduce volatility. It is pertinent to note that a substantial part of the movement in the rupee-US dollar rate during this period has been a reflection of the movement of the dollar against a basket of currencies. The rupee stabilized after October 2008, with some volatility. With signs of recovery and return of foreign institutional investment (FII) flows after March 2009, the rupee has again been strengthening against the US dollar. For the year as a whole, the nominal value of the rupee declined from Rs. 40.36 per US dollar in March 2008 to Rs. 51.23 per US dollar in March 2009, reflecting 21 percent depreciation during the fiscal 2008/09. In fiscal 2009/10, however, with the signs of recovery and return of FII flows after March 2009, the rupee has been strengthening against the US dollar. The movement of the exchange rate in the year 2009/10 indicated that the average monthly exchange rate of the rupee against the US dollar appreciated by 9.9 percent from Rs 51.23 per US dollar in March 2009 to Rs 46.63 perUS dollar in December 2009, mainly on account of weakening of the US dollar in the international market.

ECONOMIC GROWTH

From all accounts, except for the agricultural sector as noted above, economic recovery seems to be well underway. Economic growth stood at 7 percent during the first half of the current fiscal year and the advance estimates for GDP growth for 2009-10 is 7.2 percent. The recovery in GDP growth for 2009-10, as indicated in the advance estimates, is broad based. Seven out of eight sectors/sub-sectors show a growth rate of 6.5 percent or higher. The exception, as of April 2010 anticipated, is agriculture and allied sectors where the growth rate is estimated to be minus 0.2 percent over 2008-09. Sectors including mining and quarrying; manufacturing; and electricity, gas and water supply have significantly improved their growth rates at over 8 percent in comparison with 2008-09. When compared to countries across the world, Indiastands out as one of the best performing economies. Although there is a clear moderation in growth from 9 percent levels to 7+ percent, the pace still makes India the fastest growing major economy after the People’s Republic of China.

RESEARCH METHODOLOGY

Focused attention on how to organize and conduct research can increase the efficiency of the research process and its outcomes. The second edition of Research Methodology in Applied Economics provides time-tested guidelines to instruct graduate students in the research process. Emphasizing research methodology as it applies to economics, Ethridge provides (1) an overview of the conceptual and philosophical basis of research methodology and (2) procedural guidelines on designing, coordinating, and conducting research projects. This present topic is based on conceptual empirical research work and the scholar just adopted Philosophical concept to complete and perfect conclusion in the comparative analysis study. Though the scholar use relevant examples for todays and past research paper and work.

OBJECT OF RESEARCH

The balance of payment situation started improving since 1992-93. There was a satisfactory balance of payment position in that period; the scholar research objects are-

(i) To study High earnings from invisibles,
(ii) To analysis Rise in external commercial borrowings, and
(iii) To Encouragement to foreign direct investment.

THE COMPONENTS OF STUDY FOR INDIA'S BALANCE OF PAYMENTS

Trade Balance

Trade balance was in deficit throughout the period shown in the table as imports always exceeded the exports. Within the imports the POL items constituting a sizeable position continued to increase throughout. Exports did not achieve the required growth rate. Trade deficit in 2005-06 stood at $ -51,841 billion US $.

Current Account

Current account balance includes visible items (trade balance) and invisibles are in a more encouraging position. It declined to $ -2,666 million in 2000-01 from $-9680 million in 1990-91 and recorded a surplus in 2003-04 to the extent of $ 14,083 million. In 2005-06, once again there was a deficit of $ 9,186 million. The main reason for the improvement during 2001-05was the success of invisible items.

Invisible

The impressive role placed by invisibles in covering trade deficit is due to sharp rise invisible receipts. The main contributing factors to rise in invisible receipts are non factor receipts and private transfers. As far as non factor services receipts are concerned the main development has been the rapid increase in the exports of software services. As far as private transfers are concerned their main constituent is workers remittance from abroad. During this period the private transfer receipts also increased from $ 2,069 million in 1990-91 to $ 24,102 million in 2005-06. The current trend of outsourcing a number of jobs by the developed countries to the developing ones is also helping us to get more jobs and earn additional foreign exchange.

Capital Account

Capital account has been positive throughout the period. NRI deposits and foreign investment both portfolio and direct have helped to a great extent. The main reasons for huge increase in capital account is due to large capital inflows on account of Foreign direct investment (FDI); Foreign Institutional Investors (FIIs) investment on the stock markets and also by way of Euro equities raised by Indian firms. The Non-resident deposit also forms a part of capital account.

Reserves

Reserves have changed during this period depending on a balance between current and capital account. An increase in inflow under capital account has helped us to build up our foreign exchange reserve making the country quiet comfortable on this count. In April 2007 we had $ 203 billion foreign exchange reserves.

The year 2005-06 registered the highest trade deficit so far running into $ 51,841 million, because of rising Oil prices; As a result despite impressive positive earnings of as much as $ 42,655 million from invisibles, the current account deficit in this year was $ 9,189 million which is 1.1% of GDP.

The positive earnings from invisibles covered a substantial part of trade deficit and current account deficit reduced significantly. The external commercial borrowings were extensively used to finance the current account deficit. The net nonresident deposits were positive throughout the ten year period. There has been a growing strength in India's balance of payment position in the post reform period in spite of growing trade deficit and current account deficit. On September 30, 2011, the Reserve Bank of India (RBI) published India's balance of payments (BoP) using a new presentation format. The format improves the presentation of India's BoP by aligning with international best practices. A major part of the BoP report has been compiled based on the IMF's latest BOP Manual (BPM6) starting from the first quarter of the fiscal year 2010-2011 (April-June 2010), officially replacing the previous BPM5 format.

CONCLUSION

In order for India's growth to be much more inclusive than what it has been, much higher level of public spending is needed in sectors, such as health and education along with the implementation of sectoral reforms so as to ensure timely and efficient service delivery. Plan allocations for 2010-11 for the social sectors have been stepped up, this process however needs to be strengthened and sustained over time. Global financial firm Goldman Sachs today said it expects India's basic balance of payments (BoP) to turn positive in the fiscal 2009-10 on anticipations of narrowing of current account deficit and higher inflows.

- "Notwithstanding the weakness in trade credit and foreign portfolio inflows, we expect the basic balance of payments (BoP) to move to positive in FY10," Goldman Sachs economists Pranjul Bhandari and Tushar Poddar said in a note today. BoP includes current account balance (the widest measure of trade in goods and services), foreign direct investment (FDI) and portfolio investment.
- "In FY10, we expect the current account deficit to narrow sharply. We also expect FDI inflows, non-resident Indians (NRI) deposits, and external commercial borrowings (ECB) to remain relatively robust," the economists said in the note.
- Goldman Sachs further said the turning of BoP into positive will have a strengthening effect on the Indian currency over a 6 to 12-month horizon. It expects the rupee to appreciate to 48 a dollar in 6 months and to 46.9 a dollar in 12 months.
- "India's balance of payments may have had its worst quarter in October-December FY09, when it showed a deficit of $18 billion," Bhandari said. On wholesale price index

(WPI) inflation, Goldman said, "We expect inflation data to go into negative territory in April."

FUTURE SCOPE

Management of the balance of payments will remain an important problem especially if the objective is to achieve a balance which can finance the sort of growth in imports that is needed to developed a sustain technological modernization in increasing numbers of sectors of the economy. These points to the extreme importance of exports in the years on the industrial front and the changes made in policies towards exporters should help to strengthen India's export capability. Though the scholar just think this one is thrust are of research to developed a technological modern modal for perfect export and import policies for sustain balance ofpayment.

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