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9. A Study on Balance of Payment in India

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Abstract:

The world's fastest-growing economy is now India. The balance of payments serves as a representation of economic transactions and is crucial in assessing an economy's state. For all countries worldwide, international trade is essential. Numerous economic sectors flourish as a result of trade. Exports and imports are essential to the economy's growth because they raise foreign exchange, which fuels overall progress. All foreign financial transactions undertaken by a nation's citizens are documented in the balance of payments (BOP). The BOP is divided into three primary categories: financial, capital, and current accounts. The influx and outflow of commodities and services into a nation are tracked by the current account. All foreign capital transfers are documented in the capital account. In the contemporary world, international trade is vital to any nation's economy. International trade is fueled by a nation's ability to import products and services it needs and export those it has excess of or excels in. A useful indicator of a nation's trade surplus or deficit with other countries is the balance of payments. We will talk about it in this paper. An analysis of India's balance of payments.

Keywords:

Balance, Payment, Growing Economy, Financial Transactions, Current Account, Capital Account, Financial Account, Goods, Services, Fixed Assets, Components, Payments Equilibrium.

9.1 Introduction:

In international economics, a country's balance of payments, also referred to as its balance of international payments and shortened to BOP or BoP, is the difference between all of the money that enters the nation during a specific time period (such as a quarter or a year) and the money that leaves the country for the rest of the world. Stated differently, it refers to the exchange of goods and services between nations during a given period of time. Individuals, businesses, and governmental organizations conduct these financial transactions in order to compare the payments and receipts resulting from the exchange of products and services. [1]

A statement known as the Balance of Payment (BOP) documents all of the financial transactions that take place between a nation's citizens and the rest of the globe over a specific time period. All transactions made by and to individuals, businesses, and the government are included in this statement, which aids in tracking the flow of money needed to grow the economy.

In a perfect world, the BOP should add up to zero when all the components are correctly incorporated. This implies that the money coming in and going out should be equal.

In the majority of situations, though, this is not optimal. A country's BOP statement shows whether it has a surplus or a deficit of finances; a surplus is indicated when a country's exports exceed its imports. The BOP deficit, on the other hand, shows that a nation's imports exceed its exports. The double entry method of accounting is comparable to tracking transactions under BOP. Every transaction will therefore have a debit entry and a matching credit entry. [2]

The current account, finance account, and capital account are the three main parts of the balance of payments. While the financial account shows the net change in ownership of national assets, the current account shows a nation's net revenue. The capital account, which is made up of the total of unilateral capital account transfers as well as the purchases and sells of non-financial and non-produced assets, comprises a portion of the total that has minimal influence.

An economy's economic transactions with the rest of the world, or those between resident and nonresident entities, are systematically summarized by balance of payments (BoP) figures during a specified time period. It includes capital and financial accounting as well as current accounts. It makes more sense when viewed through the lens of national income accounting: GDP = C+G+I+X-M. Stated differently, GDP is the sum of net exports (X-M), domestic investment (I), government consumption (G), and private consumption (C).

The domestic economy is absorbing more than it can generate if net exports of goods and services (X-M) are negative, which indicates a negative balance of trade or a trade (including services) deficit. Stated differently, the domestic economy's absorption (C+G+I) exceeds its domestic output (GDP).

This negative trade balance (or trade deficit) is also represented in the BOP's current account, which includes income (from investments and employee remuneration) and current transfers (remittances, grants, etc.) in addition to goods and services. Current Account Deficit is the outcome if the net effect of income, trade balance, and current transfers is likewise negative. External borrowings and/or investments, which are components of financial accounts, must be used to finance the deficit. [3]

9.2 Types of Balance of Payment:

There are three categories for the balance of payment:

1. Current Account:

All incoming and outgoing products and services between nations are scanned by this account. This account covers all of the payments made for constructed goods and raw materials. A few more items that fall under this category include royalties from licenses and copyrights, engineering, tourism, stocks, commercial services, and transportation. These all come together to form a nation's BOP.

2. Capital Account:

This account is used to track capital transactions, such as the buying and selling of non-financial assets like real estate and land. The purchase and sale of fixed assets by immigrants relocating to a new nation, as well as the flow of taxes, are also documented in this account. The capital account's finances control the current account's excess or deficit, and vice versa.

3. **Finance Account:** This account records the money that moves to and from other nations through investments such as real estate, foreign direct investments, commercial ventures, etc. This account analyzes whether it is buying or selling more assets, such as stocks, gold, equities, etc., and determines the foreign owner of domestic assets and the domestic owner of foreign assets.

The Economic Policy and the Balance of Payments:

Achieving reasonable high economic development, full employment, value soundness, and balance-of-payments balance are the main objectives of the economic strategy. The main goal of economic approaches in developing economies, as in the majority of industrialized countries, is usually to develop consistently at full generation limit (or full work).

An economy operating below its maximum potential will generate less inventory overall than its assets allow and will not be able to recoup this wealth creation in the future. Rising expansion and balance of payments problems are typically indicative of an economy that is operating at a capacity above its full limit. Most people consider value security and the balance of payments to be less important and optional goals for full employment and high economic development. A country can achieve high levels of development and business creation while maintaining a moderate rate of population growth. The level of swelling that will begin to interfere with the goal of high and manageable economic development is a topic of debate among financial experts. distorts the effectiveness of lucrative processes. [4]

9.3 Review of Literature:

Both of the following are possible forms of BOP imbalances. (a) transitory, which refers to an imbalance that lasts just a brief time and is brought on by things like crop failure, environmental variables, etc. (b) fundamental, which are enduring imbalances with deep roots that impact both the firm's and the economy's output volume. (c) cyclical, typically the outcome of changes in the business cycle. (d) structural, which results from structural shifts in an economy, including shifts in technology, taste, supply sources, etc. Gebeyehu (2017). (e) Developmental, which results from significant spending on things like capital goods imports. [5]

The external sector of India shown resilience in the 2008 global financial crisis. But lately, the balance of payments has been under more and more strain. Trade and current account deficits (Balance of Payments) have increased as a result of a reduction in exports but a relatively small decline in imports. In theory, assets (credits) and obligations (debits) should balance when the BOP is zero.

However, in reality, this is rarely the case, therefore the BOP can inform the observer of a nation's deficit or surplus as well as the sector of the economy that is causing the disparities. The current account, capital account, and finance account are the three primary divisions of the BOP. There are divisions within these three categories, and each one covers a distinct kind of foreign financial transaction (Sachin N. Mehta, 2013). [6]

The balance of payments is a statistical record of a nation's business dealings with the rest of the globe, according to Shenti Kumar (2018) [18]. One of the key measures of a nation's development is its balance of payments. India has been dealing with this BOP imbalance or deficit.

In order to reap the benefits of competition, restrictions on international trade were lifted, foreign investments were permitted, and a brand-new liberalized exchange management system was implemented. After overcoming the early snags of a recently liberalized economy, we decided to take a very cautious approach and are now at this point. BOP displays the nation's advantages and disadvantages. It can have a significant impact on both the economy and a government's economic policies. [7]

9.4 Objectives:

- To understand the meaning and components of Balance of Payment
- To study the trends of balance of position of India and analyses the reasons behind it
- To state the significance of balance of payment
- To study trends in major components of Balance of Payments of India.

9.5 Research Methodology:

This paper is based on secondary data, which is collected through various sources like report of RBI, IMF, journals, books, Economic Survey etc. The paper will be Descriptive in nature.

9.6 Result and Discussion:

Balance of Payment:

A nation's transactions with the rest of the world are displayed by its balance of payments. It records financial inputs and outflows and divides them into various categories.

Balance of Payments Equilibrium:

The current account will reflect the financial account with a floating exchange rate.

The financial account will have a surplus if there is a shortfall in the import of goods. [8]

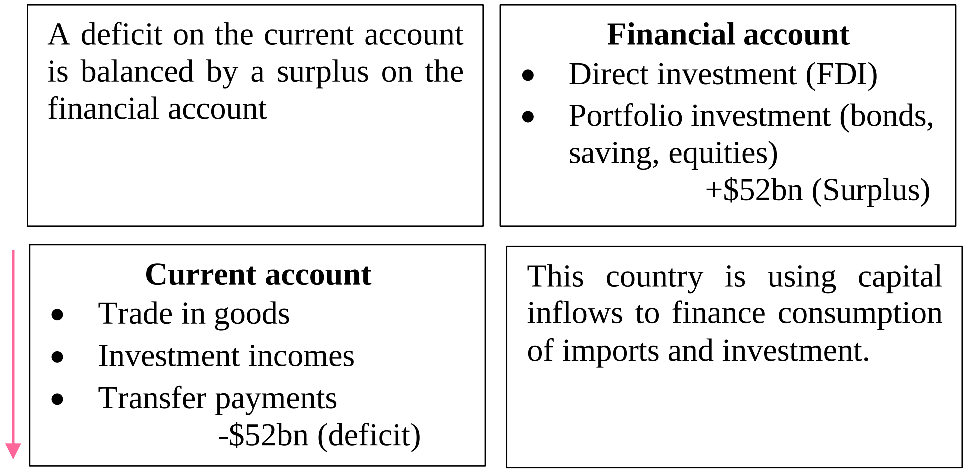

Figure 9.1: Balance of payments
(Source: www.economicshelp.org)

Components of Balance of Payments:

The following sections provide descriptions of the Balance of Payments (BoP) components.

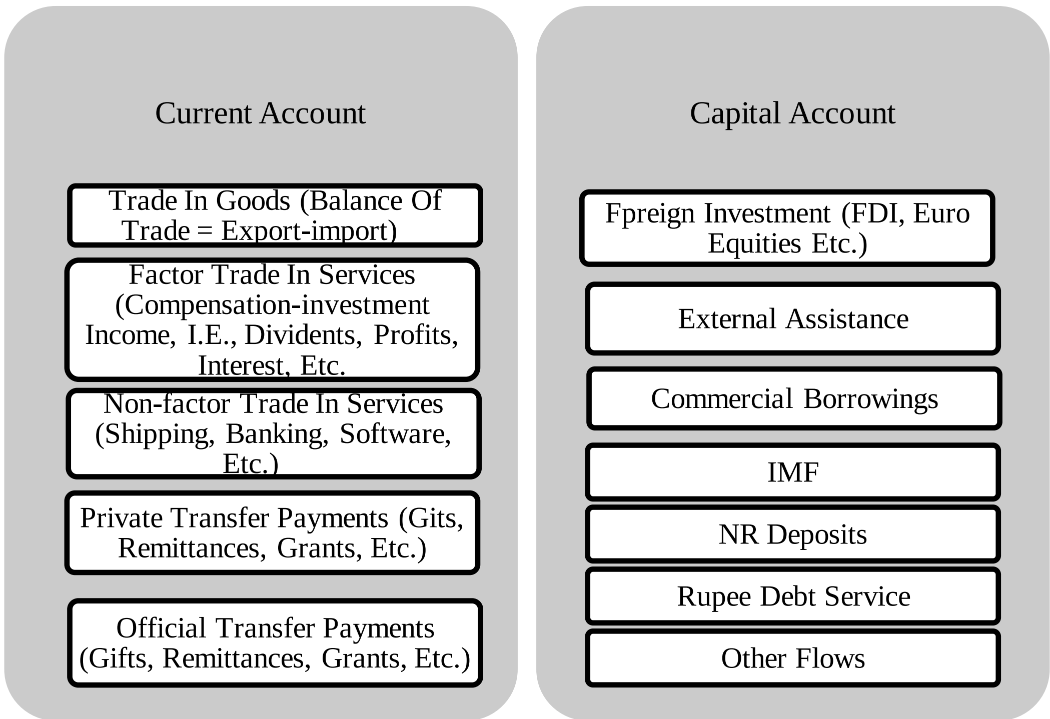

Figure 9.2: Components of Balance of Payments
(*Source: https://www.nextias.com)*

Current Account:

Businesses that deal in commodities, transfer payments, and services are documented in the current account. Commodity imports and exports are referred to as trade-in commodities. Factor income and non-factor income transactions or undertakings are included in trade-in services. Transfer payments are sums of money that a country's residents receive for free, without being required to exchange goods or services. They include gifts, grants, and remittances. The government or individual citizens residing overseas may offer them. [9]

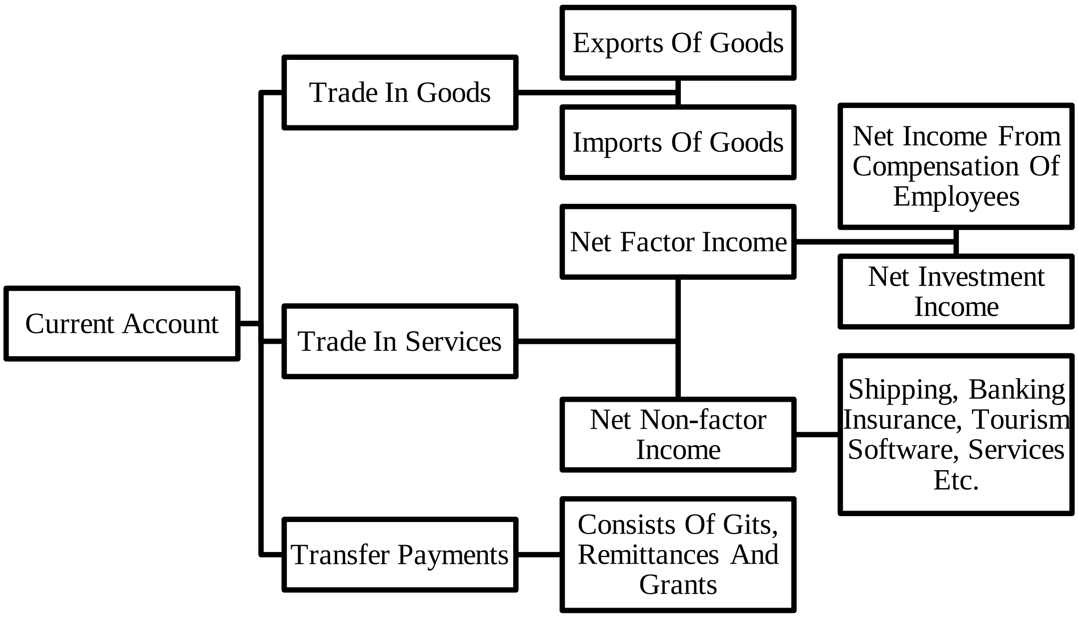

Figure 9.3: Components of Current Account
(Source: By Google)

- The flow of investments, goods, and services into and out of the nation is tracked by the current account.

As a result, it symbolizes a nation's international trade.

- It is a part of a country's balance of payments.
- The balance of trade (exports less imports of goods), net services (export less import), net primary income or factor income (i.e., profits on foreign investments less payments to foreign investors), and net cash transfers that have occurred over a specific time period are some of the components that make up the current account.

Current Account = Trade gap + Net current transfers + Net income abroad

Trade Gap = Exports – Imports

- When a nation's current account balance is positive, it indicates that it is lending money to other nations; when it is negative, it indicates that it is borrowing money from other nations.
- A current account deficit lowers the country's net foreign assets by the same amount as a current account surplus, while a current account surplus raises them by the same amount.

Errors and omissions:

There are instances where the payment balance is out of balance. The BoP displays this imbalance as mistakes and omissions. It illustrates the nation's incapacity to accurately document every foreign transaction. [10]

Capital Account:

All foreign asset endeavors are documented in the capital account. Any of the various forms of wealth might be considered an asset. For example, government debt, equities, bonds, money, etc. The capital account is debited when assets are purchased. A debit is made to the capital account undertakings if an Indian buys a UK automaker because foreign exchange is leaving India.

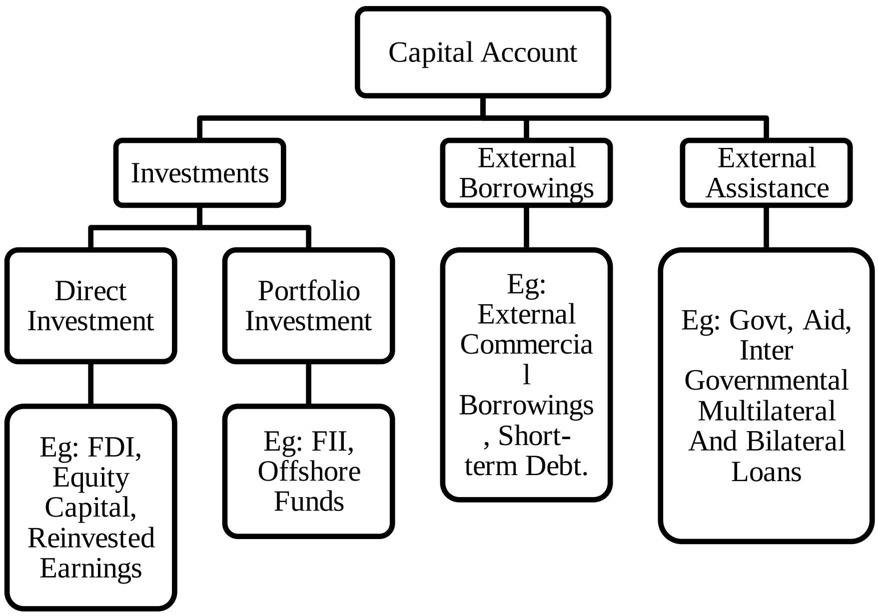

Figure 9.4: Components of Capital Account
(Source: By Google)

- All international sales and purchases of assets, including cash, stocks, bonds, and other financial instruments, are documented in the Capital Account.

- Foreign Direct Investment (FDI), portfolio, and other investments are included in the capital account along with net external borrowings, loans, and assistance.
- When there is a capital account deficit, more money is leaving the economy and the nation's holdings of foreign assets are growing, while when there is a surplus, more money is coming into the economy.

Trends in Balance of Payments (2001-2020):

The trends in the capital and current accounts are combined to form the trends in the balance of payments. With a trade deficit becoming the norm, India has been under pressure to maintain a positive current account balance. On the other hand, the Capital Account encourages more capital to enter the nation through borrowing, investment, and other forms of aid. Therefore, these key factors have a significant impact on the trajectory in the balance of payments. Since the current account deficit is funded by capital or financial accounts, the balance of payments is always balanced. Figure 5 shows the trends in India's balance of payments from 2001 - 20.

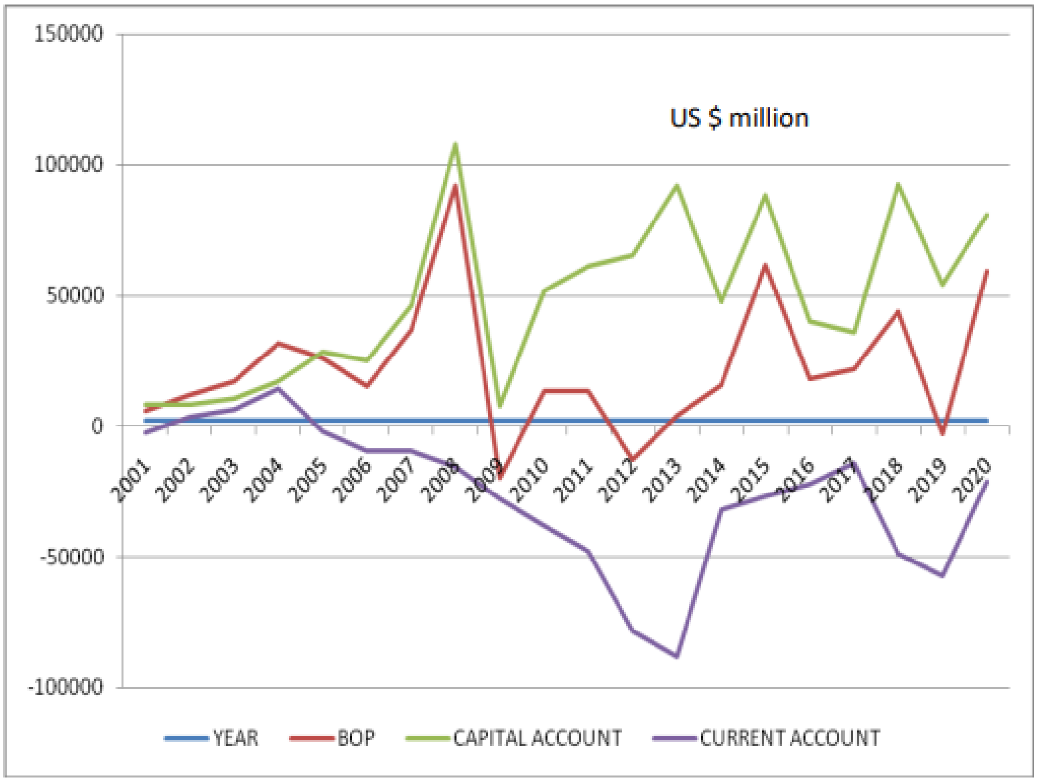

Figure 9.5: Trends in Balance of Payments
(Source: ResearchGate)

The accompanying figure 5 displays the balance of payments trend projection for India. It is evident that the Current Account and the Capital Account differ greatly from one another. The largest current account deficit was recorded in 2013, and in 2017, there were indications that the current account was improving. Nonetheless, it is anticipated that the current account deficit would increase soon. At the same time, the nation's capital account is showing a positive trend, and it is anticipated that this trend will continue in the near future. Due to a sharp decline in capital inflow after the 2008 global crisis, the Capital Account balance was insufficient to meet CAD in 2009, 2012, and 2019. In contrast, India has recovered from the recession quite rapidly. The Capital Account surplus has decreased as a result of foreign investment declining from US$60,000 in 2018 to US$41,000 in 2019. Regression analysis is used to determine which variables have a greater influence on the balance of payments.

First, the model takes into account banking capital, foreign investment, income, merchandise, services, and transfers. [11]

Table 9.1: Multiple Regression Result of Balance of Payments

Dependent variable: BOP				
Method: least squares				
Date: 03/11/21 Time: 20.26				
Sample (adjusted): 2002 2020				
Included observations: 19 after adjustments				
Variable	Coefficient	Std. error	t-statistic	Prob.
C	17380.47	6305.154	2.756550	0.0163
DFI	0.614132	0.249176	2.464646	**0.0284**
DLOANS	0.875295	0.420675	2.080689	**0.0578**
BANK_CAP	0.286867	0.532136	0.539085	0.5989
DMER	0.445941	0.240933	1.850889	0.0870
DSER	1.212490	0.793152	1.528698	0.1503
R-squared	**0.577346**	Mean depended var		23350.11
Adjusted R-squared	0.414787	S.D. Dependent var		26852.70
S.E. of regression	20542.11	Akaike info criterion		22.95043
Sum squared resid	5.49E+09	Schwarz criterion		23.24867
Log likelihood	-212.0291	Hannan-Quinn criter.		23.00091
Prob(F-statistic)	**0.0303370**			

(*Source: ResearchGate)*

The multiple regression results above make it evident that foreign loans and investment are significant. A significance level of less than or equal to 0.05 is used to quantify how the independent variable affects the dependent. The banking capital goods and services are insignificant since the P values are greater than 0.05. Additionally, the F statistic's likelihood is significant ($0.03 < 0.05$). This suggests that the Balance of Payments is significantly impacted by each of the five independent components. Up to 58% of the volatility in the balance of payments can be attributed to each of these variables. [12]

9.7 Conclusion:

An essential instrument for evaluating a nation's economic well-being and its relations with the international economy is the Balance of Payments (BoP). Economists and policymakers can assess a country's overall financial stability, investment flows, and trade performance by examining its capital and current accounts. A nation's balance of payments is a crucial idea in its economics, and it is composed of several different elements. Since a surplus in the capital account will balance a deficit in the current account, and vice versa, the balance of payments cannot be negative. However, because it indicates a high reliance on imports and foreign investment in the nation, a balance of payments imbalance is viewed as detrimental to the economy. Few nations in the modern world are self-sufficient in the sense that they manufacture all of the commodities and services they require. The variables that lead to disequilibrium in the balance of payments are population expansion, the demonstration effect, cyclic variations, natural factors, globalization, and inflation. For policymakers, managing BOP is still a difficult task. The goal of the New Economic Policy of the 1990s was to open up the economy, allow free trade and competition, and significantly reduce the involvement of the government in matters pertaining to international trade.

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