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Question 1. Explain the concept of balance of payments. How is it classified? Describe salient features of India's balance of payments.

Solution1: Balance of payments refers to all economic transactions between domestic and foreign residents over a stipulated period generally one year. The analysis of balance of payment is immensely useful for the policy makers and business communities. Moreover, it is an important instrument for maintaining external economic stability, **A** close understanding of dependence of international business upon balance of payments is necessary for successful strategy of international business. The balance of payment is broader than the balance of trade for it includes not only visible items but also invisible items. Hence, the balance of payments presents a better picture of a country's economic and financial transactions with the rest of world than the balance of trade. Balance of payment is a comprehensive and systematic record of all economic transactions between the residents of a country and the rest of the world. It presents an account of all receipts and payments on account of goods exported, services rendered and capital received by residents/Government of a country (inflows from abroad) and goods imported, services received and capital transferred by the residents/ Government of a country (outflows abroad).

Balance of Payment Claasification

In balance of payments accounting the balance of payments should be zero because every transaction is two- sided with debits balancing credits. But in practice, the balance of payments will not always be equal to zero. This can be due to, among other things, a country's central bank

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engaging in transactions that are not counted towards the country's balance of payments, or the lack of available statistical data to record all transactions. Balance of payments is classified as: (i) balance of payment on current account, and (ii) balance of payment on capital account.

Current Account: The balance of payment on current account record the current position of the country in the transfer of goods, services, and merchandise as well as invisible items, donations, unilateral transfers, etc. Current account is like an income and expenditure account, Surplus or deficit in current account is transferred to capital account which is like a balance sheet and thus balances itself in historic sense,

Capital Account: Balance of payments on capital account shows the country's financial position in the international scenario, the extant of accumulated foreign exchange reserves, foreign assets and liabilities and the impact of current transactions on international financial positions. The changes in foreign exchange reserves arising out of current account transactions are included in the capital account in order to find out the exact foreign exchange reserve. The capital account provides relief to deteriorating balance of payment positions. Its favourable effect depends upon the availability of net capital transfers, i.e., gross inflow of capital minus Payment by way of amortisation. In short, capital account reflects changes in foreign assets and liabilities of the country and affects its creditor/ debtor position. Net changes in current account are reflected by a corresponding opposite change in the capital account, changing the foreign assets and liabilities position of the country.

Balance of Payments Deficits: In India, balance of payment deficits has been largely caused by excess of imports over exports in merchandise. At times and to a small extent the deficits have been in invisible trade also. The major source of deficits has been the rising obligations to meet amortisation payments. This has involved large sums the return of loans which became due and the large interest payments thereon. Large withdrawals from non-resident accounts also contributed to deficits.

On June 21, 1991 when the new Government took the office, it inherited the economy in deep crisis. The balance of payments situation was precarious, with reserves at a low level and the weakening of international confidence having resulted in a sharp decline in capital inflows through commercial borrowing and non-resident deposits. The crisis in the Middle East had exacerbated the situation by contributing to higher oil import bill in 1990-91 and the temporary loss of exports markets and remittance earnings. Structural reforms encompassing the industrial sector, the foreign trade and foreign investment were taken. From 1991 the country embarked on **a** liberalised trade regime with a short negative list of imports, removal of quantitative restrictions for all goods except consumer goods, a phased reduction in customs duties, an adjustment in the exchange rate through a two-step devaluation of the rupee in July 1991 and the movement to a market determined exchange rate. The policy towards foreign portfolio investment has also been substantially liberalised. Foreign investment policy was modified to eliminate barriers, alignment of taxes with international levels and transparency with full repatriation benefits and investor protection.

The structural reforms were aimed at integrating industrial, trade and exchange rate policies to enhance the efficiency in the economy. The beneficial effects of these measures are reflected in a robust export and invisible growth. The post 1991 period has seen a surge in capital flows resulting in growth of foreign exchange reserves.

SALIENT FEATURES OF INDIA'S BALANCE OF PAYMENTS

From the above analysis, the following salient features emerge:

1. India has always faced trade deficits except in 1972-73 and 1976-77 where there was a small surplus.
2. Trade deficit has been rising from plan to plan with the exception of the fourth plan when the trade deficit declined.
3. The rate of growth of exports has been fluctuating from plan to plan.
4. Net invisible receipts have been positive.
5. The crisis in the balance of payments during **1990-91** and in the first quarter of 1991-92 necessitated the mobilisation of additional external funds to fill the gap. The task of the government became particularly difficult in the context of the dwindling international faith in our economy. In the end, the Government could mobilise substantial additional financial resources from the IMF, the world Bank and the bilateral donors, specially Japan.
6. Fiscal deficit not only affects the prospects for growth and stability but has a vital bearing on the balance of payment strategy. **A** strategy for ensuring a viable balance of payments requires correction in fiscal imbalance as well.
7. There has been a low level of utilisation of external assistance, resulting in a substantial part of authorised loans being in the pipeline. The main factor for under utilisation of assistance is due to the time lag between commitments and conclusions of specific credit arrangements, time consuming procedures and domestic budgetary constraints in providing counterpart funds.
8. The emergence of a number of independent states out of the erstwhile **USSR** are bound to affect the country's exports adversely. Thus, India's balance of payments continue to be under strain.
9. The underlying weakness of the balance of payments remained. The falling support from net invisible receipts resulting from interest payments, the poor industrial and export performance and high rate of inflation stood in the way of achieving a sustainable balance of payments