Vol. 3 Issue-10, June 2023 (e-ISSN: 2582-8223)

Components of India's Balance of Payments: Trends and Dynamics

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ARTICLE ID: 17

Introduction:

The balance of payments (BOP) is a comprehensive record of all economic transactions between residents of a country and the rest of the world over a specific period, typically one year. It's important to note that the balance of payments always balances, meaning that the sum of the accounts is always zero. If a country has a surplus on one account, it will have a corresponding deficit on another account, and vice versa. It provides valuable insights into a country's international trade, financial flows, and overall economic health. In this aspect, a detailed breakdown of the components of the balance of payments is listed below.

1. Current Account:

The current account captures transactions related to the flow of goods, services, income, and unilateral transfers. It consists of components:

1.1. Merchandise/Goods: Merchandise refers to tangible goods that are traded between countries. The merchandise trade balance is a sub-component of the current account and measures the difference between a country's exports and imports of goods.

Merchandise Trade Balance = Exports of Goods - Imports of Goods

1.1.1. Exports of Goods: Exports of goods represent the value of tangible products that are produced within a country and sold to foreign countries. It includes items such as machinery, vehicles, consumer products, raw materials, and agricultural commodities. The value of exports is recorded in the balance of payments based on the FOB (free on board) value, which includes the cost of the goods at the point of export and excludes transportation and insurance costs.

1.1.2. Imports of Goods: Imports of goods refer to tangible products that are purchased by a country from foreign countries. It includes items that are not

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produced domestically or are more cost-effective to import. Like exports, the value of imports is recorded in the balance of payments based on the CIF (cost, insurance, and freight) value, which includes the cost of the goods, transportation, and insurance.

1.2. Invisibles: Invisibles refer to intangible items or services that are traded between countries. They are also known as "services" or the "balance of services" component of the current account. Invisibles encompass various types of non-physical transactions and can be further classified into different categories**.** The main categories include:

1.2.1. Services: It refers to intangible economic activities provided by one country to another. They include sectors such as tourism, transportation, financial services, software development, consulting, education, healthcare, and entertainment. The balance of services records the difference between a country's exports and imports of services.

Balance of Services = Exports of Services - Imports of Services

A positive balance of services indicates a surplus, meaning that a country earns more from exporting services than it spends on importing them. Conversely, a negative balance of services indicates a deficit, indicating that a country spends more on importing services than it earns from exporting them.

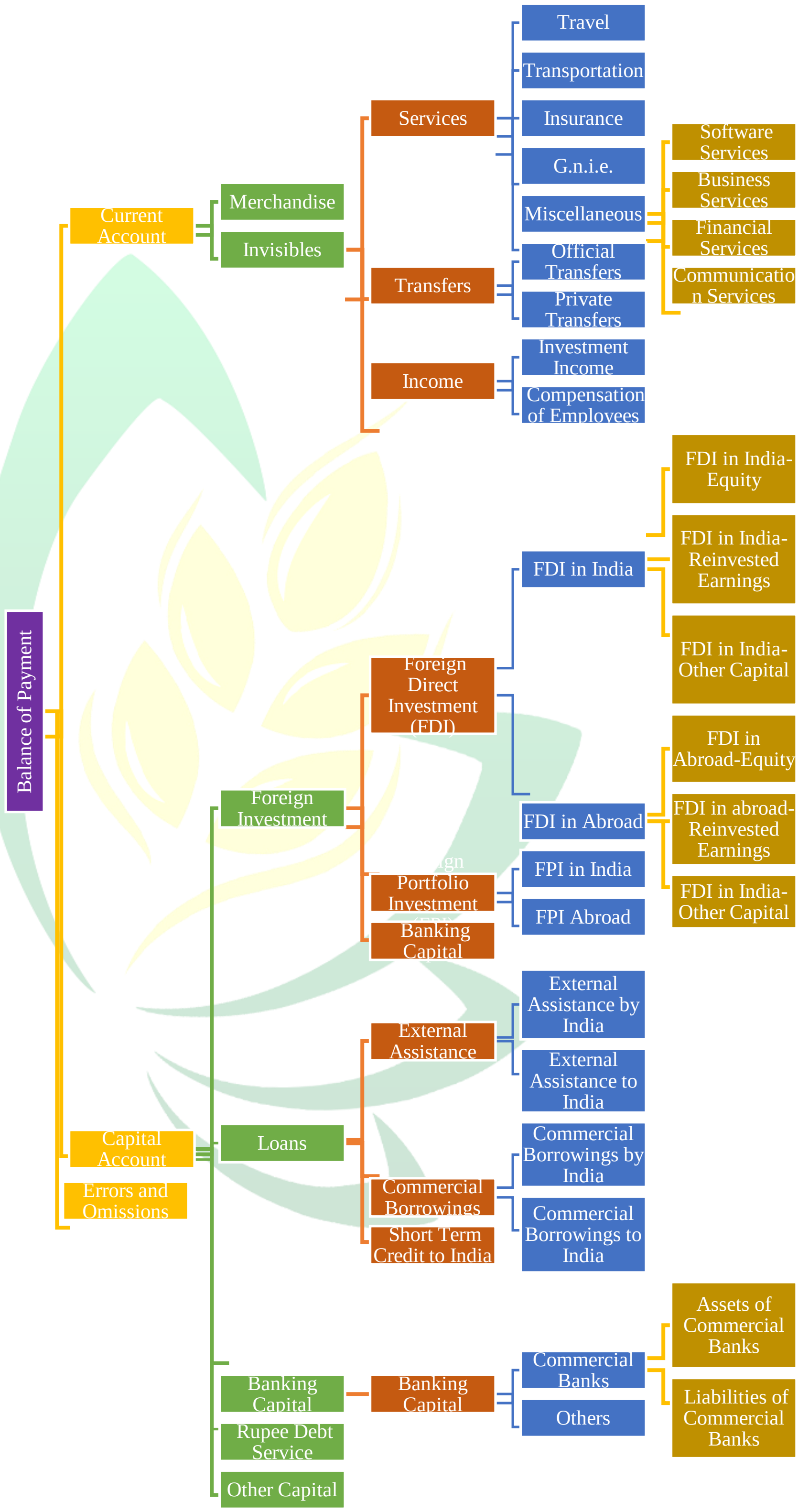
1.2.2. Transfers: Transfers represent unilateral transfers of funds without any direct economic exchange. They include items such as foreign aid, grants, remittances from overseas workers, and donations. Transfers can be both inflows and outflows, depending on whether the country is receiving or making the transfer.

Balance of Transfers = Transfers Inflows - Transfers Outflows

A positive balance of transfers indicates that a country receives more transfers (inflows) than it makes (outflows). Conversely, a negative balance of transfers implies that a country makes more transfers (outflows) than it receives (inflows).

1.2.3. Income: The income component of invisible represents income flows resulting from investments abroad. It includes income earned by residents of a country from their investments in foreign countries (income receipts) and income paid to foreign investors from their investments in the country (income payments). Income includes items such as wages, salaries, dividends, interest, and profits.

Fig.1: Tree diagram of components of the balance of payments



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Balance of Income = Income Receipts - Income Payments

A positive balance of income implies that a country receives more income from its investments abroad than it pays out to foreign investors. Conversely, a negative balance of income indicates that a country pays out more income to foreign investors than it receives from its investments abroad.

2. **Capital Account:** It helps measure a country's international transactions. The capital account records the flow of funds between a country and the rest of the world related to capital transfers, including both financial and non-financial assets that involve changes in ownership of non-produced, non-financial assets, such as land, patents, copyrights, trademarks, and mineral rights. It also includes capital transfers, which involve the transfer of ownership of financial assets or the forgiveness of debt, without any corresponding economic activity. It is primarily concerned with measuring cross-border movements of capital, which can include some key components:

2.1.Foreign investment: It refers to the acquisition of assets or ownership stakes in a country by entities or individuals from other countries.

2.1.1. Foreign Direct Investment (FDI): FDI refers to the investment made by a foreign entity in a domestic enterprise, involving a lasting interest and a significant degree of influence or control. FDI transactions, such as the acquisition of shares in a foreign company or the establishment of a new subsidiary abroad, are recorded in the capital account.

2.1.2. Portfolio Investment: Portfolio investment involves the purchase and sale of stocks, bonds, and other financial assets, typically to earn a return. These transactions are considered part of the capital account.

2.2.Loans: International loans, both short-term and long-term, are recorded in the capital account. This includes borrowing and lending between governments, commercial banks, and other entities.

2.3.Banking capital: It represents cross-border movements of funds related to banking activities. It includes transactions involving banks and other financial institutions that result in changes in the ownership of financial assets.

2.4.Rupee debt service: It refers to the repayment of debt denominated in the domestic currency of a country, which, in this case, is the Indian rupee (INR). In the balance of

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payments (BOP) framework, rupee debt service is a component of the current account and represents the payments made by a country to service its outstanding debt obligations in domestic currency.

2.5.Other Capital Flows: This category covers various capital transfers that do not fit into the above components. It can include debt forgiveness, transfers of ownership of fixed assets, compensation for non-produced resources (e.g., natural resources), and other miscellaneous items.

3. **Errors and Omissions**: It is a category that accounts for discrepancies or unrecorded transactions that arise during the process of compiling and measuring the various components of the BOP. It serves as a balancing item to ensure that the BOP equation is satisfied and that all recorded transactions are in balance. These can arise due to the reasons of statistical discrepancies, timing differences in the recording of transactions, smuggling, informal trade, data adjustments, and revisions. These are typically recorded as a balancing item in the BOP to ensure that the overall BOP equation is balanced.

Current Account Balance + Capital Account Balance+ Errors and Omissions = 0

By including the errors and omissions category, any unrecorded or unexplained discrepancies are accounted for, thereby maintaining the balance in the BOP equation.

Compound Annual Growth Rate (CAGR) of the components ofthe balance of payments:

CAGR is a measure of the average annual growth rate over a specific period. It is commonly used to analyse the growth of various economic indicators, including the balance of payments (BOP).In the context of the Indian BOP for different components and aggregates of the BOP over a period from the year 1990-91 to 2021-22. It indicates the average annual growth rate of these components.

CAGR = (Ending Value / Beginning Value) ^ (1 / Number of Years) - 1

Table 1: CAGR of the components of the balance of payments:

	CAGR (1990-91 to 2021-22)	Credit	Debit
I.	**Current Account**	12.79	12.60
1	Merchandise	11.90	12.49
2	Invisibles	14.10	12.92
II.	**Capital Account**	14.62	15.48

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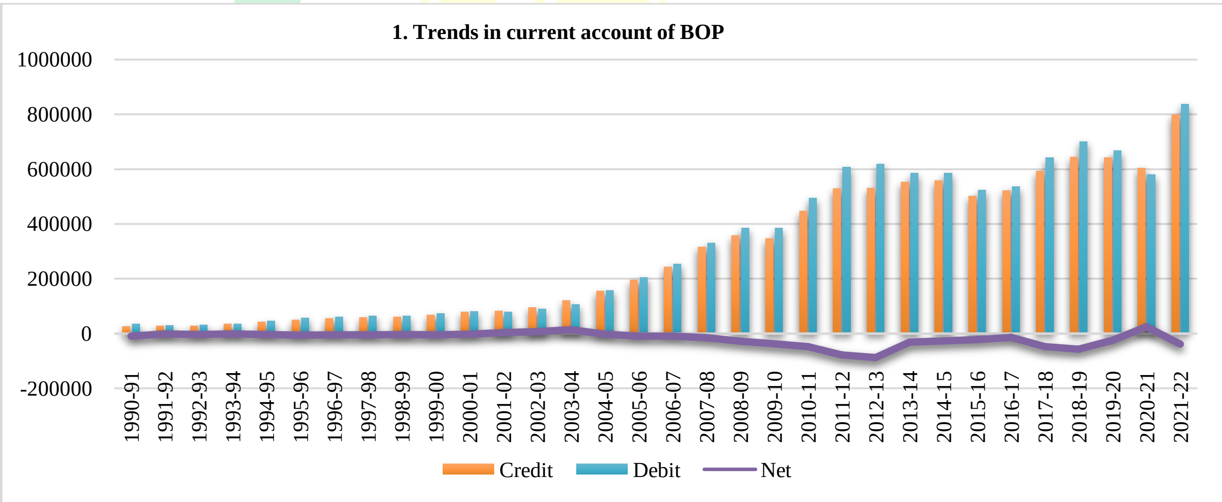
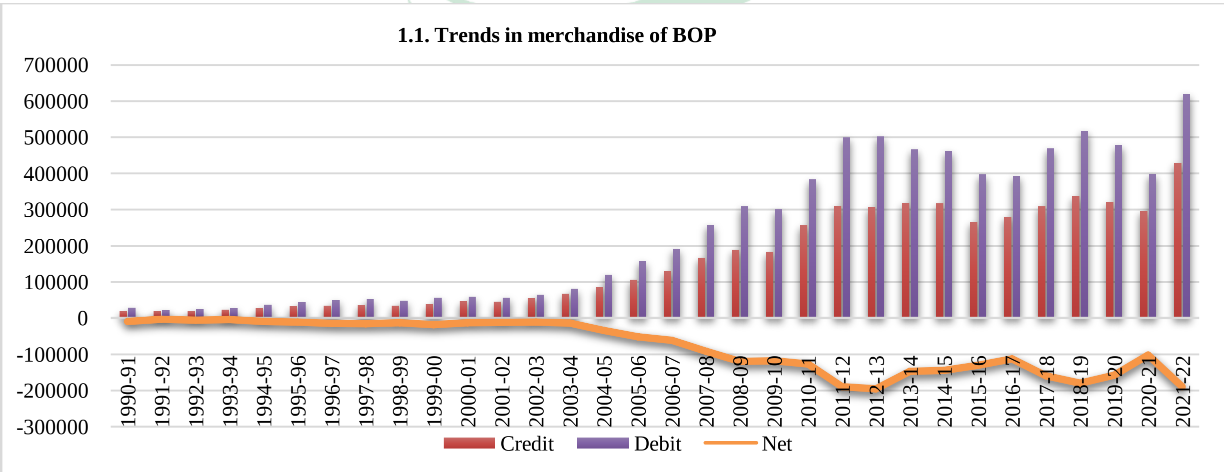
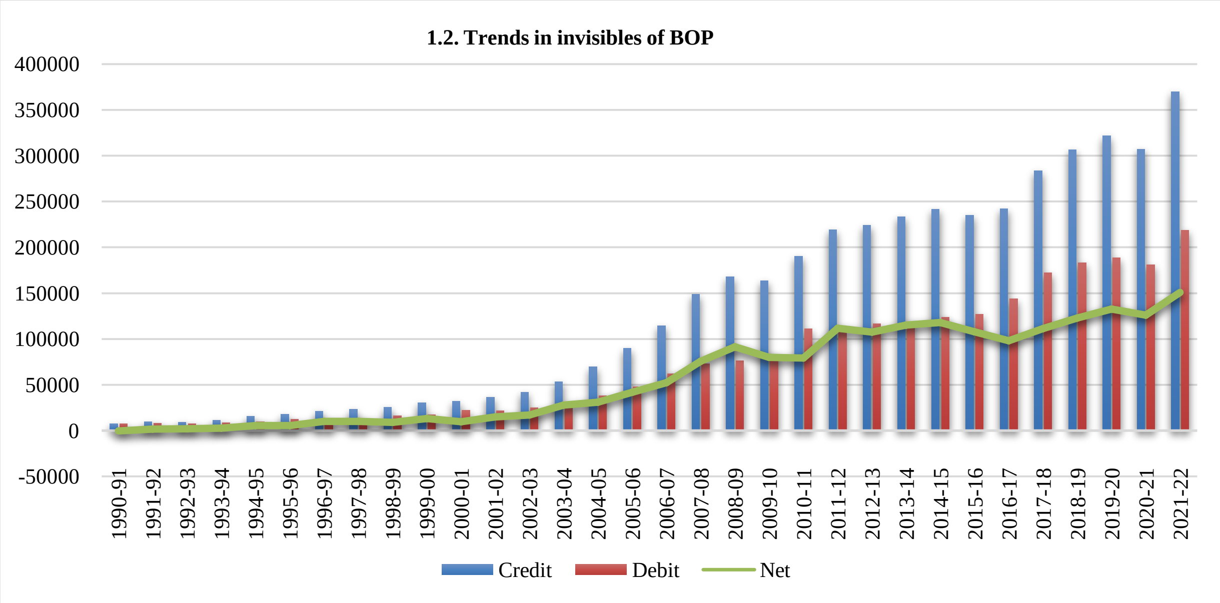
1	Foreign Investment	25.86	35.15
2	Loans	10.93	11.69
3	Banking Capital	10.73	11.29
4	Rupee Debt Service	-	-11.33
5	Other Capital	12.88	15.04
	Overall, Balance	13.58	13.67

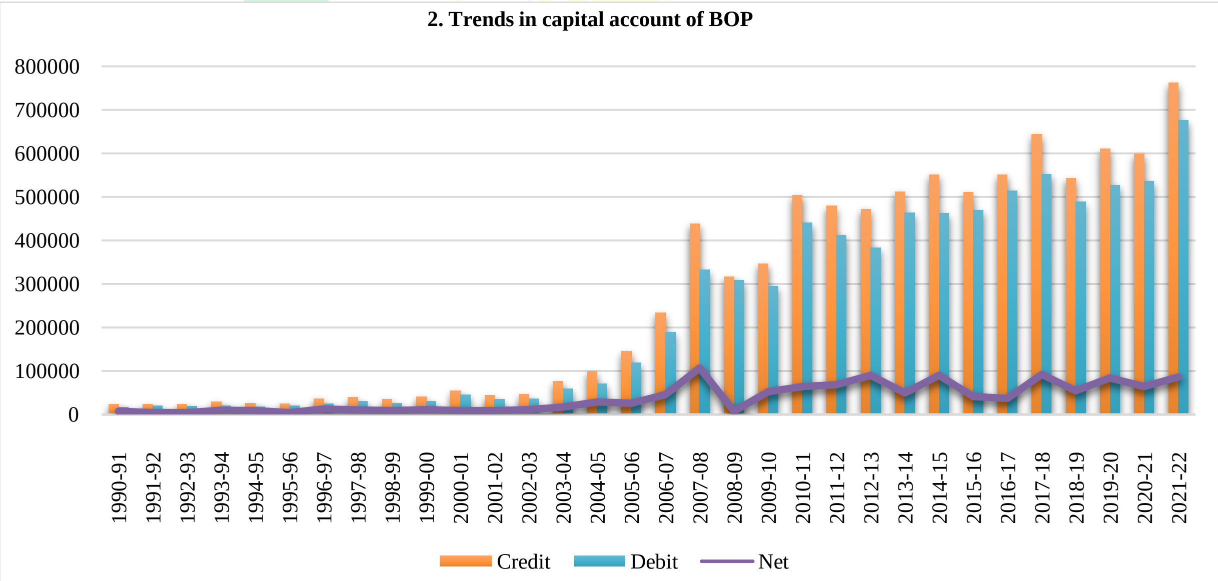
The highest CAGR is seen in foreign investment at 25.86% for credit/inflows and 35.15% for debit/outflows, and a negative CAGR is seen in rupee debt service at 11.33. Overall, the total value of funds received by the country from international transactions has been growing at an average annual rate of 13.58%. Similarly, the total value of funds paid by the country has been increasing at an average annual rate of 13.67% over the same period.

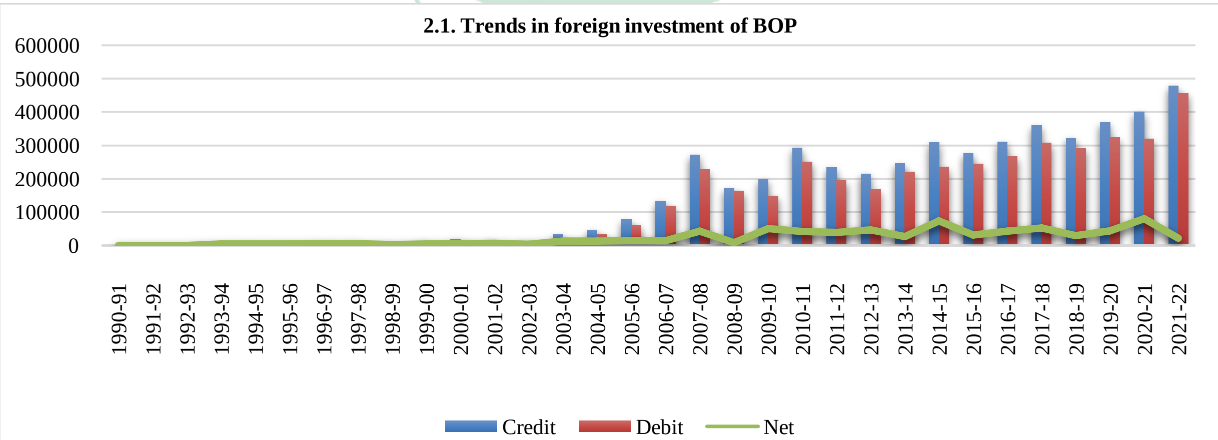
Fig. 2. Trends in India's Balance of Payments Components (1990-91 to 2021-22)



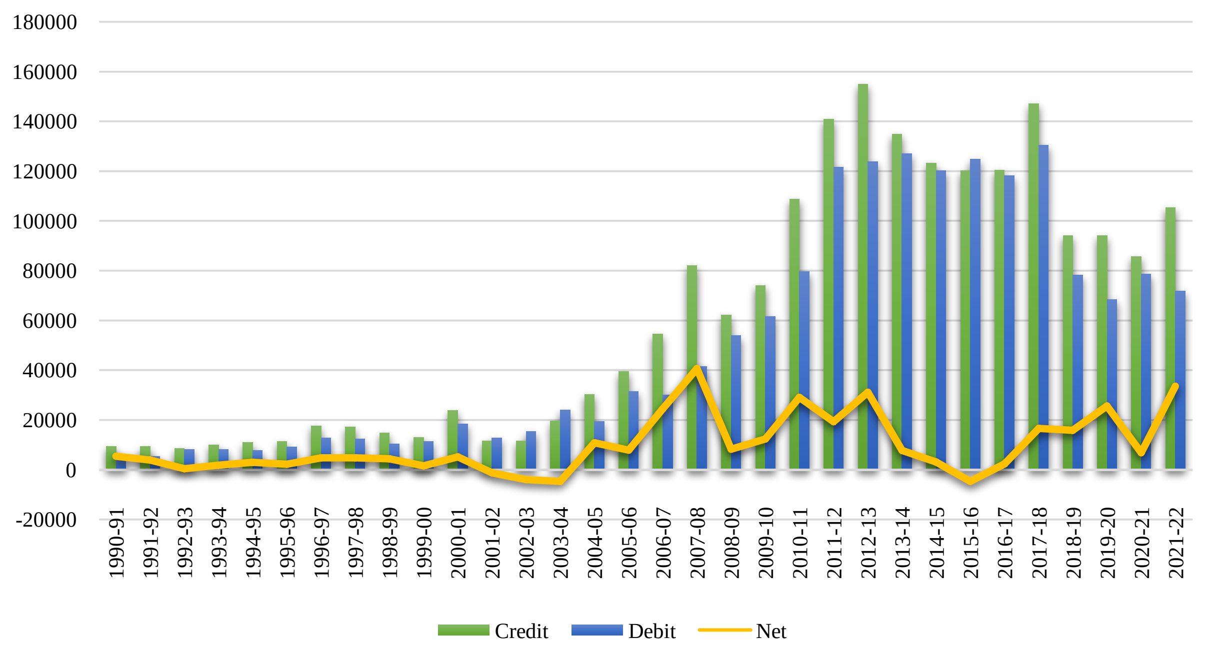



1.2. Trends in invisibles of BOP
400000
350000
300000
250000
200000
150000
100000
50000
0
-50000
1990-91 1991-92 1992-93 1993-94 1994-95 1995-96 1996-97 1997-98 1998-99 1999-00 2000-01 2001-02 2002-03 2003-04 2004-05 2005-06 2006-07 2007-08 2008-09 2009-10 2010-11 2011-12 2012-13 2013-14 2014-15 2015-16 2016-17 2017-18 2018-19 2019-20 2020-21 2021-22
Credit
Debit
Net

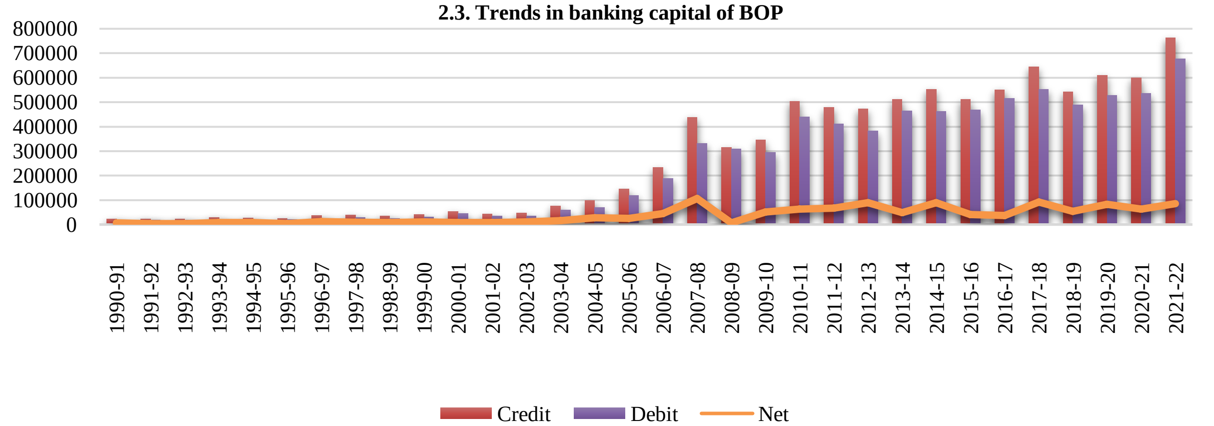

2. Trends in capital account of BOP
800000
700000
600000
500000
400000
300000
200000
100000
0
1990-91 1991-92 1992-93 1993-94 1994-95 1995-96 1996-97 1997-98 1998-99 1999-00 2000-01 2001-02 2002-03 2003-04 2004-05 2005-06 2006-07 2007-08 2008-09 2009-10 2010-11 2011-12 2012-13 2013-14 2014-15 2015-16 2016-17 2017-18 2018-19 2019-20 2020-21 2021-22
Credit
Debit
Net


2.1. Trends in foreign investment of BOP
600000
500000
400000
300000
200000
100000
0
1990-91 1991-92 1992-93 1993-94 1994-95 1995-96 1996-97 1997-98 1998-99 1999-00 2000-01 2001-02 2002-03 2003-04 2004-05 2005-06 2006-07 2007-08 2008-09 2009-10 2010-11 2011-12 2012-13 2013-14 2014-15 2015-16 2016-17 2017-18 2018-19 2019-20 2020-21 2021-22
Credit
Debit
Net

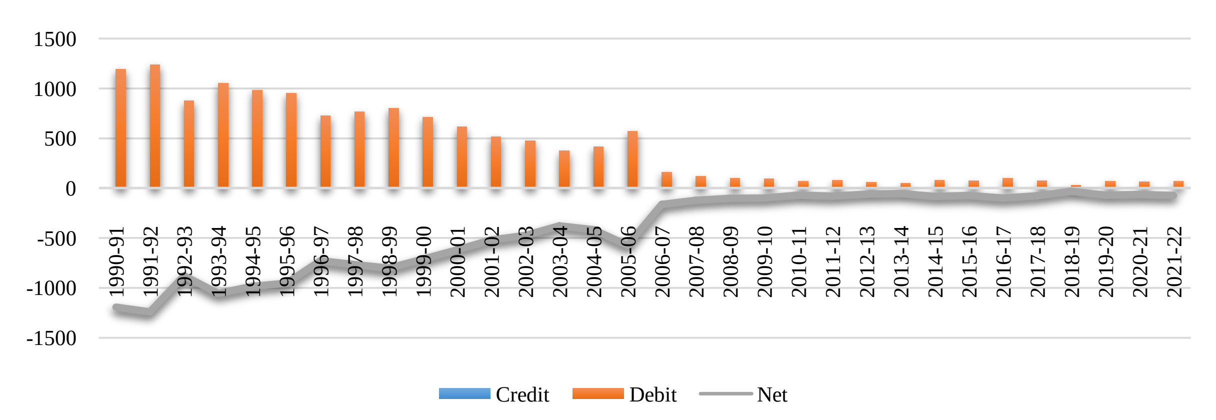
2.2. Trends in loans of BOP

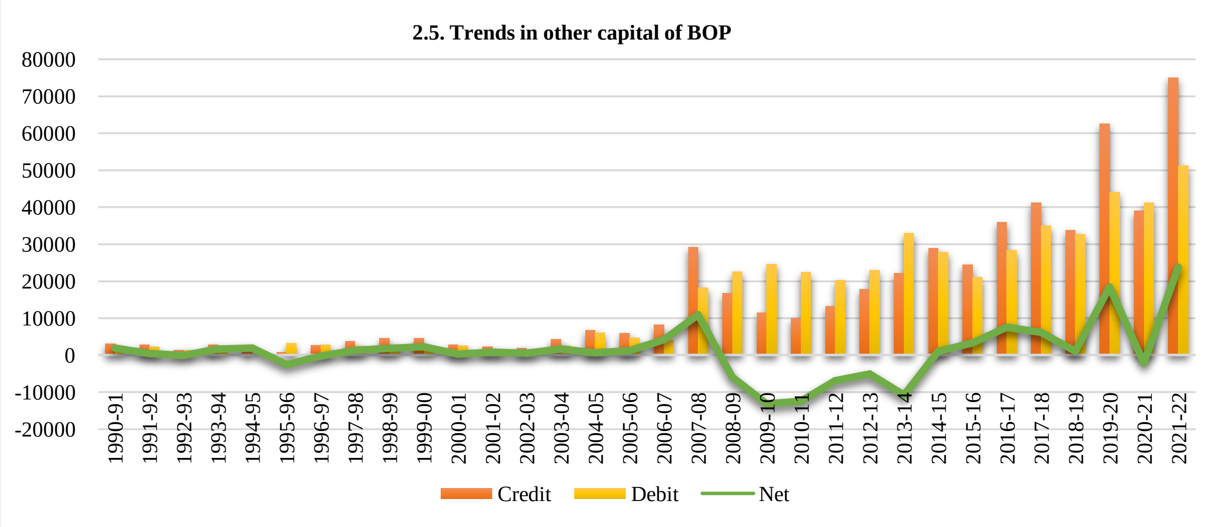


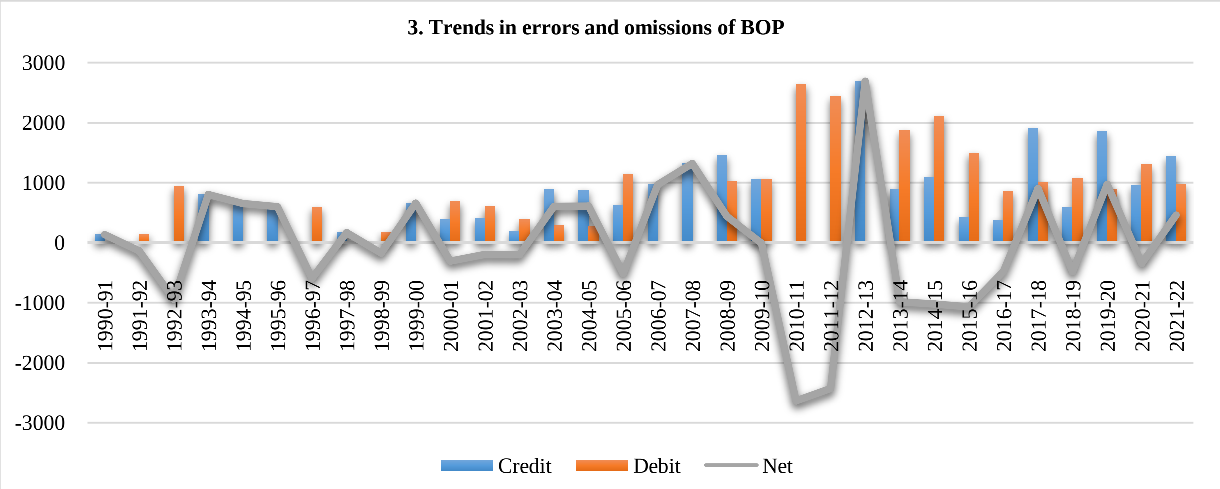
2.3. Trends in banking capital of BOP

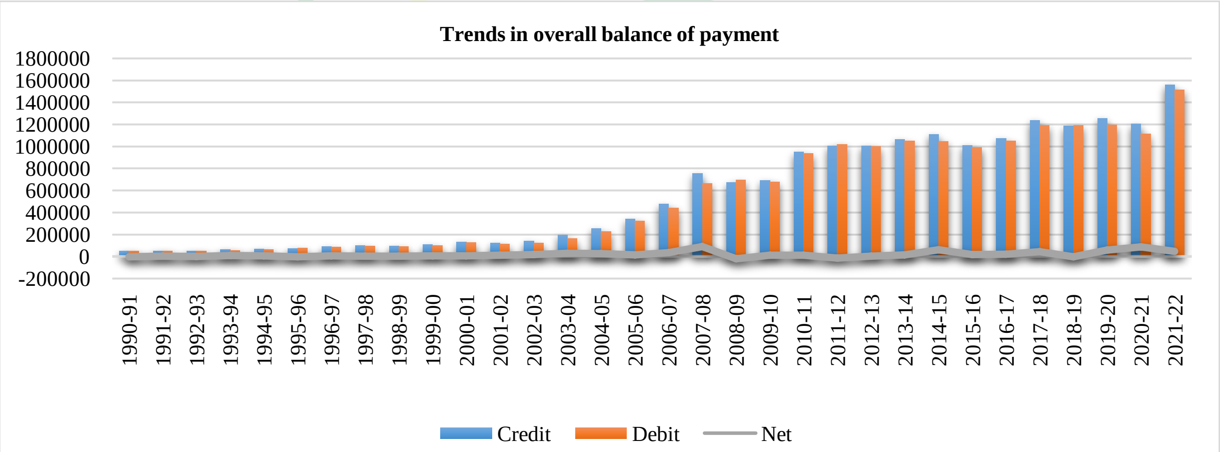


2.4. Trends in rupee debt service of BOP









Note: X-axis indicates year and the y-axis indicates US$ Million

Conclusion:

The trends in the components of the balance of payments for the country show the highest negative net value in merchandise trade compared to other components, which indicates a trade deficit, which implies that the country is spending more on imported goods than it is earning from exporting its own goods. An improvement in rupee debt services suggests that the country's ability to service its debt has strengthened over the years, with a positive net value in invisible and an overall positive balance. These trends suggest that the country has been experiencing a trade deficit but has been able to manage its debt obligations, earn more from services and other transactions, and maintain a surplus in its balance of payments by receiving more payments from the rest of the world than it has made. A surplus suggests that the country is a net lender to the rest of the world, accumulating foreign assets and strengthening its international financial position. However, it's important to note that a positive BOP doesn't necessarily guarantee economic prosperity, as it depends on other factors such as the sustainability of the surplus and the country's overall economic performance.