OPEC - Organisation of Petroleum Exporting Countries

PIO - Persons of Indian Origin

PSE - Public Sector Enterprises

PSU - Public Sector Undertakings

RBI - Reserve Bank of India

SDR - Special Drawing Rights

SLR - Statutory Liquidity Requirement

WTO - World Trade Organisations

CHAPTER I

INTRODUCTION
The annual statement of a nation’s total international trading and of its international financial transaction is known as its Balance of payments.¹

“The balance of payments is a statistical statement that systematically summarizes, for a specific time period, the economic transactions of an economy with the rest of the world”.²

**Balance of Payments**

A record of economic transactions in the current account between the residents of India and the rest of the world involving the export and import of goods, the rendering of services and the exchange of gifts. The capital account reveals the implications of the current transactions of a country’s international creditor cum debtor position. Capital movements reflect changes in the ownership of capital assets between residents of a country and foreigners.

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Structure of Balance of Payments

The balance of payments of a country is an annual record of its monetary transactions with other countries of the world. It is an important index, which reflects the true economic position of a country and whether the country is a creditor country or a debtor country and the fact whether its currency is rising or falling against its external value in relation to the other foreign currencies.

India’s balance of payments could be classified into three broad categories:

1. Balance of payments on current account
2. Balance of payments on capital account

The valuation basis for calculating the balance of payments is the free on board (f.o.b) at the customs frontier of the exporting country for calculating exports and cost insurance, freight (cif) at the customs frontier of the importing country for imports.

(i) **F.o.B value:** The value in the market at the customs frontier of a country of her exports of merchandise and other goods including all costs of transporting the goods to the customs frontier, export duties and the cost of loading the goods on the carriers unless the latter cost is borne by the carrier.
(ii) **C.I.F value:** The value in the market at the customs frontier of a country of her imports of merchandise, other goods, and the like, including all charges for transporting and the insuring of the goods from the country of export to the importing country but excluding the cost of the unloading of the goods from the ship, aircraft, and such other carriers, unless such expenses are borne by the carriers themselves.³

### I. Current account

The current account includes all the receipts on account of earnings of a country and all the payments made on account of spending.

Trade account and invisibles account put together constitute the current account. In other words, by taking the balance of trade and balance of invisibles together, we get the balance in the current account. The current account of balance of payments records all transactions relating to sale and purchase of all visible items and all transactions related to invisible items.

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(A) Merchandise

1. Exports

All transfers of the ownership of all the goods from the residents of a country to the non-residents and all the services provided by resident producers of a country to the non-residents should be covered. In practice, the exports of goods may consist of the outward movement of merchandise across the customs frontier of a country and of other goods across the boundaries of her domestic territory, including the direct purchases in the country of extra-territorial organization and non-residents. Since the import of merchandise into a country is to be valued at c.i.f, the exports of services of the country should also include the charges in respect of the imports for the transport and insurance services provided by the resident producers of the exporting country.

The target of doubling the share of merchandise exports

The foreign trade policy of India announced on the 31st of August 2004 has set the target of doubling India’s share in world trade by the year 2009.

There are four ways by which the target of doubling the share of India’s merchandise exports in world trade could be achieved.
The first strategy is to adopt the attitude that country need not “tax exports” and should thus neutralize the disadvantage caused by the domestic taxation of inputs to exporters through tax drawbacks or duty free imports.

The second method is to adopt promotional policies such as the provision of infrastructural facilities, the revamping and revitalizing the board of trade; the launching of special schemes in key export areas and the introduction such other measures.

The third measure is through strengthening the export processing zones and the export oriented units through schemes, which provide special concessions to specialized exporting units.

The fourth approach is to provide economic incentives in the form of duty free import concessions, some of which are in the form of tied up imports to exporters and the exporting units.

2. Imports

All transfers of the ownership of goods from the non-residents of a country to the residents and all the services provided by the non-resident producers to the residents of a country constitute the imports. In practice, the imports of goods may consist of the inward movement of merchandise across the customs frontiers of a country and of other goods across the boundaries or her domestic territory, including, of course, the direct
purchases of the government of the services and those of the residents of the country abroad. Since imports of merchandise are valued on the basis of c.i.f, imports also include the charges of the resident producers for transport and insurance services in respect of these imports.

3. Balance of Trade

Balance of trade is only one segment of the composition of balance of payments. It simply refers to the difference between the value of the visible exports and the visible imports. The trade account of the balance of payments includes exports and imports of the goods in one year. The difference between the value of the exports of goods and the value of the imports of goods is referred to as the balance of trade.

The trade account includes exports and imports of goods only and to the exclusion of the services. Exports and imports of goods are also referred to as the transactions of the visible items or the merchandise. Therefore, balance of trade is also called ‘balance on visible’.

(A) Invisibles

The income earned from the sale of Indian services abroad is known as invisibles. Services are a part of invisibles which include shipping, banking, insurance and
consultancy services, foreign travel, investment income, transfer payments and the like. These could be elaborated as follows:

(i) Services - Banking, Insurance, Shipping Etc.:

Services such as banking, insurance, shipping, consultancy services and the like are provided by one country to other countries. When a country gets such services from other countries, it is equal to the import of services for which payments in foreign currencies have to be made. When a country provides these services to other countries, it is similar to exports of services for which it receives payments in terms of foreign currencies.

(ii) Foreign Travel

Tourism is another source of receipts as well as payments in terms of foreign currencies. When foreign tourists visit a country, it results in the receipts of foreign currencies, which the tourists spend during their stay in the visiting countries. Similarly, when people in one country visit other countries, they require foreign currencies for their spending in those countries. This results in an outflow of foreign currencies.
(iii) Investment Income

A country may receive interest on loans given by it to other countries. It may also receive dividends on investments made by its people from other countries. These receipts are also in the form of foreign currencies. Similarly, payment of interest and dividends on loans and investments by the people of other countries results in the outflow of foreign currencies.

(iv) Transfer Payments

People living in a country may receive gifts from their friends and relatives living abroad. These come under the category of 'unilateral transfers'. Similarly people living in a country may be sending gifts to their relatives and friends living abroad. Such transfer payments also result in the inflow and the outflow of foreign currencies.

Government transfers

Foreign economic aid or assistance and foreign military aid or assistance received by the government of a country come under the category of government-to-government transfers.
Private Transfers

Private transfers are funds received from abroad or remitted in foreign countries between persons living in different countries (on person-to-person basis).

The difference between the total receipts and total payments of the foreign currencies on the invisibles is called balance on account of invisibles. If the receipts on account of invisibles are greater than the payments made of the invisibles, then there will be a surplus in the balance on the invisibles. On the other hand, if the foreign exchange receipts on account of the invisibles are less than the foreign exchange payments on this account, then there will be a deficit in the balance on invisibles.

II. Capital Account

The balance of payments in the capital account shows the implications of the current transactions on the international financial position of country. For instance, the surplus and the deficit of the current account get reflected in the capital account through the changes in the foreign exchange reserves of the country, which indicate the current strength or weaknesses of international payments position of a country.
The capital account records all the inflows and the outflows of capital of a country. These flows of capital may be in the form of borrowings from or lending to the other countries and the receipts and payments of capital on account of the sales and the purchases of the shares and the securities between countries.

The items included in the capital account could be categorised as

1. Autonomous capital transactions, and
2. Accommodating capital transactions.

**a) Autonomous Capital Transactions:**

Investments made by foreigners in a country result in the inflow of capital in the form of foreign currencies. Similarly investments made by the people of a country in other countries will result in the outflow of capital in foreign currencies. Such investment decisions are based on the expectations of the investors on the profitability of their investments. These flows are not as a result of the deficit or surplus in the current account of the balance of payments account of a country. Hence these are referred to as autonomous capital transactions. Thus due to the autonomous transactions in capital account, there might be a net inflow or outflow of foreign exchange in a country. This balance along with the balance on current account shows the total deficit or the total surplus in the balance of payments position. This surplus or deficit is used for accommodating capital transactions. The items in the capital account of BOPs could be categorised as autonomous and accommodating transactions. Those transactions, which
take place independently of the deficit or surplus in the current account of BOP are called autonomous transactions, while accommodating transactions are those which are motivated by the deficit or surplus in the current account of BOPs.

The balance in current account and the balance of autonomous capital transactions taken together will reveal the overall BOP position of a country. The overall deficit or surplus results in accommodating capital transactions, which remove the surplus or deficit and the balance of payments account is balanced through such accommodating transactions.

b) Accommodating Capital Transactions:

Those transactions, that take place due to the deficit or the surplus in the balance of payments position is called accommodating capital transactions. If a country has a deficit in the balance of payments, it discloses that the total receipts of its foreign exchange earnings fall short of the total payments that the country should make in foreign exchange. This deficit should be covered by the assistance from foreign governments or from international institutions such as the International Monetary Fund. Such receipts of foreign exchange represent the accommodating receipts. However, if the deficits were not fully covered by such an accommodation process, then the balance of deficit will have to be covered by withdrawals from its stock of foreign exchange reserves. This would lead to a fall in the foreign exchange reserves of the country. Similarly if the position of balance of payments of a country shows a surplus, then it may result in the
accommodating transactions taking the form of external assistance or an increase in its foreign exchange reserves. Sometimes both might take place.

Thus the capital account includes foreign investment, external assistance, commercial borrowings, rupee debt service, NRI deposits as other capital.

Foreign investments could be in two forms; foreign equity investors may simply buy a stake in an enterprise or take a direct interest in the management of the company. The first category, which is an indirect form of investment, designated as Foreign Portfolio Investment (FPI). Foreign Direct Investment (FDI) will imply more than just buying shares or securities of companies. It takes into account the amount of finances provided by a foreign owner, who will also get directly involved in the management of the enterprise.

External commercial borrowings in the form of loans from the international banks, bond placements, trade related credits and institutional credit lines were essentially a phenomenon of the eighties. In fact of deterioration in the utilization of the external assistance and the persistently huge deficits in the current account had resulted in the emergence of the commercial borrowings as an effective alternative source of external assistance.
For the category of direct investment, there were directional distinctions (abroad or in the reporting economy) and in the equity capital, other forms of capital, and in the financial derivative components, which were within this category, there were assets or liabilities distinctions.

In particular, for portfolio investment and other forms of investment there was a distinction between the various types of instrument (equity or debt securities, trade credits, loans, currency and deposits, and other assets or liabilities instruments). In this category, the manual, traditional and the new money market instruments and other financial instruments form a part and parcel of portfolio investment.

For portfolio investments, financial derivatives and for other investments there were distinctions by the sector of the domestic creditor for assets or by the sector of the domestic debtor for liabilities. These distinctions serve to establish and facilitate links with the income accounts, the international investment position, and other statistical systems.

The traditional distinction, which was based on the original contractual maturity period of more than a year and one year or less between a long and short-term assets and liabilities, classification was applicable only to other investment categories. In
recent years, the significance of this distinction had clearly diminished in its importance for many domestic and international transactions. However, as the maturity period continues to be important for specific purposes and for analysis of external debt, the classification also continues to be retained in the manual for other investments.

Direct investment reflecting the lasting interest of a resident individual in an economy (direct investor) on residents in another economy (direct investment enterprise) covers all transactions between the direct investors and the direct investment enterprises. That is, the direct investment covers the initial transactions between the two entities and in all-subsequent transactions between them and also among affiliated enterprises both incorporated and unincorporated. Direct investment transactions occurring in foreign countries and in the reporting economy are being further sub-divided and classified into equity capital, reinvestment of earnings. Other forms of capital investment, which were inter-company transactions and financial derivatives, claims on, and liabilities to the affiliated enterprises and to the direct investors, have also been distinguished. Transactions between the affiliated banks and between other affiliated financial intermediaries are restricted to the category of equity and permanent debt capital.
Portfolio investment covers transactions in equity securities and debt securities; the latter being sub-classified into bonds and notes and money market instruments, and various other new financial instruments. Various new financial instruments, other than the financial derivatives, are covered under the appropriate classifications of the various instruments.

The category of financial derivatives includes financial instruments that are linked to other specific financial instruments, indicators or commodities and through which specific financial risks (such as interest rate risk, foreign exchange risk, equity and commodity price risks, credit risk, and the like) could, in their own right, be traded in financial markets. Transactions in financial derivatives should be treated as separate transactions rather than as integral parts of the values of the underlying transactions to which they are closely linked.

Other investments include short and long-term trade credit loans (including the use of fund credit, loans from the fund, and loans associated with financial leases); currency and deposits (transferable and others – such as savings and term deposits, savings and loans shares, shares in credit unions, and the like) and other accounts receivable and payable.
Monetary Movements

The balance for official financing (which used to be termed as the total currency flow) shows the balance of the monetary movements into and out side the country.

The fact that the amount of official financing equals the balance for the official financing ensures that the BOP always balances.

It includes foreign exchange reserves that is, the purchase or import of gold, the net addition to the accumulation of foreign reserves, capital lending to the other countries on long term or short term basis, IMF, net and SDR allocation.

Reserve assets cover transactions in those assets that are considered by the monetary authorities of an economy to be available for use in meeting the requirements of BOPs and, in some instances, for other needs also. Such an availability of funds is not closely linked in principle to any formal criteria such as ownership or currency of denomination. The items covered in these assets are monetary gold, SDRs, reserve position in the fund, foreign assets (currency, deposits and securities) and other assets.
India’s Balance of Payments Position since Independence:

Since 1951 India had been facing the balance of payments problem in the initial years of the planning era due to imports of food, capital goods and raw materials. The trade deficit had been continuously widening during the entire planning periods.

The balance of payments was in deficit during all the Five-Year Plan periods except during the Fourth Plan period when the government undertook serious efforts to increase exports and simultaneously reduce the imports.

The trade and balance of payments position in India had always been a cause of despair for the country. The deficit became a very serious problem after the Fourth Five-Year Plan and it had become a chronic situation thereafter.

Prof. Shumoy Chakravarthy has given a solution to reduce the balance of payments problem in his book on “Development Planning, The Indian Experience.” He has stated, “In my judgement, India’s balance of payments is likely to come under pressure unless we carry out a policy of import substitution in certain crucial sectors. These sectors include energy, edible oil and fertilizers.” To lessen the problem the government of India had to set up a number of committees to review the trade policies.
The Gadgil Committee had examined the policy of giving subsidies on exports. The government had also introduced the “duty drawback credit scheme” in the year 1976. A committee under the guidance of Abid Hussain was also set up to critically analyse the trade policies pursued by the Government of India. The main findings of the Abid Hussain committee were:

1. Import liberalization was neither a necessary nor a sufficient condition for the improvements in our trade situation.
2. Export promotion and import substitution were neither mutually exclusive nor alternative solutions to the problem of importing the trading scenario.
3. There was no chance for the export-led growth in India under the existing Indian conditions.
4. Unless the trade policies were closely integrated with the fiscal and the monetary policies, we could not march on economic prosperity in India.

India’s Balance of Payments during the Plan Period

The First Plan Period (1951-52 to 1955-56)

During the first plan period, the balance of payments situation was affected by the Korean War Boom, the American Recession of 1953 and the favourable monsoon conditions.

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conditions at home, which helped to boost the agricultural and industrial production in the country.

While India had been experiencing persistent trade deficits, it had generally been enjoying a surplus in net invisible account and hence India’s adverse balance of payments during the First Plan period was only Rs.42 crores. The overall picture during the First Plan could be considered as quite satisfactory.

The Second Plan Period (1956-57 to 1960-61)

An important feature of the Second Five Year Plan Period was the heavy deficit in the balance of trade, which had aggregated to the extent of Rs.2, 339 crores. The highly unfavourable balance of payments in the Second Plan was the result of (a) heavy imports (b) the failure in agricultural production (c) the inability of the economy to increase exports and (d) the necessity of the ‘maintenance imports’ for continuing the development process. As a result, the foreign exchange reserves sharply declined and the country was left with no other choice except to think of the various ways and means to restrict the imports and to expand exports.
The Third Plan and Annual Plans and BOP (from 1961-62 to 1968-69)

The balance on current account was unfavourable during the entire Third Plan period. The serious adverse balance of payments, which had started with the Second Plan period, continued relentlessly during the period of the Third Plan and that of the Annual Plans.

It could be observed that the trade deficit during the period of the Annual Plans was quite large and more specifically during the first two years of the Annual Plans. This was due to heavy imports of food grains to overcome the famine conditions in the country and in the country’s internal shortage of food grains on the one hand and the low level of exports due to the economic recession on the other hand. Besides, the devaluation of the rupee was a failure and instead of reducing the trade balance deficit, it further aggravated it. A very interesting development during this period was the net invisibles, which used to be favourable and used to reduce the trade deficit, got reduced and even became negative. During this period, a huge amount had to be paid by India by way of interest payments on loans, which had been contracted earlier. This wiped out the entire surplus in the invisible account. Consequently, the influence of the net invisibles in reducing the balance of payments deficit was very negligible. It could be
observed from the Table no. 1.1 that the adverse balance of payments during the three annual plans was much greater than that of the third plan as a whole.


One of the objectives of the Fourth Plan was self-reliance by way of import substitution of certain critical commodities, which were of great importance for the Indian economy on the one side and the adoption of export promotion techniques so as to equate the rising import bill on the other. Accordingly, the government decided to restrict the imports and expand exports. On the export front vigorous export promotion measures had resulted in boosting the exports of the traditional as well as the non-traditional items.

**The Fifth Plan Period (from 1974-75 to 1978-79)**

During the Fifth Plan period the trade balance was affected mainly by two factors: (a) the value of the imports was rapidly rising due to the hike in the oil prices, and (b) the value of the exports was also rising under the impact of the promotional
measures adopted during the period. These two factors had explained the gradual decline in the deficit in the trade balance and the appearance of a surplus in the trade balance in the year 1976-77. But the persistent upward increase in imports and the inadequate increase in the exports due to the relative decline in the export prices of exported commodities were responsible for the revival of trade balance deficit during the last two years of the Fifth Plan period. The net invisibles amounted to Rs.6, 261 crores, which made up for the trade balance deficit of Rs.3, 179 crores and India was able to achieve a huge surplus balance of payments of Rs.3, 082 crores. For the first time since the planning era started, India was able to reach comfortable position in its external account during the Fifth Plan period.

The Sixth Plan Period (1978 to 1983 revised later as 1980 to 85)

The current balance of payments became adverse in the year 1979-80 and further deteriorated thereafter. Apart from the net external assistance, which had to be repaid, India had to meet this colossal deficit in the current account through the withdrawals of SDRs and through borrowings from the IMF under the extended facility arrangements. Besides, India had to part with a portion of its accumulated foreign exchange reserves to meet its deficit in the balance of payments account.
The Seventh Plan Period (1985 to 1990)

During the years from 1985-86 to 1989-90, the total trade deficit amounted to Rs.54, 204 crores for the whole of the five-year period. Making an adjustment for the positive balance in the invisible account, the deficit in the balance of payments in the current account was a sum of Rs.41, 047 crores. The highly adverse balance of payments position had become a matter of serious concern. At the outset, it should be realized that the problem of the adverse balance of payments situation in India was essentially due to the huge trade deficits, which, in turn, was partly due to the result of the persistently increasing imports, and also partly due to the slow rising of exports. The ultimate solution had to be found only by restricting imports to the unavoidable minimum and the promotion of exports to the maximum extent possible.

1990-91 and thereafter

New economic reforms were initiated in the year 1991 and an effort was made to step up exports so that the major part of the import bill could be paid from out of the exports earnings. Moreover with a view to achieve a technological upgradation, imports had also to be liberalized. Along with this, in the place of the debt creating inflows of
borrowed capital, non-debt creating inflows of capital such as foreign direct investments as well as portfolio investment were encouraged to a large extent.

For the first time during the immediately past 40-year period the net invisibles became negative to the extent of Rs.435 crores during the year 1990-91. Thus, the cushion, which was available through the net invisibles to partly neutralize the trade deficit, was not available.

The Eighth Plan Period (1992-93 to 1996-97)

For the Eighth Plan period (from 1992-93 to 1996-97), the invisibles neutralized the trade deficit to the extent of about 58 percent, which was a really commendable achievement. Despite this, achievement in the balance of payments had shown continuous a deficit during all the years.

The Ninth Plan Period (1997-98 to 2001-02)

During 1997-98 the current account deficit reached the record level of Rs.20,883 crores and during 1998-99, it declined marginally to Rs.16789 crores. The situation improved to a certain extent in the year 2000-01 and the current account deficit declined to the level of Rs.11,431 crores.
During the year 2001-02, although trade deficit was higher at the level of Rs.60, 427 crores, the heavy receipts of invisibles amounting to Rs.67, 146 crores not only wiped out the trade deficit completely but also resulted in a surplus in the current account balance to the extent of Rs.6, 719 crores. Taking the entire Ninth Plan period (1997-98 to 2001-02) as a whole, trade deficit was wiped out to an extent of nearly 80.2 percent by the surplus in the invisibles account.
## TABLE 1

**INDIA’S BALANCE OF PAYMENTS IN THE CURRENT ACCOUNT**

*(FROM 1950-51 TO 2001-02)*

(Rs. in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade Deficit</th>
<th>Net Invisibles</th>
<th>BOP</th>
<th>3 as % of 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>First Plan</td>
<td>-542</td>
<td>+500</td>
<td>-42</td>
<td></td>
</tr>
<tr>
<td>Second Plan</td>
<td>-2339</td>
<td>+614</td>
<td>-1725</td>
<td></td>
</tr>
<tr>
<td>Third Plan</td>
<td>-2382</td>
<td>+431</td>
<td>-1951</td>
<td></td>
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<td>Annual Plans</td>
<td>-2067</td>
<td>+52</td>
<td>-2015</td>
<td></td>
</tr>
<tr>
<td>Fourth Plan</td>
<td>-1564</td>
<td>+1664</td>
<td>+100</td>
<td></td>
</tr>
<tr>
<td>Fifth Plan</td>
<td>-3179</td>
<td>+6221</td>
<td>+3082</td>
<td></td>
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<tr>
<td>1979-80</td>
<td>-3374</td>
<td>+3140</td>
<td>-234</td>
<td></td>
</tr>
<tr>
<td>Sixth Plan</td>
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<td></td>
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<tr>
<td>Total (1980-85)</td>
<td>-30456</td>
<td>+19072</td>
<td>-11384</td>
<td></td>
</tr>
<tr>
<td>-------------</td>
<td>----------------</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>Seventh Plan</td>
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<td></td>
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<tr>
<td>Total</td>
<td>-54204</td>
<td>+13157</td>
<td>-41047</td>
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<td>1990-91</td>
<td>-16934</td>
<td>-435</td>
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<td>-6495</td>
<td>+4258</td>
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<tr>
<td>Eighth Plan</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total 1992-97</td>
<td>149004</td>
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<td>-16283</td>
<td>69.9</td>
</tr>
<tr>
<td>Ninth Plan</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Total 1997-02</td>
<td>316445</td>
<td>-253730</td>
<td>-62715</td>
<td>80.2</td>
</tr>
</tbody>
</table>

* Partially revised


**Economic Reforms**

In the post independent economic history of India, 1991 is an important landmark year. The country went through a severe economic crisis triggered by a serious balance of payments situation. The crisis was converted into an opportunity to introduce some fundamental changes in the content and approach to the economic policy of the country. The response to the crisis was to put in place, a set of policies aimed at stabilization and through structural reforms. While the stabilization policies aimed at correcting the
weaknesses that had developed in the fiscal and the BOPs front, the structural reforms sought to remove the rigidities that had entered into the various segments in the Indian economy.\(^5\)

**Policy Measures of the Economic Reforms**

India’s economic reform programme, since the 1990s had included two basic sets of policy measures. The first set of reforms aimed at achieving the macro economic stabilization by reducing both fiscal (budgetary) and the balance of payments deficits. Reducing fiscal deficits involves a cut in public expenditure, and also an attempt to raise public revenue to bring about a balanced budget over a period of time. To reduce the balance of payments deficits, the economic reform programmed in India had heavily relied on currency devaluation to boost the exports and to reduce the imports. So far, measures taken to achieve the macro economic stabilization in India have been generally half-hearted and halting frequently in its nature. Overall budgetary deficits of the central government had increased from Rs.11, 347 crores in the year1990-91 to Rs.-1,496 crores in 2001-02. The balance of trade deficit also continued to soar from Rs. 16,943 crores in 1990-91 to Rs. 60,427 crores in 2001-02 despite a massive devaluation of the Indian rupee in respect of the US dollar in July 1991. During the same period (from 1990-91 to 2001-02), the price inflation in India had somewhat continued, but was still at a very high level. The index number of wholesale prices rose from (1981-82 = 100) 182.7 in the year 1990-91 to 161.3 in 2001-02. Although the bank rate had remained generally at a stable

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level between 10 and 12 percent since 1991, it was still very high in relation to the commercial needs for the expansion of economic activities in the private sector. In general it is possible to conclude that India’s efforts to achieve the macroeconomic stabilization had not been a resounding success yet.

The second basic set of economic policies in India since July 1991, had been to alter the production structure by increasing the role of the markets in the economy, directly through privatization and through interventions, and indirectly through domestic deregulations and by trade liberalization. The overall effect of these measures had been to bring about an end to India’s relative economic isolation from the rest of the world economy. There is no doubt that there had been, by and large, an increased level of integration of the Indian economy with the global economy since the 1990s. This had led to a fundamental shift in India’s developmental strategy, which is away from the Nehruvian socialism, based on an import substitution strategy to an export oriented industrialization strategy.

A number of steps had been taken to bring about such a shift in the economic policy of India. Foreign trade had been liberalized. The import licensing procedure had been virtually abolished except in respect of consumer goods. Customs duties had been sharply reduced in different stages since July 1991. The rupee was devalued in 1991 by about 20 percent and further downward adjustments were made to a large extent due to the play of the market forces. The rupee is still not a fully convertible currency except in
the trading account, but the move away from the fixed exchange rate period had revealed the determination of the Government of India to pursue the major economic reforms.\textsuperscript{6}

**Importance of the Study**

At present, all the countries in the world join together forming global village to enrich each country’s economy. No country can survive independently. All are mutually interdependent because each country is blessed with its own endowment resources.

Over a period of time there has been a marked change in the ideology of the government towards integration with the world economy. The change in the ideology is reflected in the attitude of the government towards LPG policies.

BOP is a device, which describes the state of international economic position and relationship of the country. BOP is compiled to measure gross deficits or surplus with the rest of the world. BOP acts as a guide to monetary, fiscal exchange and other policies.

India is no exception to the changes taking place entire world over. With the gradual change in the ideology regarding the approach to development (from the inward oriented import substituting approach to the outward looking approach) during the late 1980s and especially after the Balance of Payments crisis of 1991-92 the liberal approach towards trade and capital has been adopted by the Indian government.

In this global integration process, the promotion of external trade, the reduction of external debt, and the enhancement of foreign direct investment have assumed very crucial importance in the Indian economy. Liberalization has involved a significant paradigm shift from the protective tendencies adopted in the past years. The ideological predilections of Nehru and the Mahalanobis model of socialistic planning have given way to the new wave of globalization, privatization and liberalization.

Faster economic growth can be achieved only through the good international trade. Hence, BOP is a tool to inform government authorities of the actual international economic position.

A country may have a deficit on trade balance, while it may have a surplus in BOPs on current account. India under the British rule used to have a favourable trade balance, but its surplus on BOPs was considerably reduced because of a host of invisible payments like the ‘home charges’.

**Objectives**

1. To analyse the composition of current account of the balance of payments in India pre and post economic reforms.
2. To analyse the components of capital account and also foreign exchange reserves of the balance of payments in India pre and post economic reforms.
3. To suggest the remedial measures to improve balance of payments.
Limitations of the Study

1. The study is macro in its nature, portraying the picture of the whole of India, which is the unit of study; and hence comparisons at the micro level may not be feasible.

2. As the study had been completely based on the available secondary data, the limitations pertaining to secondary data such as the inadequacy and the lack of reliability apply to this study also. The twenty-two year data and the results are applicable to those particular years only.

3. The item-by-item analysis of the position of the BOP could be undertaken in further research work and by other researchers.

As the study is completely based on the secondary data, limitations such as inadequacy and lack of reliability apply to this study also.

Layout of the Study
The present study “Economic Reform and Its Impact on Balance of Payments in India” has been presented in five chapters.

Chapter I is the introductory chapter, which introduces the new economic policy, the concepts of Balance of Payments, India’s Balance of Payment position since Independence, presents the importance of the study, lists the Objectives of the study and also presents the Layout of the study.

Chapter II is devoted to the Review of Literature and Methodology.

Chapter III analyses the different patterns and trends of current account on Balance of Payments.

Chapter IV speaks of the trends, composition and determinants of capital account and also the components of foreign exchange reserves on Balance of Payments.

The last chapter presents the findings of the study and in the light of the empirical analysis, draws some conclusions in terms of supportive measures of the Balance of Payments.
CHAPTER II

REVIEW OF LITERATURE AND METHODOLOGY