A STUDY OF EFFECTS OF LIBERALIZATION ON BALANCE OF PAYMENT IN INDIA

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Abstract

Balance of payment includes the current account, capital account and foreign reserve. Current account includes Export-Import, while capital account include the capital flow and foreign reserve includes SDRs, Gold and foreign currency reserve. Country's economic wealth major by many factors but among them one of the most important factors is BOP. Generally if the BOP is surplus it shows the positive side while BOP deficits show negative side but it doesn't true for all time. Because surplus means country's current account is higher than its capital account that means we are exporting more than investment while if the BOP is deficits means country's current account is less than capital account, means we are relay on the investment if it happen we are on safer position but one of the main reason for healthy investment is BOP surplus. We know that after 90s government opened the Indian economy and attract the foreign investors. This paper shows that what happen to BOP before and after liberalization. Which condition is better than other or we can say that how we performed after 90s. And what was the cure we have to take for betterment of BOP future.

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INTRODUCTION

Balance of payment is the systematic summary of the economic transactions of the residents of a country with the rest of the world during a specified time period, normally a year. The following features of the balance of payments are implicit in the above definition: **(C.Jeevanandam)**

• Economic Transactions
• Residents with Non-residents
• A flow Statement
• Periodicity

COMPONENTS OF BOP

1. Current Account
2. Capital Account
3. Official Reserve

The current account comprises the transactions of the goods and services, income and transfers. Capital account comprises the transfer of money and other capital items. Official reserve comprises the reserve that India had. Balance of payment is the addition of the three components in the simple word. Here current account comprises export and import, when the Export is higher than the import means we are exporting more than what we are importing. When we are exporting, our goods are cross the international boarder and we get the money means cash inflow but if we are importing from other country than we have to pay them for imported goods, means cash outflow. In calculation of current account transaction we have to add both the export and Import amount both. Suppose India is exporting more than Importing means India gets more money in comparison to India buy from other country so when we add both these transaction we get the amount to be held with India. Simply say you are earning 100$ and your expense would be 80$ than it's obviously you are having 20$ with you same as here if we export more than import than current account is in positive side means its surplus but if the Import are better than export than we have pay extra money from our pocket. In short we have to use our reserve to meet those expenses. So most of the country focuses on more export rather than Import but the real practical scenario shows us different picture.

COMPARISON OF BOP

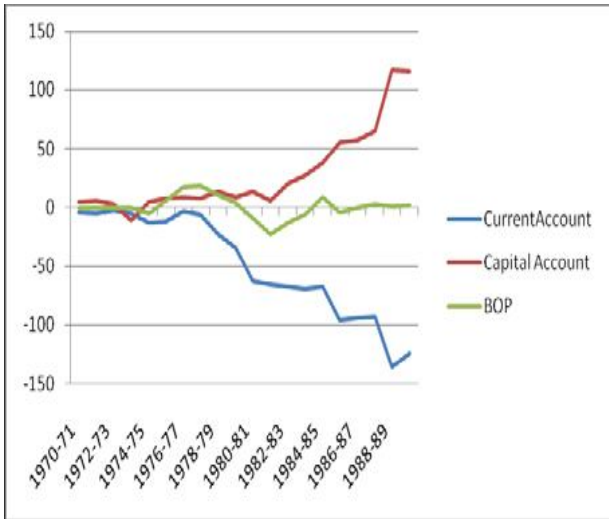

Fig 1 Source : RBI(1970-90)

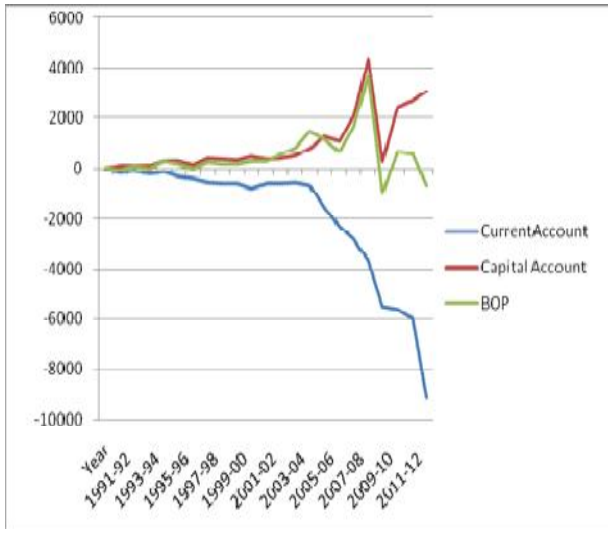

Fig 2 Source : RBI (1990-12)

From above figure we can easily conclude that before liberalization India's BOP is not on the positive side for continuous interval or not even going positive for some of the year, we can see that BOP is almost to the Zero level means no much more money for the reserve side. While after liberalization we can see that the BOP is almost positive for the interval between 97-08 after that there is certain downfall. The reason is obvious of meltdown effect to the Indian BOP. Also we can conclude that before liberalization the quantity of export and investment is very limited but after liberalization we can see that the export and investment has been in very large quantity. Obvious reason is that the country has its economy and also this is the reason for liberalization. But note one thing that the current account is always in negative side in both the figure means our export is less than our import. From this we can conclude that the consumption ratio of India is more than its productions and that the reason still India doesn't have much more impact of Global Recession.

CURRENT ACCOUNT HISTORY

The reason behind great negative side of current account is high price of crude oil in the international market. The consumption of the oil and non-oil is also play major role in the current account. We can easily understand it by **figure no 3 and 4.**

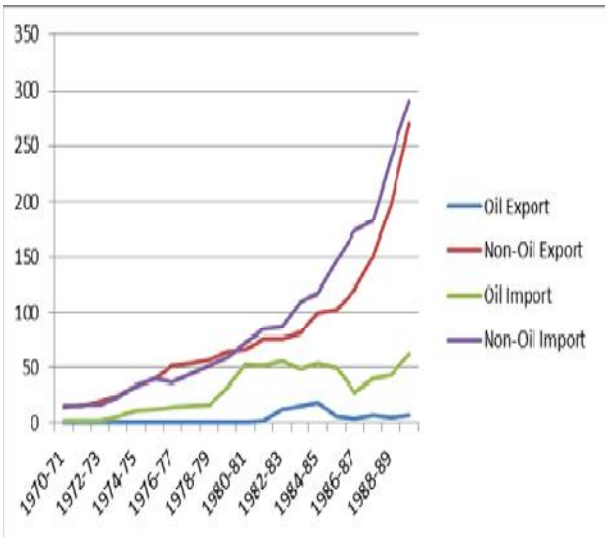

Fig 3 Source RBI (OIL, NON-OIL)

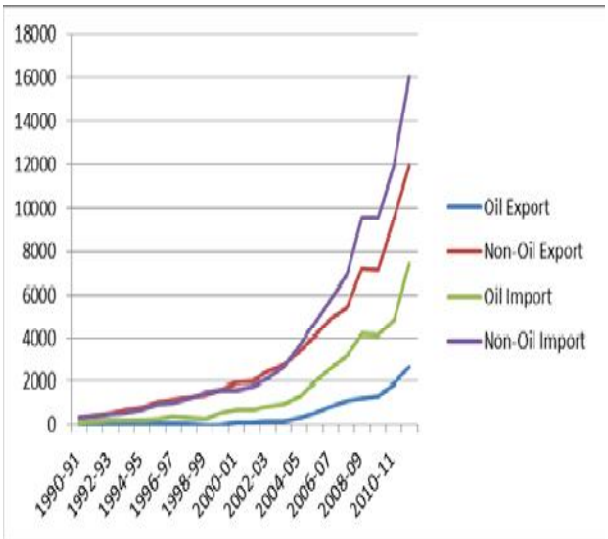

Fig 4 Source: RBI (OIL, NON-OIL)

We can see that before liberalization the ratio of the oil import is higher than the oil export and accordingly our current account deficits but the ratio of the non-oil import and export having little variation compare to the oil. So when there is a high price of the oil in the international market affects the India's current account although we export more in non-oil products. But after the liberalization as we have discussed that the consumption ratio is increased day by day so the consumption of the oil is also increase so after the liberalization the scenario doesn't change after the liberalization. So we can conclude only that we have to put restriction on import of the oil but this is not possible for India.

REASONS FOR DEFICITS IN THE CURRENT ACCOUNT

• HIGH PRICE OF THE OIL IN THE INTERNATIONAL MARKET:

Today even government is worried about the high price of the oil in the international market. The consumption of oil in India is more than its production of the oil. Today thanks to automobile industry development we have more option for law consumption of oil but it's too difficult for us to minimize the consumption.

• CONSUMPTION:

Consumption of the India is very high compared to the production. We are the country 80-90% production is consummated by the own. And that's one of the reasons that most of the MNCs find India as a great market for the business. But we do not worry for that because this will be our monopoly for being noticed by the world that India is not dependent for its consumption because we can produce most of our necessities by own.

• **LACK OF PRODUCTION:**

As we have discussed that we are producing enough for our own consumption but to fight with high price of crude and technology we have to produce more than consumption and the rest we have to export so by that we can sum up the current account deficits.

• **CURRENCY FLUCTUATION**

Recently we have seen that the Indian Rupee is depreciated in comparison to the major traded currency. We are not discussed why Indian rupee is depreciated but we can understand it by simple example. Suppose today the 1$=50 Rs. Now today if we export product of Rs 200, we get the amount just 4$ but if we Import at this rate we have to pay 4$ for the same. Now if the Exchange rate is changed and it would be of 1$=45 then we get 4.44$ but if we import than we have to pay 4.44$. Means for importer it would be worst but for exporter it will good. Same as we can understand it if the rate is 1$=55. The relation between export and import is like Zero Sum game but sometime it's motivated the export or import.

SUGGESTIONS FOR IMPROVEMENT:

• Motivate the SMEs for export.
• Liberalized the export policy.
• Government support.
• Adopt new technology for the better production.
• Create the image of Good quality manufacturer.
• Stabilized currency fluctuations.
• Aware the consumers to consume the local product rather than imported products.
• Try to provide the local goods at lower rate with high quality.

CAPITAL ACCOUNT HISTORY

We can easily see from the fig 1 and 2 that the ratio of the capital account is much higher than current account. The main difference between them is the amount that covered after and before liberalization. After 90s capital account sum is huge because we have opened our economy for the investors and we got success in attracting the investors. After 90s we have opened our economy and welcome the foreign investment so before liberalization the investment in India is not that much too count so here we have data after liberalization from that we conclude the things.

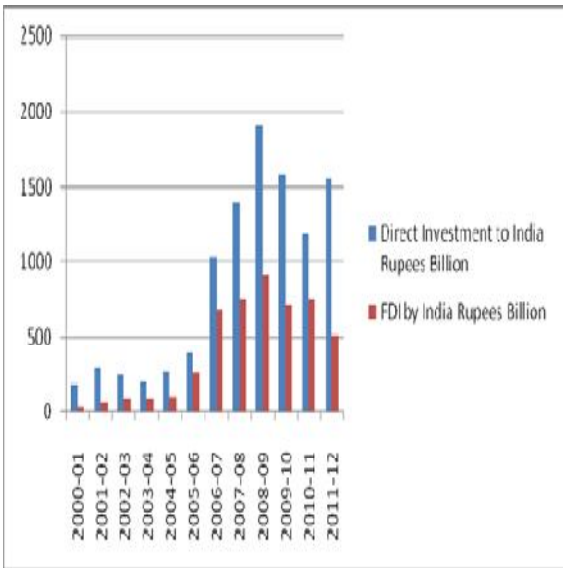

Fig 5 Source: RBI (Capital Flow)

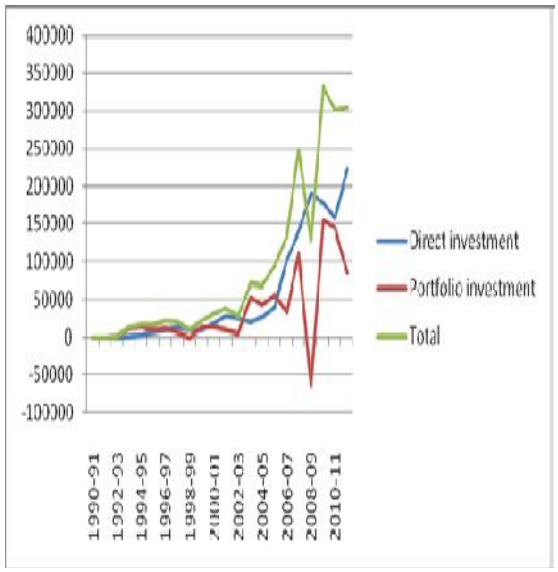

Fig 6 Source: RBI (FDI & FPI)

From the fig 5 we can conclude that the ratio of the investment by India is lower than Investment to India. Means in the BOP transaction the sum of capital inflow is much higher than the capital outflow from the India. High inflow of investment form abroad helps India to sum up the current account deficits.

REASONS FOR THE HIGH INVESTMENT IN INDIA

• HIGH RATE OF INTEREST

Let us assume that the spot rate is Rs.50 and the forward rate is 50.50. Suppose the interest rate in US is 2% P.A. while the interest rate in India is 6% P.A. Now the Investors Borrow the US dollar from the US at 2% and invest that US dollar in the India at 6% For 6 Months. Here we can understand it by following results:

Borrowing from US Investment in India
Principal Amount USD 1, 00,000 Principal Amount Rs. 50, 00,000
Interest rate at 2% USD 1,000 Interest rate at 6% Rs.1, 50,000
Total Due USD 1, 01,000 Total Realisation Rs 51, 50,000
Rupee required for USD 1, 01.000 at Rs 50.50 per Dollar Rs 51, 00,500
Profit Rs. 49,000

From the above example we can just understand the possibilities of the Arbitrage and also we can understand that as the interest rate is increased the investment also increased. India is the country whose interest rate is higher than other country.

• HIGH CONSUMPTION RATE

We know that the consumption of the India is much higher. Government also invites the Investment. Even the rate of interest is also high. So investor finds huge market. Interest rate also attracts the high investment.

• GOVERNMENT SUPPORT

Indian government supports the investment from abroad as well as from NRIs. Also one of the main sources of investment is NRIs.

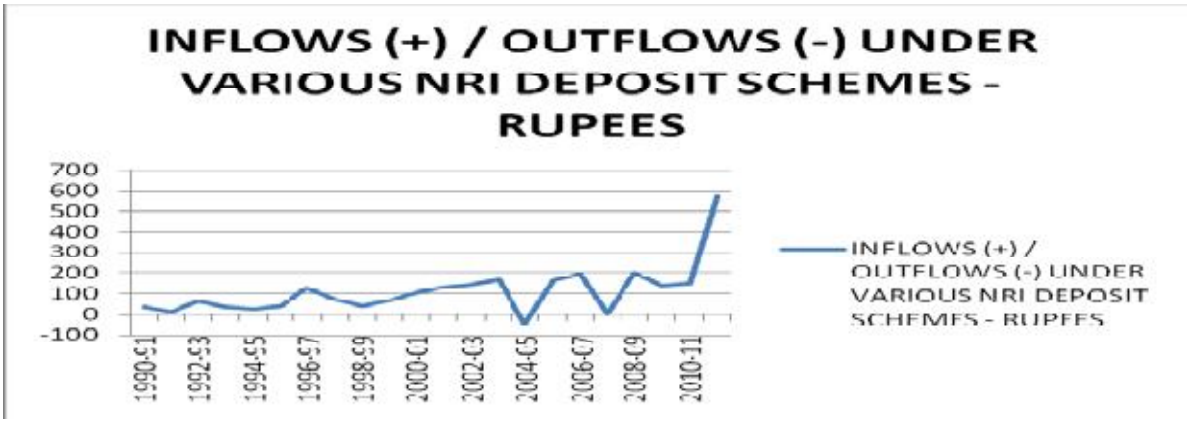

Fig 7 Source RBI (NRI DEPOSITS)

We can easily conclude that the NRI deposits mostly increase every year. In 2005 and 2008 we are having decline in the deposits. We know the reason of global crisis during that time is the key reason.

• EMPLOYEMENT/ PURCHASING POWER

We can relate it with economic development of India. That's true but we also have to understand that if India having enough investment opportunities than and than its development is possible. And today we have vast numbers of vacancies in private as well as public sectors. That's possible just because of liberalization. As people gets the employment, their purchasing power increase. Means the consumption or the expectation is increased and that creates the hunger of the India. To satisfy that hunger we have to produce more and more and that attracts more investment.

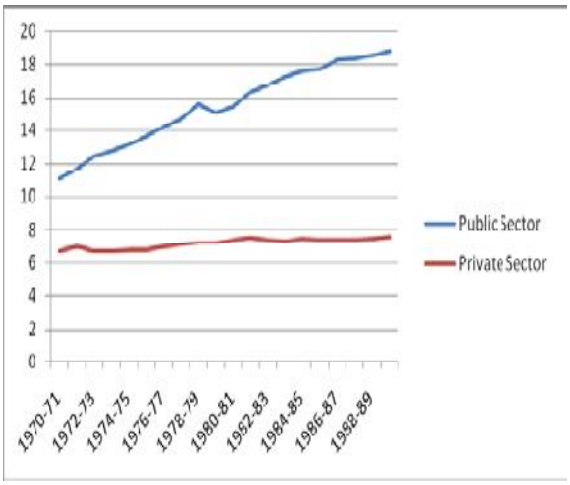

Fig 8 Source RBI (Employment)

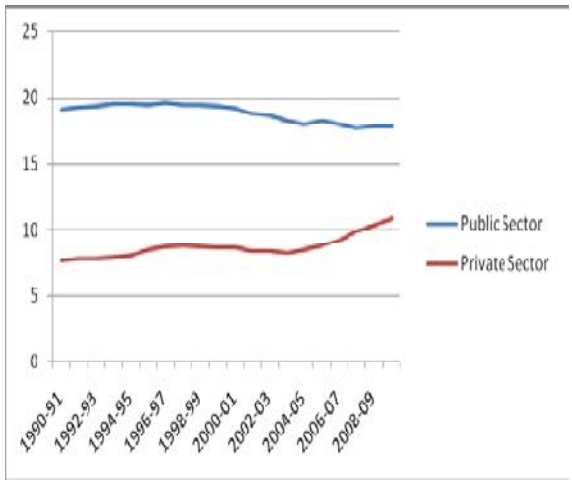

Fig 9 Source RBI (Employment)

We can see that from the figure that the employment in both the public as well as private sectors having not that much changed up to 2000-03. We can say the steady employment rate. But after 2003 the private sector has employed higher employee but in public sector the employment is declining but not up to that much extend. And another reason for the batter purchasing power is due to SMEs. Today government gives subsidies for the small scale enterprise as well as agriculture has shown positive in the production.

• IMAGE OF EMERGING ECONOMY

India is now considered as the most emerging economy of the world. Most of the economist believes that India is the right choice or we can say that India is the secure place where we have to invest. Most of the investor feels that India is booming so we have to invest here more and India also gives the high interest so it's natural for high investment in India.

RESERVE AMMOUNT:

As we know that BOP includes Current, Capital and reserve for the balancing the deficits if it is there. If deficits do not occur the surplus amount goes in the reserve account of the India. Its not the issue here nut the main issues is that how much reserve India has. Before going to discuss that, let assumes that one person earning Rs 1000, his expenses would be say 800rs; now the rest of 200rs would be his reserve and that 200rs he uses in his betterment. If his expense is 1200rs, he has shortage of 200rs. If he has enough reserve in his account, he can use that reserve amount to meet his deficits. Same as India has surplus in BOP than no need to use reserve but it BOP is in negative than we have to use our reserve to maintain BOP. So we can conclude that if country has enough reserve, country can survive even in high consumption or we can say that in even recession also.

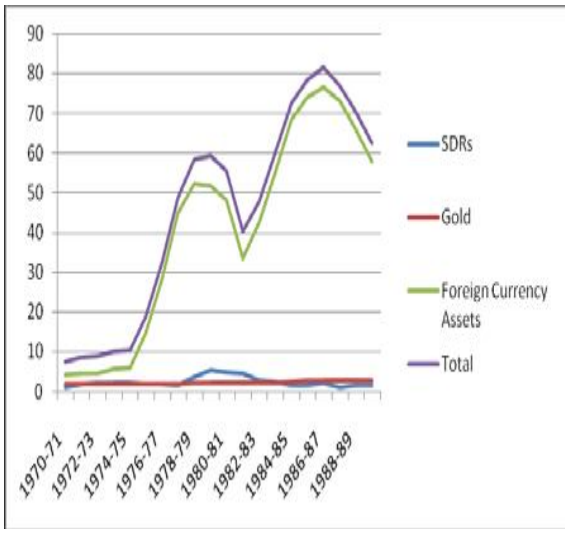

Fig 10 Source RBI (RESERVE)

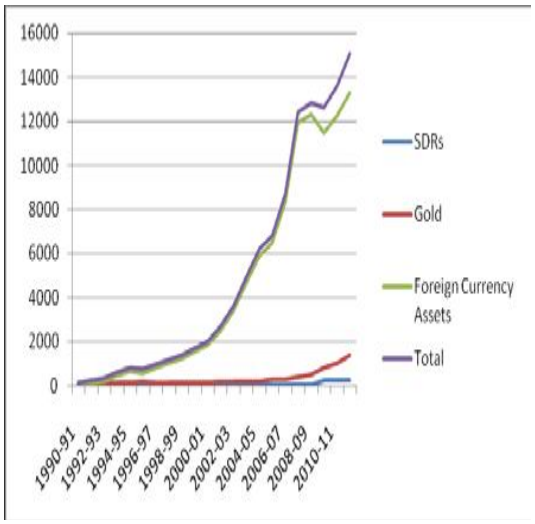

Fig 11 Source RBI (RESERVE)

From the above graphs we can easily say that our reserve is more concentrated on foreign currency rather than gold and SDRs. But apart from that just compare the amount covered in both the graphs. Before liberalization the amount of reserve did not that much high but after the liberalization the amount increase like anything. We know that the consumption is also increased after the liberalization but we can say that after liberalization although our consumption increased but we are having enough recourse for consumption satisfaction.

From above, we can say that the country' wealth is decided on the basis of its reserve that central bank of the country having. We can understand it by simple example that if you are having 2000rs as reserve. You can use your 1000rs for fulfillment of your needs means your betterment. And still you had 1000Rs as reserve for bad situation say job loosing. Same as if India has good amount of reserve in his account than India can use some of that amount for the betterment of the country. This leads country towards better productions, higher income of the people, attract better and better investment. Means we can say that if the country having good amount of reserve in its hand than it can use for his betterment.

OTHER SILENT FEATURE THAT AFFECT THE BALANCE OF PAYMENT

- GDP of the country
- Per capita Income of the nation
- Employment
- Awareness of consumer
- Currency fluctuation
- Foreign reserve
- Development of the Indian industry
- SMEs contribution

- Government role
- Quotas and Tariff

SUGETIONS FOR THE BETTER BOP

- Promote export
- Revised Export – Import procedure
- Appreciate the Indian currency
- Give tax benefits to Exporter
- Improve Quota and Tariff procedure
- Safeguards from Dumping
- Aware the consumer to buy local products
- Attract more investment
- Develop the production facilities
- Develop Infrastructure
- Increase the employment

CONCLUSION

Boosting export and looking for more stable longer foreign inflows have been suggested to ease to concerns on current account deficits. The exports have been raised but so have prices of Crude oil leading to further widening of current account deficits. Efforts have been made to invite the FDI but much more needs to be done especially after the holdback of retail FDI and recent criticism of policy paralysis.

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