Balance of Payments Problem in India

What measures can be adopted to tackle the problem of disequilibrium in the balance of payments will also be discussed: About 15 years ago in 1991 India had to experience a severe balance of payments crisis.

A default on payments, which would have a disastrous consequent for the Indian economy, had become for the first time in our history a serious possibility in June 1991. It was at this time that new Congress Government with Dr. Manmohan Singh as our Finance Minister took several short-term and long-term measures to overcome the balance of payments crisis.

Apart from undertaking various measures of domestic liberalisation, he took several for-reaching measures relating to balance of payments problem. Rupee was devalued in July 1991 and later in two years' time, foreign exchange rate of rupee was made market-determined and also convertible into foreign currencies.

Anti-export basis in our economic strategy was removed and accordingly tariffs on imports were reduced, so as to promote competition. In this way costly import-substitution strategy of industrialisation was abandoned. These measures bore fruits and India was successful in solving the balance of payments problem. Our exports started growing at a relatively rapid rate than before. Capital flows and remittances by NRIs increased manifold. Of course for a short time, we got special assistance from IMF and World Bank to fulfill our obligations regarding balance of payments.

Balance of Trade and Balance of Payments:
Balance of trade and balance of payments are two related terms but they should be carefully distinguished from each other because they do not have exactly the same meaning. Balance of trade refers to the difference in value of imports and exports of goods only, i.e., visible

items only. Movement of goods between countries is known as visible trade because the movement is open and can be verified by the customs officials.

During a given period of time, the exports and imports of goods or merchandise may be exactly equal, in which case, the balance of payments of trade is said to be balanced. But this is not necessary, for those who export and import are not necessarily the same persons. If the value of exports exceeds the value of imports, the country is said to experience an export surplus or a favourable balance of trade. If the value of its imports exceeds the value of its exports, the country is said to have-a deficit or an adverse balance of trade.

The terms "favourable" and "unfavourable" are derived from the mercantilist writers of the 18th century. In those days, settlements of the foreign transactions were made in gold. If India had exported Rs. 100 crore worth of goods but had imported Rs.80 crore worth of goods, India would receive Rs. 20 crores worth of gold from the foreign countries. As gold was regarded as wealth and as the receipts of gold made a country wealthy, the mercantilist writers regarded exports surplus as being favourable to the country.

On the other hand, if India had exported Rs. 100 crores worth of goods, but imported Rs. 150 crores worth of goods, it had to pay Rs. 50 crores in gold to the foreigners. India would be losing gold and would be poorer to that extent. Therefore, an import surplus was regarded by the mercantilist writers as adverse balance. But in these days, the international transactions are not settled in terms of gold. Even then, the terms "favourable" and "unfavourable" balance of trades has continued to be used till today.

Distinction between Current Account and Capital Account:

The distinction between the current account and capital account may be noted. The current account deals with payment for currently produced goods and services; it includes also interest earned or paid

on claims and also gifts and donations. The capital account, on the other hand, deals with payments of debts and claims.

The current account of the balance of payments affects the level of national income directly. For instance, when India sells its currently produced goods and services to foreign countries, the producers of those goods get income. In other words, current account receipts have the effect of increasing the flow of income in the country.

On the other hand, when India imports goods and services from foreign countries and pays for them, money which would have been used to demand goods and services within the country flows out to foreign countries; current account payments to foreigners involve reduction of the flow of income within the country and constitute a leakage.

Thus, the current account or trade account of the balance of payments has a direct effect on the level of income in a country. The capital account, however, does not have such a direct effect on the level of income; it influences the volume of assets which a country holds.

Determinants of Balance of Payments:
There are several variables which determine balance of payments position of a country. They are:
(1) National income at home and abroad,

(2) Exchange rate of national currency,

(3) The domestic prices of goods and factors,

(4) International oil and commodity prices and

(5) Demand for and supply of foreign currency.

At the back of these variables lie the supply factors, production function, the state of technology, tastes, distribution of income, economic conditions, the state of expectations, etc. If there is a

change in any of these variables and there are no appropriate changes in other variables, disequilibrium in balance of payments will occur.

The main cause of disequilibrium in the balance of payments arises from imbalance between exports and imports of goods and services, that is, deficit or surplus in balance of trade. When for one reason or another value of exports of goods and services of a country are smaller than the value of its imports the disequilibrium in balance of payments is likely to occur.

The value of exports may be small due to the lack of exportable surplus which in turn results from the low production of goods to be exported or the exports may be small because of the high cost and prices of exportable goods and severe competition in the world markets.

The important causes of lower exports are inflation or rising prices in the country or over-valued exchange rate. When there is higher rate inflation in a country resulting in higher prices of exportable goods, its exports are discouraged and imports encouraged. If it is not matched by other items in the balance of payments, disequilibrium will occur.