Roundtable on "State of the Indian Economy"
Association of Indian Economic Studies, Jan.3, 2003.
Annual Meeting of the American ***Allied Social Science Associations***, Jan 3-5, Renaissance Hotel, Washington D.C., USA.

Trends in India's Balance of Payments

Alok Sheel
Counsellor (Economic)
Embassy of India
Washington DC
USA

Topics of Discussion

- India's BOP till the Early Nineties
  - Structure
  - Drivers
- The BOP Crisis of 1991-92
  - Triggers
  - Response
- Current BOP Trends
  - Statistics
  - Structural shifts
  - Drivers
  - Straight line projections
  - SWOT Analysis

India's BOP till the Early Nineties: Structure

- Current Account
  - Physical Trade Deficit exceeding 3.5% of GDP
  - Slightly positive, but negligible, balance of less than .5% of GDP in Invisible Trade
  - Current Account deficit in excess of 3% of GDP

- Capital Account
  - Foreign Aid and external commercial borrowings used to balance current account deficit
  - Negligible non-debt Flows
  - Relatively large (10%) short-term and concessional (multilateral) debt.
  - Substantial rupee trade with Soviet bloc reduced hard currency financing requirements.
  - No build up of FC reserves

India’s BOP till the Early Nineties: Drivers

- Current Account
  - POL imports accounted for one fourth of imports.
  - Substantial Defense imports, captured in central bank ‘flow’ data, but not in DGCIS data
  - Over-valued (fixed) exchange rate made for implicit anti-export bias.
  - Capital flight through trading channels?
- Capital Account
  - Fiscal deficit spilt over into external sector
  - Liberal ECB policy in the eighties leads to sharp increase in commercial and short term component of debt.
  - External debt/ GDP ratio rises to over 35%, the lagged impact of persistent CAD.

The BOP Crisis of 1991-92 : Triggers

- Growing fiscal deficits spilling over into external sector.
- Deteriorating external balances: rapid build up of debt, especially commercial and short-term.
- The Gulf war and Oil Price Shock
- Very low FC reserves (poor liquidity) to absorb external shock. Liquidity not solvency crisis.
- Credit rating downgradation and loss of international confidence:Inability to roll-over short-term debt and loss of market access. (only Aid and export credits accessible).
- Flight of NRI investments.
- Real threat of default on external debt repayments.

The BOP Crisis of 1991-92 : Response

- BOP management the biggest success story of the Indian economic reform process.
- Scraping the barrel: pawning of gold reserves.
- Conscious decision to avoid default on external debt payments.
- IMF structural adjustment loan with attendant conditionalities.
- Tight control on sovereign guarantees.
- Major economic restructuring and opening up
  - Float of the rupee and sharp depreciation.
  - Industrial delicensing
  - Fiscal adjustment
  - Tight caps on external commercial borrowing and short-term debt.
  - Mobilizing non-debt creating capital account flows:opening up the foreign investment regime
  - Major tax reforms: lowering direct & indirect tax rates to ride the Laffer curve and align with global trends.

Current BOP Trends: Statistics

Physical Exports		
	1990-91	2000-01
OECD	54%	53%
EU	28%	23%
USA	15%	21%
EE	18%	2%
ASIA	14%	21%
OPEC	6%	11%

Yr.ending	**Mar-91**	**Mar-97**	**Mar-02**	**Mar-08**
US $ Bill	actuals	actuals	actuals	proj.
CURRENT ACCOUNT				
TB	**-9.4**	**-14.8**	**-12.7**	**-30.8**
IB	**-0.2**	**10.2**	**14.1**	**44.2**
CAB	**-9.6**	**-4.6**	**1.4**	**13.4**
CAPITAL ACCOUNT				
NET	**8.4**	**10.4**	**10.4**	**20.2**
Res.+/-	**-1.3**	**5.8**	**11.8**	**33.6**
FI STOCK	***0.1***	***20.4***	***44.2***	***100.7***
Net FC Res	**2.2**	**23.0**	**56.4**	**187.0**

Current BOP Trends: Structural Shifts

- Current Account
  - POL imports still account for one fourth of imports.
  - Physical trade shifts away from East Europe towards US, Asia and OPEC.
  - Market-determined exchange rate removed anti-export bias. Impact felt mostly in services exports, notably IT.
  - Technology exports and NRI remittances have made the current account surplus
  - Relatively high tariffs, weak infrastructure, inflexible labour policies and other factors continue to constrain physical export performance. Physical trade deficit as percentage of GDP no better than early nineties.
- Capital Account
  - Negative Aid and debt flows in the decade following 1991-92.
  - External debt/GDP ratio down to 20%. Fiscal deficits do not spill over into external sector.
  - Short-term debt less than 5% of total debt.
  - Elimination of rupee trade with East Europe.
  - Sharp increase in FE reserves to about US $ 70 billion because of equity flows: adequate to cover one years imports plus outstanding stock of portfolio investment.

Current BOP Trends: Drivers

- FC reserves accumulating @ over 1 billion every month.
- Good liquidity to cushion oil price shock impact of possible middle eastern war.
- Current account increasingly driven by invisible trade. From less than 15% of the Current Account, it now accounts for over 35%, and is rising sharply. Robust technology and service exports, and NRI remittances the main drivers.
- Services also the major driver of increase in GDP growth rates over the last decade.
- Invisible flows appreciating the rupee: Negative fall-out on physical exports: a ‘Dutch Disease’ variant?
- Capital Account driven by non-debt creating flows.
- India’s credit rating continues to be sub-investment grade despite robust BOP because of Rating Agency fears that uncontrolled budget deficits might spill over into external sector.
- Importance of US economy: single largest trading partner and foreign investor, and absorbs about 2/3 of IT exports.

Current BOP Trends: 2008 Projections

- Trade deficit of 4.5% and current account surplus of 2% of GDP
- Invisible trade over 40% of Current Account.
- FC reserves $ 187 Billion.
- Since DGCIS data used as basis, provisions for defense purchases not included.
- Net FI stock about $ 100 Billion.
- Physical Imports at $ 100 Billion
- Assumptions:
  - X GR of 8%; IM GR of 10%.
  - Inv X GR of 15%; Inv IM GR of 10%.
  - GDP GR of 5.5% and Rupee dep. Rate of 2%.
  - FDI GR of 15%, PI, NRI and Banking K GR 10%.
  - Negligible net Aid and ECB flows.

Current BOP Trends: SWOT Analysis

- Strengths
  - Invisible Exports on current account
  - Equity flows on capital account
  - Adequate Liquidity to defend currency
  - Self-adjusting Market determined exchange rate
  - Low NPV of long-term debt and negligible short-term debt.
- Opportunities
  - Capital account convertibility
  - Pre-payment of costly debt
  - Supplement domestic savings to boost growth rates
  - Boost infrastructural investments
  - Upward revision of credit rating
- Weaknesses
  - Dependence on POL imports
  - Physical exports
  - Increase in public debt to sterilize increased money supply
  - Ability of domestic investment to absorb large FC inflows.
- Threats
  - Instability in Middle East
  - Volatility induced by portfolio flows
  - Rupee appreciation
  - Fiscal deficit