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An Analysis of Invisibles on India's Balances of Payments on Current Account Since 2001

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Abstract: ***A Balance of Payments (BOP) statement is essentially a double-entry system of record of all economic transactions between the 'residents' of a country and the rest of the world carried out in a specific period of time. 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. The invisibles have been providing substantial support to India's balance of payments in the recent years and are reflective of the ongoing structural transformation within the economy as well as its increasing integration with the world economy.***

Keywords: LPG, BOP, Current account, Capital account, invisibles, Trade

1. Introduction

A Balance of Payments (BOP) statement is essentially a double-entry system of record of all economic transactions between the 'residents' of a country and the rest of the world carried out in a specific period of time. It presents a classified record of all receipts on account of goods exported, services rendered and capital received by residents, and payments made by them on account of goods imported and services received from and capital transferred to 'non-residents' or foreigners. The balance of payments statement is divided into two major accounts viz., current account and capital account. Transactions relating to goods, services and income constitute the current account, while those relating to claims and liabilities of a financial nature, which go to finance the deficit on current account or to absorb its surplus, from the capital account.

1) Current Account

The transactions relating to goods, services and income, constituting the current account on the balance of payments, are functionally classified into two broad categories: merchandise and invisibles. As per the IMF's balance of payments manual, imports and exports of goods (merchandise) should be presented on a Free-on-Board (FOB) basis, i.e ., without including freight and insurance costs. Such freight and insurance costs should logically be covered under 'invisibles'. However, due to data constraints, the Indian authorities present imports on C.I.F (Cost, Insurance and Freight) basis while the exports are presented on Free on Board (FOB) basis.

2) Capital Account

Capital account in India is classified into three main sectors (i) Private Capital (ii) Banking Capital and (iii) Official Capital. Private capital is subdivided into (a) long term and (b) short-term, with loans of an original maturity of one year or less constituting the relevant dividing line. Long-term private capital covers foreign investments (both direct and portfolio), long-term loans, foreign currency deposits, Foreign Currency Non-Resident and Non-Resident External Rupee (FCNR and NRER) and an estimated portion of the unclassified receipts allocated to the capital account. Banking capital essentially covers movements in the external financial assets and liabilities of commercial and co-operative banks authorized to deal in foreign exchange. Official capital transactions, RBI's holdings of foreign currency assets and monetary gold (SDRs are held by the government), are classified into (i) loans, (ii) amortization and (iii) miscellaneous receipts and payments.

2. 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 of the economy.

3. Objectives

- To study the trend in the analysis of net invisibles in India's balance of payments
- To analyse the changes in the growth rate of invisibles

Hypothesis

Ho: There is no change in the growth rate of invisibles in the current account of balance of payments. **Ha:** There is a change in the growth rate of invisibles in the current account of balance of payments.

4. Review of Literature

Narinder Kaur in her work had concentrated on the study of exports. She had analysed data on exports pertaining to a number of commodities for the period from 1970-71 to 1990-91. She had analysed the growth of exports, income and price elasticities and the instability in commodity exports. In her work, she had estimated export projections for the traditional commodities and non-traditional commodities. She also had estimated export projections for different destinations to the major regions and the major countries. The main objective of her study was to examine the trends in the growth of the external variables.

Leonard, A.G. and Sebastian M. (1990) had analysed India's trade against Japan during the period 1977-78 to 1984-85. They had adopted the Net Barter Terms of Trade method to analyse the trends, and they had concluded that for India, its trade relations with Japan were precious and valuable. India's share in its trade with Japan both in respect of its exports as well as that of its imports was very low which was hardly one per cent.

Bhatt P.R. (1992) had made an attempt to measure the export competitiveness of India and had examined the role of the exchange rate policy on the export competitiveness of India for the period 1973 to 1989. The relative export prices, the relative wholesale prices, the relative profitability of exports and the index of import price competitiveness had been taken by him to measure the price competitiveness. It was found that the export competitiveness did not improve during the period 1973 to 1983. The index of relative export price competitiveness was also computed for six commodities namely spice coffee, tobacco, tea, cotton and rice. Indian exports were found to be less competitive in case of coffee and cotton and more competitive in the case of spices, tobacco, tea and rice.

Bibek Deb Roy (1993) had discussed the crisis indicators that the author analyses for the period 1980-81 to 1990-91 are, trade deficit as a percentage of GDP, current account deficit as a percentage of GDP, reserves as months of imports. After analysing the crisis indicators that led to liberalization, author discusses medium term structural adjustments that are implemented in the post 1991 period. According to the author structural adjustments are in the neo-classical framework. However, the author is of the view that there were no people oriented macro theory of balance of payments was followed.

Janaki I. (1995) had calculated the gains from international trade with the help of the income terms of trade and the expenditure terms of trade. The calculated gains had strongly suggested that India's expenditure terms of trade were greater than that of India's income terms of trade indicating that India's gains from international trade had also become negative during the same years. If India's propensity to import was to strictly depend upon its export performance, there was no possible way through which India could import its requirements based on its export earnings alone. But India continued to import notwithstanding the negative trends that were found both in the income terms of trade and in the gains from international trade. This in other words, had suggested that the imports had also been determined by considerations other than that of terms of trade.

Abdul Raheem (2007) had examined an alternative approach on Indian agricultural trade and performance of export of agricultural produce. Overstress on exports of agricultural product will change the cropping pattern in favour of each crop as against food crops. We are compelled to export of our agricultural product without having any surplus to meet the need of foreign exchange for importing conspicuous consumers' goods".

Vedphal and Sudesh (2007) have attempted to evaluate the relationship between the openness of external sector and the economic growth of India. For the purpose, co-integration type and error correction models have been applied to estimate the causal relationship between real

GNP and openness by using annual data for the period 1951-2002. The author has pointed out "openness is taken in broader sense by taking the summation of both exports and imports. The integration and co-integration properties of the data have been analyzed and the Granger Representative Theorem has been used to identify the nature of the casual relationship, and the results suggest that a feedback casual relationship exist between economic growth and exports plus imports. Further the authors concluded "There is no evidence for short run Granger causality between the economic growth and openness. Further they have found that India's economic growth and openness reinforce each other. A high degree of openness is associated with enhanced economic growth of India.

5. Methodology

Any serious and scientific research study requires an appropriate methodology, which should be a well-knit method that is adopted to solve systematically the research problem and to prove the authencity of the work that has been carried out. 2001-022018- 19

5.1 Reference period

The period of the study taken for analysis is 18 years (2001-02) to 2018-19). However, much emphasis has been given for India's service sector after the economic reforms process initiated after 1991 to assess the impact of service sector reform on Indian economy.

5.2 Data sources

The information required for the study has been collected from Reserve Bank of India Bulletin, RBI-Report on Currency and Finance, Economic Survey, Statistical office records, annual reports available in government and non-government websites, various Indian Economy and Econometrics books, articles published in Economic and Political Weekly, Global Economic Prospects, International Monetary Fund's Balance of Payments Statistics. Articles published in the Journal of Econometrics, International Review of Applied Economic Research, the Journal of typ

World Economic Review, Asian-African Journal of Economics and Econometrics.

5.3 Data analysis and tools used

The collected data have been processed both manually and with the help of computer software systems, Microsoft EXCEL and Statistical Package for Social Sciences (SPSS) for the analysis of data and testing the hypotheses. The following, appropriate statistical tools have been used in this study.

The methodology adopted to analyse the dynamics of invisibles on India's balances of payments on current account since 2001

5.4 Role of Invisibles in India's Balance of Payments

Invisibles play their dominant role, not only in enhancing foreign earnings, but also in covering the large parts of balance of payment deficit. The invisibles account in balance of payments reflects the combined effects of the transactions relating to international trade in services, income associated with non-resident assets and liabilities, labour and property and cross border transfers mainly workers' remittances. The invisibles have been providing substantial support to India's balance of payments in the recent years and are reflective of the ongoing structural transformation within the economy as well as its increasing integration with the world economy. Receipts under invisibles, particularly in the last one-decade, have grown significantly. The emphasis on reforms and liberalization since the early 1990s has not only unfolded newer opportunities for businesses but also for skilled labour as reflected in the direction of India's trade in goods and services and nature of labour migration. This transformation is reflected in the growth of receipts under invisibles, which has kept pace with merchandise exports growth as the principal foreign exchange earners for the country. It is not an exaggeration to say that invisibles play an important role in India's external sector. Surplus in the invisibles accounts has provided valuable balance of payment support in the face of external shocks. It is enthusiastic to note that surplus on invisibles have been able to cover merchandise trade deficit and hence assist in limiting the size of current account deficit after the initiation of Economic reform process in our country.

6. Results and Discussion

The following section shows the emerging trends in invisibles in India's balance of payments. Indicators: The various indicators relevant in analysing the balance of payments are presented in table l.

Table 1: India's Balance Of Payments Situation

Indicator	210-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Current Account Balance (% of GDP)	-0.6	0.7	1.3	2.3	-0.4	-1.2	-1.2	-1.8	-4.1
Import Cover of Foreign Exchange Reserves (no.of months)	8.8	11.5	14.2	16.9	14.3	11.6	12.5	14.3	9.8
Imports, dollar values (annual growth rate)	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	28.3	30.6
Exports, dollar values (annual growth rate)	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	21.9	17.5

Source: Govt of India, Economic Survey, 2018-19 (Delhi, 2020).

Table 1 shows that in 2010-11 the current account deficits was -1.7 per cent of GDP and the growth of exports was just 3.3 per cent on balance of payment basis. The import cover of foreign exchange reserves was also of only 4.9 months. But, the balance of payments situation 2011-12 improved considerably in 2011-12 In this year, the current account deficit was only 0.4 per cent 201-12 of GDP and another important development in 2011-12 was the exceptionally good performance on the export front. Exports recorded a growth of 20.0 per cent on balance of payment basis, in 2011-12 dollar terms, against an increase of 10.0 per cent in imports. All these facts show that there was a marked turnaround in the balance of payments situation in1 2011-12 The situation in 2012-13 was also satisfactory on many counts. The growth in imports continued untapped in 2013-14 as2013 well due to renewal of economic growth. Imports, in dollar value, grew by 21.6 per cent in this year. However, exports with a growth of 20.3 per cent almost matched the rate of increase in imports. Foreign exchange reserves in 2005-06 were enough to finance six month's imports.

The balance of payment situation improved further in 210-11 and the current account deficit in this year narrowed further to about 0.6 per cent of GDP. From the point of view of balance of payments, most significant have been the three years 2011- 2012 and 2013-14. The surplus on current account was 0.7 per cent of GDP in 2013-14. After recording a surplus for three years in a row, the current account once again recorded a deficit in 2014-15 which was 0.4 per cent of GDP. In the year 2015-16, 2016-17, 2017-18 and 2018-19 the current account deficit were 1.2, 1.1, 1.8 per cent of GDP and 4.1 per cent of GDP.

Table 2 shows the balance of payment position from 2001-02 to 2018-19. The trade balance is neither continuous decrease nor continuous increase up-to the year 2013-14 from the 2003-04. After the year from 2003-04 trade balance had increased as US $ -33702 million and further it has continuously increased to US $ -119403 million in 2008-09. The net invisibles column also shows the ups and downs in the growth of net invisibles from 2011-12 to 2012-13, after 2012-13 it shows the increasing trend and in the year 2018-19 it had increased as US $ 89586 million. Current account Shows a zigzag trend, it implies that the negative growth in current account from 2001-02. After that it had increased continuously from US $ 3400 million in 2011-12 to US $ 14083 million, which shows the positive growth. Emergence of positive balance on current account is a major achievement of the post reform period. The capital account was U/S $ 1665 n the year 2000-01 had increased to US

$ 109198 in the year 2017-18 and it decreased to US $ 9737 million in the year 2017-18. It shows that the volume of capital account was increasing at a faster rate and it has surplus account.

Table 2: India's balance of payments: 2001-02 to 2018-19 (us $ million)

Year	Trade balance	Invisible (Net)	Current account (Net)	Capital account Total (Net)	Reserve use (-increase)	Overall balance
2001-02	-2798	1620	-1178	3777	-3384	2599
2002-03	-55447	1921	-3526	2936	-698	-590
2003-04	-4056	2897	-1159	9694	-8723	8535
2004-05	-9049	5680	-3369	9156	-4644	5187
2005-06	-11359	5447	-5912	4690	2937	-1222
2006-07	-14815	10906	-4619	11412	-5818	6793
2007-08	-15507	10008	-5499	10010	-3893	4511
2008-09	-13246	9208	-4038	8260	-3829	4222
2009-10	-17841	13143	-4698	11100	-6142	6402
2011-12	-12460	9794	-2666	8535	-5842	5868
2012-13	-11574	1974	3400	8957	-11757	11757
2013-14	-10690	17035	6345	10540	-16985	16984
2014-15	-13718	2781	1483	17338	-31421	31421
2015-16	-32702	31232	-2417	28629	-2659	2659
2016-17	-15904	42002	-9902	24944	-15052	15052
2017-18	-61782	52212	-9565	46171	-36606	36606
2018-19	-91626	74592	-17034	109198	-92164	92164

Source: Govt of India, Economic Survey, 2019-20, RBI Bulletin Various Issues.

Table 3: Percentage Share of Invisibles in Covering Current Account of Balance of Payments (US $ million)

Year	Trade Balance	Invisible (Net)	Percentage Invisible
(1)	(2)	(3)	(4)
2003-04	-4056	2898	71.45
2004-05	-9049	5680	62.77
2005-06	-11359	5449	47.97
2006-07	-14815	10196	68.82
2007-08	-15507	10007	64.53
2008-09	-13246	9208	69.51
2009-10	-17841	13143	73.67
2010-11	-12460	9794	78.6
2011-12	-11574	14974	129.38
2012-13	-10690	17035	159.35
2013-14	-13718	27801	202.66
2014-15	-33702	31232	92.67
2015-16	-51904	42002	80.92
2016-17	-61782	52217	84.52
2017-18	-91626	74592	81.41
2018-19	-119403	89586	75.03

Source: Govt of India, Economic Survey, 2018-19 (Delhi, 2019),

Table 3 clearly brings out the role played by invisibles in the balance of payments since 1993-94. As is clear from the table, invisible has all along contributed positive earnings since 1993-94 while there were always heavy deficits on trade account. The positive earnings from invisibles op covered a substantial part of the trade deficit with the result that the current account deficit was reduced significantly. In 2003-04, the trade deficit was $ 4.06 billion, while net earnings from invisibles were $ 2.90 billion. Thus, invisibles covered 71.4 per cent of the trade deficit. A calculation of percentage of invisibles to trade deficit brings out that invisibles covered 62.8 percent from trade deficit exceeded in 2004-05, 73.7 percent trade in account 1999-2000 in 2001-02, and 82.0 2010-11.Earnings from invisibles exceeded the deficit on trade account in 2001-02, 2002-03 and 2003-04 with the result that there was a surplus on current account in these years. In2014-15,invisibles covered 2 92.7 percent, Further the per cent of invisibles have been continuously decreased to 75.03 per cent in the year 2008-09) 2018 - 19

6.1 Emerging Trends in Invisibles

The trend in the analysis of net invisibles in India's balance of payments is summarized below.

Table 4: Trend Analysis of Net Invisibles in India's Balance of Payments

Net Invisibles	A	B	t	R2	Sig t
Pre-reform period 1980-81 to 1990-91	5381.67	-453.90**	-11.45	0.94	0.0000
Post-reform period 1991-92 to 2008-09	-16218.032	4159.52**	6.890	0.75	0.0000
Whole period 1980-81 to 2008-09	-14151.66	1974.69**	5.860	0.56	0.0000

Source: Computed by the researcher ** 5 per cent level of significance

From 2001-02 to 2018-19 net invisibles increased at the absolute rate of US $ rom 4159.52 million per annum. For the whole period from 1980-81 to 2018-19, the net invisible has 2001-02 increased at the absolute rate of US $1974.69 million per annum. The R^2 values are satisfactory for net invisibles in the pre reform, post reform and in the whole periods. The t values are statistically significant at 5 per cent and 1 per cent levels for invisible receipts and payments in the pre reform, post reform and for the whole periods. The growth of net invisibles, witness that India's Invisible trade always generated surplus, except the year 2001-02. It also reflects the positive impact of foreign trade and investment policy changes with regard to invisibles. It means invisibles are playing their crucial role in covering the current account deficit and lowering down balance of payment of our country.

6.2 Student 't' Test:

To analyze the changes in the growth rate of invisibles student't' test is used and the following hypothesis is tested.

Ho: There is no change in the growth rate of invisibles in the current account of balance of payments.

Ha: There is a change in the growth rate of invisibles in the current account of balance of the payment

$$t = \frac{b1 - b2}{\sqrt{(S.E\,b1)\,2 + (S.E\,b1)2}}$$

$$t = \frac{453.90 - 4159.52}{\sqrt{(39.6569)2 + (603.6633)2}}$$

$$t = \frac{3705.62}{\sqrt{604.96}}$$

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t = 6.125 degree of freedom = (n1 + n2 - 2), = (29-2), = 27, For d.f = 27; t 0.05 = 2.052

The calculated value of 't' is greater than the table value at 5 per cent level of significance. So, the null hypothesis that is, there is no change in the growth rate of invisibles in the current account of balance of payments is rejected.

7. Findings and Suggestion

The study has amply shows that the invisibles have been providing substantial support to India's balance of payments in the recent years and are reflective of the ongoing structural transformation within the economy as well as its increasing integration with the world economy.

In 2002-03 the current account deficits was -1.7 per cent of GDP and the growth of exports was just 3.3 per cent on balance of payment basis. The import cover of foreign exchange reserves was also of only 4.9 months. But, the balance of payments situation improved considerably in 2003-04.In this year the current account deficit was only 0.4 percent of GDP and another important developments in 2003-04 was the exceptionally good performance on the export front. Exports recorded a growth of 20.0 per cent on balance of payment basis, in dollar terms, against an increase of 10.0 per cent in imports. All these facts show that there was a marked turn around in the balance of payments situation in 1993-94. The situation in 1994-95 was also satisfactory on many counts. The growth in imports continued untapped in1995-96 as well due to renewal of economic growth. Imports, in dollar value, grew by 21.6 per cent in this year. However, exports with a growth of 20.3 per cent almost matched the rate of increase in imports. Foreign exchange reserves in 2005-06 were enough to finance six month's imports.

The balance of payment situation improved further in 2000-01 and the current account deficit in this year narrowed further to about 0.6 per cent of GDP. From the point of view of balance of payments, most significant have been the three years 2001-02, 2002-03 and 2003-04. The surplus on current account was 0.7 per cent of GDP in 2013-14. After recording a surplus for three years in a row, the current account once again recorded a deficit in 2014-15, which was 0.4percent of GDP. In the year 2015-16, 2016-17, 2017-18 and 2018-19 the current account deficit were 1.2, 1.1, 1.8 per cent of GDP and 4.1 per cent of GDP.

From 2001-02 to 2018-19 net invisibles increased at the absolute rate of US $ 4159.52 million per annum. For the whole period from 2001-02 to 2018-19 the net invisible has increased at the absolute rate of US $ 1974.69 million per annum. The R^2 values are satisfactory 2001 for net invisibles in the pre reform, post reform and in the whole periods. The t values are statistically significant at 5 per cent and 1 per cent levels for invisible receipts and payments in the pre reform, post reform and for the whole periods. So the null hypothesis that is, there is no change in the growth rate of invisibles in the current account of balance of payments is rejected.

During the period 2001-02 to 2008-09, the invisibles receipts constituted 45.7 per cent of current account receipts, while invisibles payments accounted for 24.2 per cent of current account payments.

The analysis has shown that the 'b' value for trade balance for the pre-reform period was -166.236 which shows that the trade balance has decreased at an absolute rate of US $ -166.24 million per annum, where as in the post-reform period the trade balance has decreased at an absolute rate of US $ -4804.68 million per annum. For the whole period, the trade balance has decreased at an absolute rate of US $ -2144.81 million per year: The R^2 values for the pre reform, post-reform and for the whole periods were 0.25, 0.62 and 0.44 respectively. The 't' per values for the pre-reform, post-reform and for the whole periods are statistically significant at 5 percent and 1 percent level.

In order to attain surplus in the trade account of balance of payments exports should be encouraged. Inward remittances should be further encouraged.

The government should encourage producing high quality low cost products to capture a major share of the world market.

The openness in trade should be further encouraged.

8. Conclusion

The liberalization of India's external sector during the past decade was extremely successful in meeting the balance of payment crisis of 1990 and putting the balance of payments on a sustainable path. These reforms improved the openness of the Indian economy vis-?-vis other emerging economies. Much, however, remains to be done. The main lesson of the nineties is that liberalization of the current and capital account increases the flexibility and resilience of the balance of payment. The impact of fiscal profligacy on the external account has become indirect and circuitous with implementation of external sector reforms. It operates much more through the general expectations about economic prospects and the risk premium demanded by foreign (and domestic) investors and lenders. Thus its negative effects are likely to be focused on the domestic rather than the external account. In other words, the negative long term effects of fiscal profligacy are more likely to be felt in future on the growth rate of the economy and the domestic financial sector.

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