

Chapter 4

BALANCE OF PAYMENTS

4.1 Balance of Payments & Its Components: Balance of Payments (BOP) statistics systematically summaries the economic transactions of an economy with the rest of the World (i.e. transactions between resident & non resident entities) during a given period. It comprises **current and capital & financial accounts** to understand BoP, we should first understand what Gross Domestic Product (GDP) means. $GDP = C+G+I+X-M$, where C stands for private consumption, G stands for government consumption, I stands for domestic investment, (X-M) stands for net exports and X stands for export & M stands for imports. If net exports of goods and services (X-M) are negative (i.e. Balance of Trade is negative or there is a trade (including services) deficit,), the domestic economy is absorbing more than it can produce. In other words, absorption (C+G+I) by the domestic economy is greater than domestic output (GDP). This adverse trade balance (or trade deficit) is also reflected in Current Account of BOP, which besides covering goods and services also covers income (investment income & compensation of employees) and current transfers (remittances, grants etc). In case the combined net effect of trade balance, income and current transfers is also negative, the same results in Current Account Deficit. The deficit needs to be financed by external borrowings and/or investments which are constituents of Financial Accounts.

- **Current Account:** As per Balance of Payment Manual (IMF), **current account** covers all transactions (other than those in financial items) that involve economic values and occur between resident and non resident entities. Also covered are offsets to current economic values provided or acquired without a quid pro quo. Specifically, the major classifications are *goods and services*, *income*, and *current transfers*. Thus, current account is a broader measure than trade balance as it also includes income (investment income & compensation of employees) & current transfers. The current account of the BoP provides information not only on international trade in goods, but also on international transactions in services. Current account of the BoP, transactions can be classified into merchandise (exports and imports) and invisibles. Invisible transactions are further classified into three categories, namely (a) Services-travel, transportation, insurance, Government not included elsewhere (GNIE) and miscellaneous (such as, communication, construction, financial, software, news agency, royalties, management and business services etc); (b) Income (investment income & compensation of employees); and (c) Current Transfers (grants, gifts, remittances, etc.) which do not have any quid pro quo. Investment income covers receipts and payments of income associated, respectively, with residents' holdings of external financial assets and with residents' liabilities to non-residents. Investment income consists of direct investment income, portfolio investment income, and other investment income.
- The former balance of payments capital account has been redesignated as the **capital and financial account** as per the fifth edition of Balance of Payments Manual(IMF) and the revised account has two major components:
 - The Capital Account
 - The Financial AccountThese are in accordance with the same accounts in the System of National Accounts

(SNA). Assets represent claims on residents and liabilities represent indebtedness to non residents.

- **Capital Account:** The major components of the capital account are (a) capital transfers and (b) acquisition/disposal of nonproduced, nonfinancial assets.
- **Financial Account:** The financial account records an economy's transaction in external financial assets and liabilities. All components are classified according to type of investment or by functional subdivision ((a) direct investment, (b) portfolio investment, (c) other investment,(d) reserve assets (external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes)).For the category of direct investment, there are directional distinctions (abroad or in the reporting economy) and, for the equity capital and other capital components within this category, asset or liability distinctions. For the categories of portfolio investment and other investment, there are the customary assets or liability distinctions. Particularly significant for portfolio investment and other investment is the distinction by type of instrument (equity or debt securities, trade credits, loans, currency and deposits, other assets or liabilities). The traditional distinction, which is based on original contractual maturity of more than one year or one year or less, between long- and short-term assets and liabilities, applies only to other investment. Classification according to Sector of the domestic transactor (general government, monetary authorities, banks and other sectors) is also used.

4.2 Data Source: The **Reserve Bank of India (RBI)** is responsible for compilation and dissemination of BoP data. The data on India's Balance of Payments (BoP) are published by the Reserve Bank on a **quarterly basis with a lag of one quarter** BoP is broadly consistent with the guidelines contained in the BoP Manual of the International Monetary Fund.

4.3 The data on merchandise trade are available from two sources namely; (a) from the Directorate General of Commercial Intelligence and Statistics (DGCI&S) on customs basis; and (b) from RBI on payments (which includes both receipts and payments) basis.

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1	4.1	Overall Balance Of Payments
2	4.2(A)	External Assistance-Authorization Classified By Source
3	4.2 (B)	External Assistance-Utilisation Classified By Source

References:

A) Reserve Bank of India.

B) Department of Economic Affairs, Ministry of Finance.