Balance of Payments (BoP) for a country is a statistical statement that summarizes economic transactions between its residents and non-residents during a specific time period. In 2010-11, Reserve Bank of India shifted to the reporting pattern of International Monetary Fund’s *Balance of Payment and International Investment Position Manual 6 (BMP 6)*, which classifies BoP transactions as (i) current account (ii) capital account and (iii) finance account transactions. Current Account includes transactions under the heads “goods” (including general merchandise, non-official gold imports etc.), “services”, “primary income” (including compensation of employees, investment income etc.) and “secondary income” (including personal transfers and remittances etc.). Also, while Capital Account transactions now include official transactions affecting economy’s gold reserves (i.e. the gold owned by monetary authorities and held as a reserve asset), special drawing rights, financial claims and liabilities etc., Financial Account transactions include unrequited transfers like direct investments, portfolio investment, external commercial borrowings etc.

It may be worthwhile to note here that Current Account transactions are sometimes also classified as “visible transactions” (including merchandise goods, non-official gold imports etc.) and “invisible transactions” (including “services” and “income”) with visible transactions usually presenting “trade balance” of an economy at a given point of time.

In the year 2011-12 and 2012-13, current account balance for India reached deficit levels of 4.6% (US$ 78 billion) and 4.8% of GDP (US$ 87 billion), mainly on account of a more specific “trade deficit” phenomenon arising from merchandise goods and gold trade deficits. Compared to Current Account Deficit (CAD) figures of 4.6% and 4.8% of GDP, India’s trade deficits stood at 10.2% and 10.8% of GDP for the years 2011-12 and 2012-13. Also, usually “invisible” surpluses comprising “service” exports and “income” transfers like remittances from abroad have played a crucial role in evening out large trade deficits in India. The remaining CAD in turn have been getting financed by net capital inflows belonging to the *financial account (capital account* according to earlier BMP5 of IMF), although concerns about volatile nature of these inflows due to predominant share of portfolio investment have been expressed time and again. However, in recent times, while “invisibles” have remained stagnant, capital inflows have reduced significantly in the post financial crisis scenario.

Given these basic trends in India’s CAD and its financing pattern, detailed analysis of present CAD reveals *oil, gold, coal* and *iron ore* as some of the key contributors for the present
situation. With a stockpile of 25000 tonnes and accounting for around a quarter of the world demand, gold imports in India increased from US$ 33 billion (in 2009-10) to US$ 57 billion (2011-12) and US$ 53 billion (2012-13). Share of gold in imports has also increased considerably from 7.6 % (2005-06) to 12.6 % (2011-12). Main reason for this phenomenon is said to have been the increase in global prices of gold in the post financial crisis scenario, as the world’s savers looked for ‘safe havens’ to park their savings. Since 2005, gold price has doubled in terms of US$ and tripled in terms of Rupee. Surpassing returns on other investment, between 2007 and 2012, gold gave annual average returns of 23.7 % as compared to 7.3 % by Nifty (National Stock Exchange in India) and 8.2 % by Savings Deposits (Sehgal et al 2012, cited in Economic Survey 2012-13). In addition, it acts as a good hedge against inflation, which reduces real return on investments (inflation in India stood at 9.6 % and 8.9 % for the years 2010-11 and 2011-12 respectively). Hence, the recent spurt in gold demand and import by India is less about its historical affinity for consumption as jewelry and more about investment dynamics. Gold Loan schemes by Banking and Non-Banking Financial Companies (NBFCs) have further encouraged this demand. While in the year 2008, total gold loans stood at Rs 20,000 crore, the same stood at Rs. 1,50,000 crore in the year 2012. In addition to these, other benefits associated with gold like liquidity, safe source for parking black money, saving instrument for rural areas lacking banking facilities etc. also continued to exert pressure on gold demand.

However, though gold imports have been one of the main reasons for the present CAD, non-gold trade deficits also deteriorated sharply from US$ 96 billion (2010-11) to US$ 131 billion (2011-12) and US$ 144 billion (2012-13). Rising oil and coal import bills and reduced iron ore export earnings have been some of the main components for this trend. Oil bill continues to be one of main components on Indian import bill in light of the inelastic and growing energy demand and rising global crude prices due to exogenous factors like Middle East political economy and recent Arab Spring episodes. Studies have estimated that each US$ 10 per barrel change in crude price impacts current account balance in India by around US$ 8 billion.

For Coal, though possessing world’s second largest coal reserves, India’s import of the same has increased steadily from 20 million tonnes (mt) in 2001 to 74 mt in 2009 and 130 mt in 2012, resulting in an import bill of around US$ 18 billion. With around 60 % to 70 % of the country’s electricity being generated from coal, imports are expected to increase further in future due to domestic production constraints.

As regards Iron Ore, while India exported 117 mt of iron ore in 2009-10, the figures saw a steep decline to 18 mt in 2012-13. With India expected to be a net importer of iron ore in 2013-14, this will mark a quick shift in India’s position from being the third largest exporter of iron ore to a net importer over a very short period of time. Main reasons for this trend are said to have
been a cap in production in Karnataka, ban in Goa and strict enforcement of environmental regulations in Odisha due to Supreme Court rulings and state interventions.

Given these diverse forces at play, an effective policy intervention to address present CAD has also to be necessarily multi-pronged. Also, with little room available for managing oil imports in the short run, present CAD management has to be through non-oil components only. While since January 2012, government has gradually raised import duty on gold from 2 % to 10 %, the same has been protested by gems and jewelry industry saying that it would adversely impact the Rs. 2,75,000 crore industry employing around 60 million people. Increased duty is also believed to have resulted in increased smuggling of gold.

Hence, given the complexities involved and the time it might take to set the non-oil current account deficit to tune, government is exploring options to finance the same via long term stable finance account flows. Some of the options that have been recently suggested and tried include liberalization of Foreign Direct Investment policy, allowing PSUs to raise money abroad, continued attracting of sovereign wealth and pension funds to India, raising money from NRIs, and loosening of restrictions for borrowing by Indian companies abroad etc.

Today, the external sector transactions amount to around 108 % of GDP, as compared to around 30 % of GDP for the year 1990-91. These figures point towards a more compelling need to diversify Indian exports, both destination wise and commodity wise. While it is always prudent to take lessons from history, every situation or challenge comes with its own peculiarities. Recent CAD trends in India have clearly shown that increased integration with the global economy brings with it both opportunities and challenges, and it is here that the role of government becomes most crucial to play a balancing act between these two tendencies.

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