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COMPOSITION AND CONTRIBUTION OF CURRENT ACCOUNT TO INDIAN ECONOMY

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ABSTRACT

An important component of Balance of Payments (BOP) that depicts the country's foreign transactions is Current Account. Current Account, being a part of BOP includes all the transactions involving exchange of economic value between resident and non-resident entities. The Current Account element includes Merchandise Exports, Merchandise Imports and Invisibles. The present study is an attempt to analyse the various elements of Current Account balance of India and thereby examining the impact of Current Account on Gross Domestic Product (GDP) in India during 2004-2005 to 2013-2014. Regression analysis represents the significant impact of Current Account balance on GDP and Correlation analysis indicated the significant relationship between various elements of Current Account during the study period. The study found that the Current Account deficit of the nation remain a great obstacle in the path of economic growth of the nation.

KEY WORDS: Balance of Payments, Merchandise Exports, Merchandise Imports, Invisibles and Current Account.

JEL Classification code: F10, F14.

INTRODUCTION

Conventionally, the main intention of the Indian International Trade Policy has been to guard its market from alien competition. Up until the 1980s, India was not fascinated in exporting its goods and services abroad and not ready to untie its economy to foreign investments. India's track of overseas trade has exhibited a structural swing during the last decade. Trade dimensions and trade split of emerging and developing economies has improved while the share of conventional trading partners has showed a declining trend. However, the slowdown in world growth and trade in 2012 and forecast of only a gradual increase in global growth by international institutions signify a weak and slow recovery for world trade. An important component of Balance of Payments (BOP) that depicts the country's foreign transactions is Current Account. Current Account, being a part of BOP includes all the transactions involving exchange of economic value between resident and non-resident entities. Current Account balance of India's Balance of Payments (BOP) comprises of Merchandise Exports, Merchandise Imports and Invisibles. India's exports, which had surpassed pre-crisis levels within a year in 2010-11 with a record 40.5 per cent growth, continued growing even in 2011-12, but were finally affected by the global slowdown in 2012-13 with exports declining even more at - 4.9 per cent in the first ten months than the -3.5 per cent recorded during the crisis-ridden year of 2009-10, contributing for BOP to about 368 USD billion in 2013-2014. On the other hand, the country's imports, grew by 26.0% (CAGR) during the period, 2003-2013 and stood with USD 466 billion in 2013-2014. In recent years, India's Balance of Payments (BOP) developments have been marked by strong growth in invisibles receipts, which have provided sustained support to the Current Account position with the share of USD 115 billion during 2013-2014.

PROBLEM DISCUSSED IN THE STUDY

The global economy is still struggling to return to a strong and sustained escalation path after crisis. Indian financial system and overseas trade are on a growth trail. The Current Account balance of India was always been a deficit for most of the fiscal years since independence and became supplementary in the past decade, which has been on a growing trend. India's Merchandise Export growth has almost constantly been above world export growth in the 2000s decade and even after 2010. Export was never above the level of import for almost three decades. The country imports both Oil and Non-oil items to meet out the needs of the nation. The contribution of invisibles also inevitable while studying the prospects of Current Account in India's Balance of Payments. As the years pass by, the increasing Current Account deficit comprising unfavourable trade balance and invisibles' least contribution has added burden to Capital Account contribution. If an economy is running into Current Account deficit, it means that domestic consumption, spending and investments are more than what it is actually producing. This will lead to rising foreign liabilities and decline in foreign asset. This may have certain strong action on the economy of India. Thus, a study has been made to identify the growth of components of Current Account balance and its impact on Gross Domestic Product (GDP) in India during 2004-2005 to 2013-2014. With the foresaid observations, the research, in the present study has attempted to identify the answers for the following research questions.

- ❖ What is the growth of Current Account in India?
- ❖ Is there, significant relationship between the elements of Current Account?
- ❖ How far the Current Account affected the GDP in India?

REVIEW OF LITERATURE

📁 **Dr. Mehernosh B. Mehta and IProf.**

Hatim F. Kayumi (2013), found that Current Account is an important component of Balance of Payment which represents country's foreign transactions. A Current Account Deficit indicates negative sales abroad. They suggested that there are various factors which influence country's External Borrowings as well as Foreign Exchange Rates. One such important factor is Current Account (Trade Balance) Deficit. They concluded with the fact of having correlation between India's Current Account Balance with External Debt, its components, and selected Foreign Exchange Rates that includes US Dollar, Pound Sterling, Japanese Yen and Euro Dollar.

📁 **Rajesh K Pillania (2008)**, suggested that Indian economy and foreign trade are on a growth trajectory. Indian exports have come a long way in value terms from the time of gaining independence in 1947. The total value of India's merchandise exports increased from US \$ 1.3 billion in 1950-51 to US \$ 63.8 billion in 2003-04. The composition of trade is now dominated by manufactured goods and services. India services exports share in global exports is more than double of that of Indian manufacturing exports. East Asian countries, particularly China have become a major trading block. There is huge untapped potential for Indian foreign trade in years to come.

📁 **Arslan Razmi (2005)**, applied the Balance of Payments Constrained Growth (BPCG) model to India, a large developing country with a relatively low

trade to GDP ratio. The researcher found that, the average growth rates predicted by various forms of the BPCG hypothesis are found to be close to the actual average growth rate over the period 1950-1999, although individual decades display substantial deviations.

OBJECTIVES OF THE STUDY

The objectives of the study are:

- ↳ To examine the growth of Current Account in India.
- ↳ To analyse the relationship between various elements of Current Account of India.
- ↳ To identify the impact of Current Account on GDP in India.

SCOPE OF THE STUDY

The study has been attempted to analyse the growth of various elements of Current Account and its impact on GDP. It does not cover volatility or risk-return analysis of the Current Account on Balance of Payments.

HYPOTHESES OF THE STUDY

The hypotheses framed for the study are:

H_{01} : Elements of Current Account have no significant relationship among themselves.

H_{02} : Current Account have no impact on Gross Domestic Product of India.

METHODOLOGY FOR THE STUDY

Sources of data:-

The study is based on secondary data and the reliable data for the study has been compiled from the Statistical handbook of Indian Economy 2013 of Reserve Bank of India.

Period of study:-

The study period is 10 years from 2004-2005 to 2013-2014.

Tools Used:-

The collected data have been used for analysis with the help of statistical tools namely Mean, Standard Deviation, Skewness, Kurtosis, Jarque Bera test, Compound Annual Growth Rate, Coefficient of Variation, Corelation and Regression.

SIGNIFICANCE OF THE STUDY

The Current Account of Balance of Payments is inherent that has a remarkable impact on Indian economy. The Current Account with its negative contribution all through the way have remarkable connotation in Indian financial system. The study analysed

the effect of Current Account on GDP, which has its implications with benefits to policymakers, academicians and information seekers.

LIMITATIONS OF THE STUDY

The major limitations of the study are;

- ☞ The study is made only in consideration with India and not applicable to any part of the globe.
- ☞ The study fully depends on the secondary data, which has its own limitations.

ANALYSIS OF THE ELEMENTS OF CURRENT ACCOUNT AND ITS IMPACT ON GROSS DOMESTIC PRODUCT

Table - 1 Descriptive Statistics of Current Account Elements in India during 2004-2005 to 2013-2014

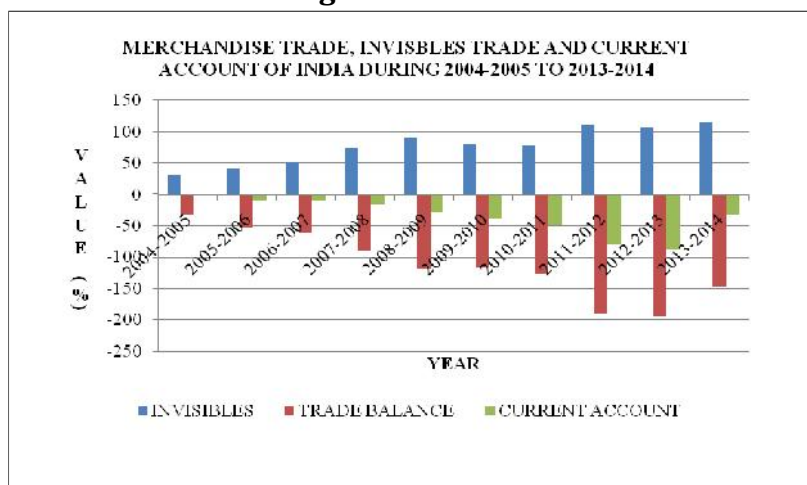
	INVISIBLES	EXPORTS	IMPORTS
Mean (US \$ billion)	78.63	204.79	318.48
Std. Dev (US \$ billion)	29.29	87.69	141.00
CAGR (%)	0.14	0.16	0.30
CV(%)	37.25	42.82	44.27
Skewness	-0.29	0.10	0.04
Kurtosis	1.84	1.55	1.64
Jarque-Bera	0.69	0.89	0.77
Probability	0.70	0.63	0.67

Source: Compiled and calculated from Statistical Handbook of Indian Economy 2013.

The table - 1 represents the Descriptive Statistics of Elements of Current Account of India for the period 2004-2005 to 2013-2014. The mean value of Invisibles is US \$ 78.63 billion, Exports at US \$ 204.79 billion and Imports US \$313.48 billion with the standard deviation of US \$ 29.29 billion, US \$ 87.69 billion and US \$ 141 billion respectively. The growth rate among the components is high for Imports at 0.30 per cent followed by Exports 0.16 per cent and Invisibles 0.14 per cent. The consistency level

was high with Invisibles with CV 37.25 per cent that shown sustainable development during the study period followed by Exports 42.82 per cent and Imports 44.27 per cent. Both the Merchandise Exports and Imports are positively skewed when Invisibles skewed negatively. There is playkurtic kurtosis for all the elements during the study period. The Jarque-Bera test shows the positive normal distribution of elements of Current Account during the study period.

Chart -1 Growth of Merchandise Trade, Invisibles Trade and Current Account of India during 2004-2005 to 2013-2014

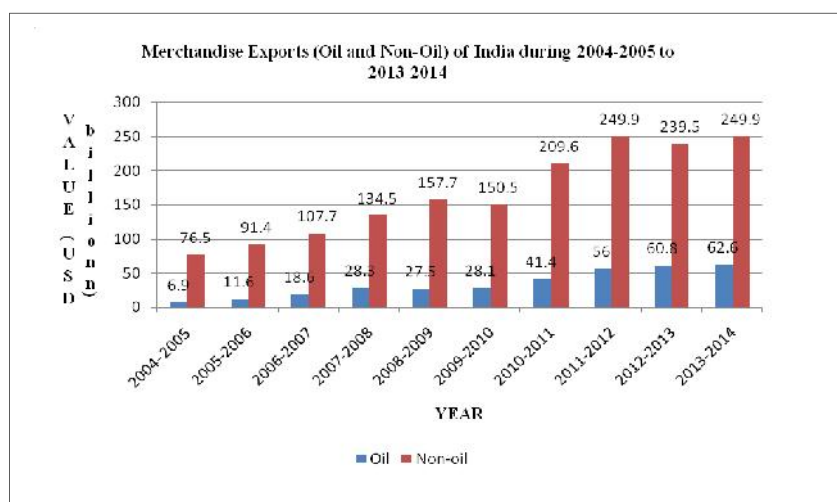


Source: Compiled and calculated from Statistical Handbook of Indian Economy 2013.

The chart-1 shows the growth of Merchandise Trade balance, Invisibles and the overall Current Account Balance in India during the study period from 2004-2005 to 2013-2014. The chart shows the sustainable development in Invisibles Trade during the study period. Despite fluctuations during 2009-2010 and 2010-2011, it has registered a favourable growth for Current Account of Balance of Payments. The Trade Balance (Merchandise Exports-

Merchandise Imports) was never positive during the study period. There were heavy imports against exports to meet out the internal country needs. The growth was unstoppable till 2012-2013 and has shown a decrease at the end of the study period. The Current Account was shown the deficit during the study period. It has shown increasing trend until 2012-2013, with a mild dropdown in 2013-2014.

Chart - 2 Merchandise Exports (Oil and Non-oil) of India during 2004-2005 to 2013-2014

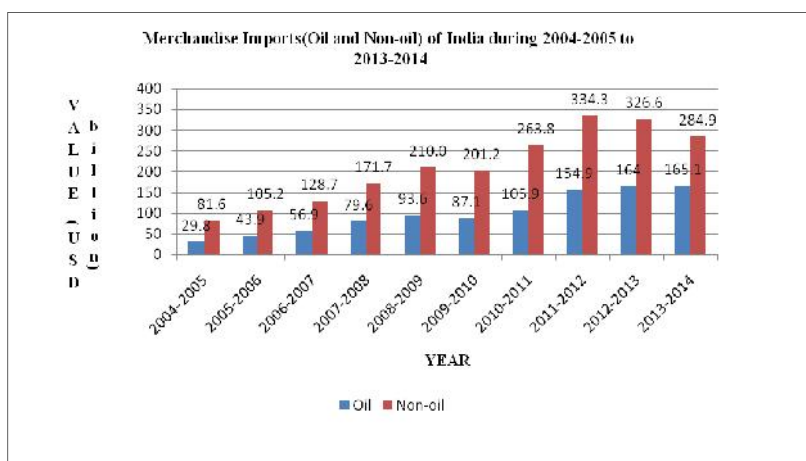


Source: Compiled and calculated from Statistical Handbook of Indian Economy 2013.

The chart - 2 shows the Merchandise Exports (both Oil and Non-oil) of India during the study period from 2004-2005 to 2013-2014. There were excessive Non-oil exports when considering Oil exports during the study period. It is so because India is not rich in Oil resources. Despite having unfavourable trade balance,

India tends to export lesser than imports. Oil exports have shown escalating trend during the study period. Non-oil exports were quite pathetic with drop downs during 2009-2010 and 2012-2013. It is clear from the chart that Non-oil exports leads Oil exports in India during the study period 2004-2005 to 2013-2014.

Chart - 3 Merchandise Imports (Oil and Non-oil) of India during 2004-2005 to 2013-2014



Source: Compiled and calculated from Statistical Handbook of Indian Economy 2013.

The chart-3 depicts the Merchandise imports (Oil and Non-oil) of India during the study period from 2004-2005 to 2013-2014. The Oil import was lesser than Non-oil imports. Both the Oil and Non-oil imports felt frequent fluctuations during the study period, in which

the rate of fluctuations were higher in Non-oil imports than Oil imports during the study period.

H_{01} : Elements of Current Account have no significant relationship among themselves

Table - 2 Correlation analysis of various elements of Current Account of India during 2004-2005 to 2013-2014

		Correlations		
		INVISIBLE	EXPORTS	IMPORTS
S				
INVISIBLE	Pearson Correlation	1		
EXPORTS	Pearson Correlation	.957**	1	
IMPORTS	Pearson Correlation	.972**	.995**	1
** Correlation is significant at the 0.01 level (2-tailed).				

Source: Compiled and calculated from Statistical Handbook of Indian Economy 2013.

The table - 2 represents the Correlation analysis of various elements of Current Account of India during 2004-2005 to 2013-2014. It is

clear from the table that the various elements namely Invisibles, Merchandise Exports and Merchandise Imports during the study period

were positively correlated with each other. Hence, the null hypothesis is rejected and confirmed that there is a significant relationship between the elements of Current Account in India during the study period 2004-2005 to 2013-2014.

ANALYSIS OF IMPACT OF CURRENT ACCOUNT ON GROSS DOMESTIC PRODUCT IN INDIA

H_{02} : Current Account has no impact on Gross Domestic Product of India.

Table – 3 Regression analysis of Current Account and Gross Domestic Product of India during 2004-2005 to 2013-2014

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	F Value	Significance/Non-Significance
1	.800 ^a	.640	.595	1494084.87238	14.222	Significance

a. Predictors: (Constant), CURRENT ACCOUNT

Source: Compiled and calculated from Statistical Handbook of Indian Economy 2013 and World Bank.

The above table 3 shows the regression analysis between Current Account and Gross Domestic Product for the period 2003-2004 to 2013-2014. The analysis placed Gross Domestic Product as dependent variable and Current Account as independent variable. The analysis shows ($R^2 = 0.640$), which states that the Current Account contributed significantly for the growth of Gross Domestic Product in India. The calculated F value is more than the table value and hence, the null hypothesis is rejected and there is a significant effect by Current Account on Gross Domestic Product during the study period.

FINDINGS OF THE STUDY

The major findings of the study are:

- ★ The Current Account balance and its respective components are found growing. In particular there was unfavourable trade balance and deficit in Current Account of Balance of Payments all through the study period.
- ★ Non-oil exports leads Oil exports and Non-oil imports leads Oil imports during the study period.

- ★ There is a significant relationship between various elements of Current Account.
- ★ There is a significant impact of Current Account on Gross Domestic Product in India.

SUGGESTIONS

The important suggestions based on findings are:

- ✓ The imports can be reduced to meet out the favourable balance of trade, but at the present situation of the nation with inadequate inevitable goods it is unavoidable to import more. The country can maximise production to enlarge exports to meet global demands as well as improving the Current Account balance of the nation.
- ✓ Since price rise in Oil leads to price rise in basic goods, the nation has to take steps to make utilisation of Oil resources of the nation to avoid excessive Oil imports. The country has to spent more money to find out Oil resources in the nation's soil.

- ✓ Invisibles trade can be improved by providing assistances in its trade.
- ✓ The authorities has to take steps to improve the Current Account balance in order to reduce the burden of Capital Account contribution to Balance of Payments in India, by setting up more Export Promotion Zones, setting up of large scale industrial goods undertakings in backward states of the nation specially for export (though expensive, can simultaneously provides employment to people of backward states), providing Import tariffs and Non tariff barriers.

CONCLUSION

Current Account balance of an emerging nation plays a significant role in the development of economic growth. It owes the nation, the fame and credit worthiness during the particular reign. The credit worthiness of the nation depends largely on it. Though it is not appreciable for India while considering Current Account balance of various Asian and European nations, it is not permanent and the nation will have its own supremacy in the future to prosper in international trade above meeting internal need. With this view, the Trade Policy 2009-2014 aims to accelerate export and discourage imports to ensure surplus trade in five years. The measures comprise concessions as well as relaxations in procedures. The policy envisages doubling India's export of goods and services by 2014 and also doubling its share in global trade by 2020. After all, Balance of Payments of a nation ought to stand as a barometer to measure the particular nation's trade performance. It reflects efficacy of the country with its transactional dealings to the globe. For a developing nation like India, it is inevitable to maintain a healthy Balance of Payments at all times to meet out future uncertainties.

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