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Sufficiency and Sustainability of Foreign Exchange Reserve of India

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Abstract

A country must have sufficient amount of foreign currency to meet the import bill and stabilising currency. The sufficiency of foreign exchange reserve is measured in terms of import cover that should b 10 months. Therefore, a country must have foreign exchange reserve to finance its import for at least 10 months. The sustainability of foreign exchange reserve has been measured by non-declining trend of percentage change in import cover. The present study finds that India has sufficient foreign exchange reserve but it is not sustainable.

Keywords: Foreign Exchange Rate, Foreign Currency, Economy.

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1. INTRODUCTION

India is an open economy and net importer. India must have sufficient and sustainable foreign exchange reserve to finance the imports. India is having around 575 bn dollar of foreign exchange reserve. One should know whether it is sufficient and sustainable or not. The present study has been devoted for it.

2. OBJECTIVE

1. The present study tries to estimate whether the available foreign exchange reserve is sufficient or not.
2. To know whether the available foreign exchange reserve is sustainable for India or not.

3. SOURCES OF DATA AND METHODOLOGY

Data for foreign exchange reserve and expenses on import have been taken from Handbook of Statistics on Indian Economy, RBI. Sufficiency of foreign exchange reserve has been estimated on the basis of import cover ratio. It has been calculated in terms of months. The ideal value of the Import cover is 10 months showing the value more than it infers sufficient forex. Sustainability has been estimated on the basis of non-declining percentage trend of change of import cover.

$$\textbf{Import Cover Ratio} = \frac{\text{Forex}}{\text{Import expenses}}$$

4. Literature Review

The benchmark of import cover is three months (IMF , 2013 and Yavuz Arslan and Carlos Cantu, 2003) .It is 10 months for the stability of the currency. Foreign exchange reserve plays a vital role in financing imports therefore it is good to hold sufficient foreign exchange reserve (Abri, 2023). The literature gap shows that one should estimate sufficiency and sustainability of India’s foreign exchange reserve. The present study has been divided into two parts.

4.1. Sufficiency of Foreign Exchange Reserve

The foreign exchange reserve comprises foreign currency, gold, Reserve Tranche position (RTP) and Special Drawing Right (SDR). It is also called FOREX. It increased from USA $ 5.83 $ in 1991 to USA $ 576.98 Bn in 2020-21. The import bill increased from USA $ 19 Bn in 1991 to USA $ 394 Bn in 2021. Over the period both the foreign exchange reserve and import bill of India are rising. In the line of this fact, the import cover ratio has also increased from 3.6 months in 1991 to 11.57 months in 2021. Ideally, the import cover ratio should be 10. The import cover ratio was less than 10 before the year 2000 reflecting insufficient foreign exchange reserve. However, after 2000, in the period of neo-liberalism, the import cover ratio has improved and more than 10 for the most of the period reflecting sufficient foreign exchange reserve. It has been shown in the table-1. Why foreign exchange reserve is rising over the period? One should consider the composition of Forex to know the answer.

FOREX = SDR + RTP + Gold + Foreign currency assets

FOREX (2021) = SDR (0.24) + RTP (0.8) + Gold (5.8) + Foreign currency assets (93.14)

FOREX (1991) = SDR (0.00) + RTP (0.00) + Gold (60.35) + Foreign currency assets (39.65)

The given composition of forex reflects that the share of the gold was the highest in 1991 and that of foreign currency asset was 39.65. SDR and RTP was zero in 1991. This composition changed in 2021 and the share of foreign currency asset increased to 93.14 per cent and 5.8 per cent of the gold. Therefore, one can infer that forex has increased because of rise in the foreign currency asset. Two facts come up. **First**, the share of foreign currency asset was lower than the share of gold in 1991 when import cover was not sufficient because Import cover is less than 10 months. **Second,** when the share of foreign currency asset became more than the share of gold in 2021, the forex reserve became sufficient because import cover became more than 10 months.

Table.1. Import Cover and its percentage change

Year	Forex(Bn $)	Import(Bn $)	Import Cover (months)	% Change
1990-91	5.834	19	3.6	
1991-92	9.22	21	5.2	**44**
1992-93	9.832	23	5.1	**-2**
1993-94	19.254	28	8.2	**61**
1994-95	25.186	36	8.4	**2**
1995-96	21.687	36	7.2	**-14**
1996-97	26.423	39	8.1	**13**
1997-98	29.367	41	8.6	**6**
1998-99	32.49	42	9.2	**7**
1999-00	38.036	49	9.3	**1**
2000-01	42.281	50	10.1	**9**
2001-02	54.106	51	12.7	**26**
2002-03	76.1	61	14.9	**17**
2003-04	112.959	78	17.4	**17**
2004-05	141.514	111	15.2	**-13**
2005-06	151.622	149	12.2	**-20**
2006-07	199.179	194	12.3	**1**
2007-08	309.723	251	14.8	**20**
2008-09	251.985	303	10	**-32**
2009-10	279.057	288	11.6	**16**
2010-11	304.818	369	9.9	**-15**
2011-12	294.397	394	8.9	**-10**
2012-13	292.046	474	7.4	**-17**
2013-14	304.223	514	7.1	**-4**
2014-15	341.638	465	8.8	**24**
2015-16	360.176	384	11.2	**27**
2016-17	369.955	381	11.6	**4**
2017-18	424.545	448	11.4	**-2**
2018-19	412.871	450	11	**-4**
2019-20	477.807	490	11.7	**6**
2020-21	576.984	394	11.57	**-1**

Source: Handbook of Statistics on Indian Economy, RBI

4.2. Sustainability of Foreign Exchange Reserve

The availability of foreign exchange reserve and its sufficiency has been estimated in the previous section. One finds that foreign exchange reserve was insufficient before the period of 2000 and after this period it became sufficient. Currently, the foreign exchange reserve of India is sufficient and hence India is able to meet the import bill**. Now question arises whether the available foreign exchange reserve is sustainable for India or not. One should estimate it. It has been estimated by non-declining trend of percentage change in the import cover. Figure-1 has been incorporated here to know the sustainability of import Cover of India.**

The trend line of the figure-1 clearly infers that it is declining over the period. It is not satisfying the condition of non-declining trend of sustainability. Therefore, the available foreign exchange reserve is not sustainable for India.

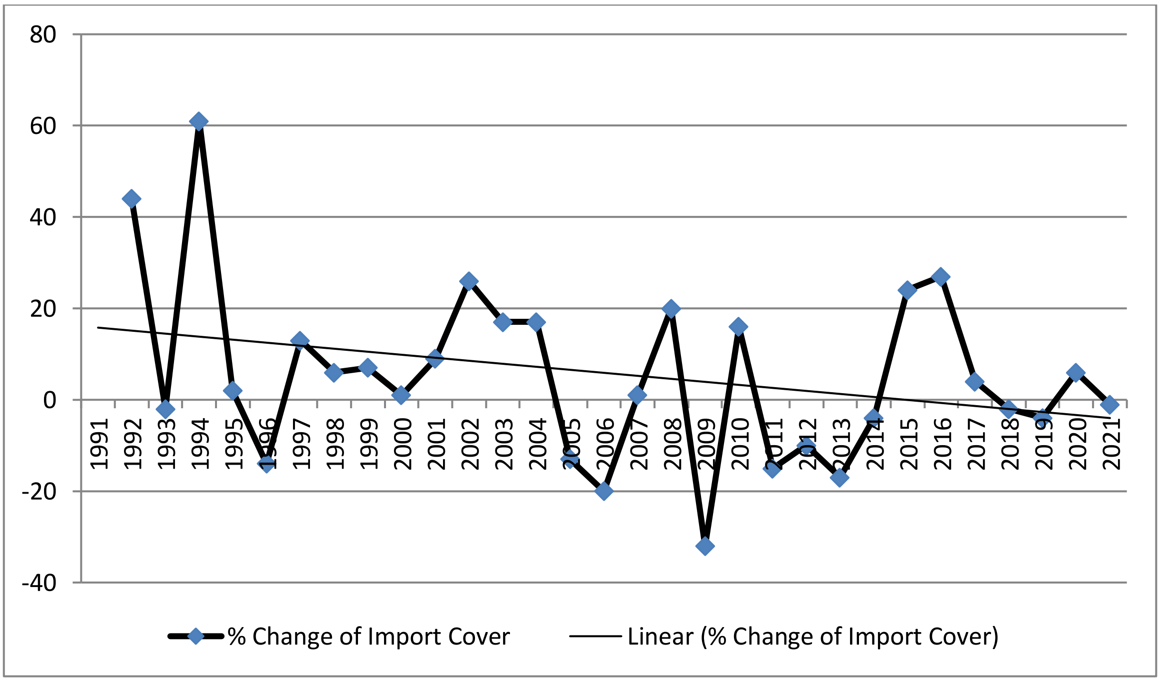

Figure.1. Sufficiency of Foreign Exchange Reserve and its Sustainability

5. Conclusion

The composition of foreign exchange reserve of India is comprised of SDR, Gold, RTP and foreign currency asset (FCA). Currently, the share of FCA is the highest showing most liquid forex. This liquid asset has been rising over the period. It has caused to increase import cover. Import cover ratio was more than 10 months after the year of 2000 and less than 10 months before 2000. One can conclude that foreign exchange reserve for India is sufficient currently the credit of which goes to FCA. However, it is not sustainable because percentage change in the import cover has been declining over the period.

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