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Foreign Exchange Reserves Accumulation : A Cost-Benefit Analysis for India and BRICS

NAMITA SAHAY*

Abstract

Foreign Exchange Reserves (FER) in India have created a milestone in the history of Indian economy for having crossed the US$ 500 billion mark and reached US$ 590.18 bn (RBI, 2021). It is sign of a strong economy as compared to the situation of 1991 when India was left with US$ 9.2 billion of FER and not in aposition to service its foreign debt and had to pledge its gold. There has been an increasing trend of FER accumulation by India since 1991 and also a similar trend was observed in other emerging economies. Increased FER accumulation has benefited India as a cushion against any external vulnerability or currency attack by creating sufficient liquidity buffer but has also come under a scanner as to the social cost of holding excessive FER. This paper seeks to analyse the optimal level of reserves using both the traditional thumb rule of CAD financing and (Guidotti-Greenspan-IMF, 2006) actually needed by India. The paper also throws light on other BRICS countries' reserve accumulation trends and rationale vis-a-vis India.

I. Introduction

FOREIGN EXCHANGE RESERVES (FER) are cash and other reserve asset held by the central bank of a country or any other monetary authority. They include 93 percent of Foreign Currency Assets (FCA), 6% of gold and reserve tranche position and SDR with IMF. These reserve assets can be put to multiple use but are mostly used as a backup by central banks of countries to support their domestic currency against any devaluation or currency crisis. Foreign exchange reserves help to keep the exchange rate steady when faced with any changes in macroeconomic factors of domestic or international economy. As observed in the past during the Asian Financial Crisis of 1997, many Asian countries experienced a free fall of their currencies in the absence of sufficient reserves to back up their currencies.

FER also indicate the ability of a government to repay its foreign debt and make payments of imports esp. crude and gold as currencies of emerging countries like India are generally not accepted for payments of imports. In

* Associate Professor and Head of Department of Finance, Amity University, Amity International Business School, I-3 Block, Sector 125, Uttar Pradesh 201301, INDIA

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X. Conclusion

Thus, we can conclude that despite the economic slowdown and in most cases economic contraction, falling revenue collection, large stimulus packages to revive the economy, besides creating a burden on government fiscal plans, it is time to re-think the optimal utilization of the excessive reserves. India's economic position in 2021 is better than most of the BRICS economies. At present, as already pointed out, the cost of holding high reserves surpasses the benefit of holding it as a cushion against any impending crisis. Reserve Management is the need of the hour.

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