BALANCE OF PAYMENTS

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“A record of international transactions between residents of one country and the rest of the world”

INTRODUCTION

- BALANCE OF TRADE:- The **balance of trade** is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation's imports and exports. A positive balance is known as a **trade surplus** if it consists of exporting more than is imported; a negative balance is referred to as a **trade deficit** or, informally, a trade gap.

- BALANCE OF PAYMENT:- **Balance of payments (BoP)** accounts are an accounting record of all monetary transactions between a country and the rest of the world.These transactions include payments for the country's exports and imports of goods, services, financial capital, and financial transfers. The BoP accounts summarize international transactions for a specific period, usually a year, and are prepared in a single currency.

OBJECTIVE

- Its main objective is to represent the economic position of a country, whether its currency is rising or falling in its external value.

THE GENERAL RULE IN BOP ACCOUNTING

- a) If a transaction earns foreign currency for the nation, it is a credit and is recorded as a plus item.
- b) If a transaction involves spending of foreign currency it is a debit and is recorded as a negative item.

COMPONENTS OF BALANCE OF PAYMENTS

- Current Account
- Capital Account
- Official Account

CURRENT ACCOUNT

- BOP on current account refers to the inclusion of three balances of namely – Merchandise balance, Services balance and Unilateral Transfer balance. In other words it reflects the net flow of goods, services and unilateral transfers (gifts). The net value of the balances of visible trade and of invisible trade and of unilateral transfers defines the balance on current account.

CURRENT ACCOUNT

CREDIT	DEBIT
VISIBLE:-	**VISIBLE**:-
1. Merchantise exports.	1. Merchantise imports.
2. Sell of goods.	2. Purchase of goods.
INVISIBLE:-	**INVISIBLE**:-
1. Transfer and Insurance services sold abroad.	1. Transfer and Insurance services bought from abroad.
2. Foreign tourist expenditure in the country.	2. Indian tourist expenditure outside the country.
3. Incomes received on loans and investment abroad.	3. Interest on incomes payment on loans and investment abroad.

CAPITAL ACCOUNT

- The capital account of a country consist of its transaction in financial assets in the form of short-term and long-term lending and borrowing.

CAPITAL ACCOUNT

- Capital accounts deals with the accounts related to cash or liquid assets.
- Capital account includes :-

1. **Short term capital movements**:-

- Purchase of short-term securities.
- Cash balance held with Foreign countries for a time period less than a year.

2. **Long term capital movements**:-

- Direct investments in shares, bonds, real-estate, plant, building, etc.
- Cash balance held with Foreign countries for a time period more than a year.

CAPITAL ACCOUNT

CREDIT	DEBIT
Foreign Long-Term investment in Home country	**Long-Term investment Abroad**
a)Direct investment in home country. b)Foreign investment in Domestic securities. c)Foreign corporate loan to the home country.	a)Direct investment abroad. b)Investment in Foreign securities. c)Government LOAN to foreign countries.
Foreign Short-Term investment In Home country	**Foreign Short-Term investment In Home country**
a)Purchase of shares of foreigners. b)Short-term loans. (for less than 1 yr)	a)Sales of shares abroad . b)Short-term loans.(for less than 1 yr)

THE OFFICIAL RESERVES ACCOUNT

- Official reserves assets include gold, foreign currencies, SDRs, reserve positions in the IMF.

UNILATERAL TRANSFER ACCOUNT

- These accounts deal with the transactions related to the donation factors like,
- DISASTER RELIEF
- GIFTS FROM GOVERNMENT
- CHARITIES. Etc.

4) OFFICIAL SETTLEMENT ACCOUNTS

CREDIT	***DEBIT***
Official sales of foreign currencies or other reserve assets abroad.	Official purchase of foreign currencies or other reserve assets.

CAUSES OF DISEQUILIBRIUM IN BALANCE OF PAYMENTS

- Temporary causes
- National Income
- Inflation
- Economic Development
- Borrowing and Lending
- Change in exchange rate
- Political factors-like instable govt.

- Temporary Causes- Temporary causes may arises due to variations in the trade, effect of weather on agriculture production etc.
- National Income - Another cause is the change in country’s national income. If the national income of a country increases, it will lead to an increase in imports thereby creating a deficit in balance of payments.

- Inflation- Inflation is another cause of disequilibrium in the balance of payment. If there is inflation in the country prices of exports increase, thus increase in export prices leading to decline in exports and rise in imports result in adverse.
- Economic Development- A country's balance of payments also depends on its stage of economic development. If a country is developing it will have a deficit in its balance of payments.

- Borrowing and lending- A country which gives loans and grants on a large scale to other countries has a deficit in its balance of payments on capital account. On the other hand, a developing country borrowing large funds from other countries may have a favourable balance of payments.

- Change in exchange rate – This change arise due to change in exports and imports. If exports of the country are more then imports the demand for its currency increase so that the rate of exchange moves in favours. On the other hand if imports are more than exports the demand for the foreign currency increase and the rate of exchange will against the country.

DISEQUILLIBRIUM OF BOP

- *MEANING*:- Though the credit and debit are written balanced in the balance of payment account, it may not remain balanced always. Very often, debit exceeds credit or the credit exceeds debit causing an imbalance in the balance of payment account. Such an imbalance is called the disequilibrium.
- Disequilibrium may take place either in the form of *deficit* or in the form of *surplus*.

DEFICIT:- Disequilibrium of **Deficit** arises when our receipts from the foreigners fall below our payment to foreigners. It arises when the effective demand for foreign exchange of the country exceeds its supply at a given rate of exchange. This is called an 'unfavourable balance'.

SURPLUS:- Disequilibrium of **Surplus** arises when the receipts of the country exceed its payments. Such a situation arises when the effective demand for foreign exchange is less than its supply. Such a surplus disequilibrium is termed as 'favourable balance'.

CAUSES OF DISEQUILLIBRIUM

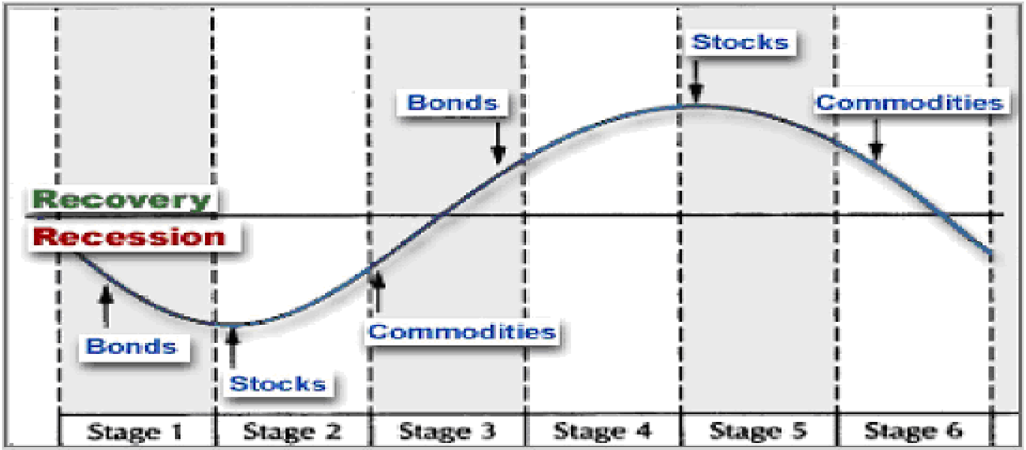
- A number of factors may cause disequilibrium in the balance of
payments. These various causes may be broadly categorized
into:

- (i) Economic factors
(ii) Political factors and
(iii) Sociological factors.

CAUSES OF BOP CONTINUED

- *1.) ECONOMICAL FACTOR*

- **DEVELOPMENTAL STRUCTURAL** **CYCLICAL** **SECULAR**
- Causes due to imports due high Causes by Causes in Causes
- of technological change BUISNESS CYCLE. developed countries import to
- Equipments and structures.
- Instruments for
- Developing purpose.



CAUSES OF BOP CONTINUED

- *2) POLITICAL FACTOR:-* Certain political factors may also produce a balance of payments disequilibrium. For instance, a country plagued with political instability may experience large capital outflows, inadequacy of domestic investment and production, etc. These factors may sometimes, cause disequilibrium in the balance of payments.

- *3) SOCIAL FACTOR:-* Certain social factors influence the balance of payments. For instance, changes in tastes, preferences, fashions, etc. may affect imports and exports and thereby affect the balance of payments.

CORRECTIVE MEASURES OF DISEQUILLIBRIUM IN BOP

- Every country tries to remove or reduce BoP

- Various measures for correcting
- BoP disequillibrium can be divided into 2 categories :-

1. AUTOMATIC MEASURES

2. DELEBRATE MEASURES

1) AUTOMATIC MEASURES

- This theory says that if market forces of demand and supply are allowed to have free play, than with time equilibrium will be automatically restored.

- E.g. If there is a deficit BoP then the demand for foreign exchange exceeds its supply this leads to increase in exchange rates.

  This means the external value of Domestic currency decreases. This increases the exports and in imports is seen BoP equilibrium is established.

DELIBRATE MEASURES

- These corrective measures are taken deliberately taken to restore equilibrium.

- These measures can be divided into 3 groups :-

1. *Monetary measures.*
2. *Trade measures.*
3. *Miscellaneous.*

DELIBERATE MESURES CONTINUED

- **MONETARY MEASURES :-**

1. *MONETARY CONTRACTION :-*

- Demand for import and export is influenced by contraction or expansion of money supply in the economy.
- In the case of BOP deficit if money supply is reduced then the purchasing power and demand for imported products automatically comes down.
- Also fall in domestic prices increases exports. All these factors lead to correction in BOP.

DELIBERATE MESURES CONTINUED

2. DEVAUATION :-

- It means reduction of official rates at which one currency is exchanged for another.
- A country with disequilibrium in BOP will devalue its currency to encourage exports and decrease imports.
- Devaluation makes export cheaper and imports expensive.

3. EXCHANGE CONTROL :-

- Under it govt. or central bank assumes complete control over the foreign exchange reserves and earnings of country.
- Exporters are required to surrender foreign exchange to the Central Bank.
- Govt. also have a control over imports.

DELIBERATE MESURES CONTINUED

- **TRADE MEASURES :-**

  It includes measures to encourage exports and to reduce imports :-

a) *Export Promotions*:- Exports are encouraged by removing export duties, providing exports subsidies, monetary, physical and institutional incentives.

b) *Import Control*:- Imports are controlled by iposing import duties, import quotas, licensing and prohibiting exports for some products.

DELIBERATE MESURES CONTINUED

- **MISCELLANEOUS MEASURES** :-

- Measures like obtaining foreign loans.
- Encouraging foreign investment in home country.
- Development of Tourism to attract foreign tourists.