

Balance of Payments [aka - Balance of international payments]

→ Accounting statement that provides a country's systematic record of all the economic transactions between its residents & rest of the world, for a given period i.e. a financial year.

It is a statement of a country's sources and uses of foreign exchange.

Sources - exports, transfers & remittances from abroad, borrowings from abroad, foreign investments

Uses - imports, transfers to abroad, lending abroad, and purchase of assets.

→ BOP is maintained using double-entry book keeping method.

Current Account - Records the inflow and outflow of goods, services & payments. investment incomes and transfer [Dividends, interest] [International aid]

Capital Account - Records all the receipts & payments that involve the residents of a country changing either their assets or liabilities to residents of other countries.

→ Involves direct investment, portfolio investment & borrowing & lending to & from other countries.

Forex Reserves - Reserves which the country holds in the form of foreign currencies like dollar, pound etc. gold & special drawing right [S.D.R.s]

- Autonomous Transaction
- Accommodating Transactions. (Reserve sale) (Eg)

Problems of BOP [in India]

1) Expanding trade gap

- Reasons
- Import liberalisation
 - Rise in import intensity
 - Import of oil
 - Import of essential items
 - Rising price of import
 - Devaluation of Rupee

2) Rising current account deficit

- Decline in the growth of net-invisible earnings
- Decline in migrant remittances from abroad
- Repayment obligation, debt servicing to IMF and other source of external public debt

3) Rising capital account deficit

- Amortization payment obligation

Types of Disequilibrium in BOP.

Cyclical Disequilibrium:-

Cyclical disequilibrium in BOP, ^{is} caused by cyclical fluctuations due to cyclical changes in income, employment output & price variable.

Short run & Long run Disequilibrium :-

Short-run disequilibrium is caused by due to imbalances in international borrowing & lending.

Disequilibrium emerging on the account of the chronologically accumulated short term deficit or surpluses.

Structural Disequilibrium.

Disequilibrium arising out of structural changes occurring in some sectors in home & abroad which may alter the demand and supply of export or imports or both.

A change in foreign demand for the export can arise from a change in technology, the invention of the cheaper substitute.

Causes of Deficit in BOP.

Economic Factors

- Inflation - Rising prices makes exports costlier
- Expenditure on Developing Relation - Newly independent spend huge amount of money to build relation with other countries.
- Fall in Demand - Fall in demand for exports
- Import - Rise Imports of capital & services are necessary for development of LDCs; thereby causing BOP deficit

Social Factors

- Demonstration effect - Underdeveloped countries often imitate the consumption pattern of developed countries leading to increased level of exports.
- change in Tastes, Preferences, Fashion & Trends

Political Factors

Measures Taken to correct BOP deficit

- Restriction on imports - 1) ~~Import~~ Import Licensing
2) Tariffs, Duties, & quotas

Export Promotion

- 1) devaluation
- 2) cash Assistance [subsidies]
- 3) Relaxation of controls on Exports & simplification of procedures.
- 4) Export Promotion organisation like - Export Advisory Council, Export Promotion Council, Directorate of export Promotion

Difference Between Autonomous & Accommodating Transaction

Autonomous Transaction
International transaction undertaken for profit motive

Accommodating Transaction
International transactions undertaken to cover BOP surplus/deficit.

- Undertaken by private sector
- Undertaken irrespective of effect on BOP.
- Undertaken by Monetary Authority [Central Bank, RBI]
- Undertaken after seeing the status of BOP.