Presentation
on
Balance Of Payment

Introduction

- **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.

- A country has to deal with other countries in respect of 3 items:-
- **Visible items** which include all types of physical goods exported and imported.
- **Invisible items** which include all those services whose export and import are not visible. e.g. transport services, medical services etc.
- **Capital transfers** which are concerned with capital receipts and capital payment.

Definition-

- According to **Kindle Berger**, "The balance of payments of a country is a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries during a given period of time".

Features

- It is a systematic record of all economic transactions between one country and the rest of the world.
- It includes all transactions, visible as well as invisible.
- It relates to a period of time. Generally, it is an annual statement.
- It adopts a double-entry book-keeping system. It has two sides: credit side and debit side. Receipts are recorded on the credit side and payments on the debit side.

Components of BOP

1. **Current Account Balance**

- BOP on current account is a statement of actual receipts and payments in short period.
- It includes the value of export and imports of both visible and invisible goods. There can be either surplus or deficit in current account.
- The current account includes:- export & import of services, interests, profits, dividends and unilateral receipts/payments from/to abroad.

2. Capital Account Balance

- It is difference between the receipts and payments on account of capital account. It refers to all financial transactions.
- The capital account involves inflows and outflows relating to investments, short term borrowings/lending, and medium term to long term borrowing/lending.
- There can be surplus or deficit in capital account.
- It includes: - private foreign loan flow, movement in banking capital, official capital transactions, reserves, gold movement etc.

3. Overall BOP -:

Total of a country's current and capital account is reflected in overall Balance of payments. It includes errors and omissions and official reserve transactions.

The errors may be due to **statistical discrepancies** & omission may be due to certain **transactions may not be recorded**.

For e.g.: A remittance by an Indian working abroad to India may not yet recorded, or a payment of dividend abroad by an MNC operating in India may not yet recorded or so on.

The errors and omissions amount equals to the amount necessary to balance both the sides

Causes of Disequilibrium

1. Natural causes – e.g. floods, earthquake etc.
2. Economic causes – e.g. Cyclical Fluctuations, Inflation, Demonstration Effect etc.
3. Political causes – e.g. international relation, political instability, etc.
4. Social factors – e.g. change in taste and preferences etc.

How to correct the Balance of Payment?

1. **Monetary measures –**

- ***Deflation -*** Deflation means falling prices. Deflation has been used as a measure to correct deficit disequilibrium. A country faces deficit when its imports exceeds exports.
- Deflation is brought through monetary measures like bank rate policy, open market operations, etc. or through fiscal measures like higher taxation, reduction in public expenditure, etc.
- Deflation would make our items cheaper in foreign market resulting a rise in our exports. At the same time the demands for imports fall due to higher taxation and reduced income.
- This would build a favourable atmosphere in the balance of payment position. However Deflation can be successful when the exchange rate remains fixed.

- ***Exchange Depreciation -*** Exchange depreciation means decline in the rate of exchange of domestic currency in terms of foreign currency. This device implies that a country has adopted a flexible exchange rate policy.
- Suppose the rate of exchange between Indian rupee and US dollar is $1 = Rs. 40. If India experiences an adverse balance of payments with regard to U.S.A, the Indian demand for US dollar will rise.
- The price of dollar in terms of rupee will rise. Hence, dollar will appreciate in external value and rupee will depreciate in external value. The new rate of exchange may be say $1 = Rs. 50. This means 25% exchange depreciation of the

- ***Devalution -*** Devaluation refers to deliberate attempt made by monetary authorities to bring down the value of home currency against foreign currency.
- When devaluation is effected, the value of home currency goes down against foreign currency, Let us suppose the exchange rate remains $1 = Rs. 10 before devaluation. Let us suppose, devaluation takes place which reduces the value of home currency and now the exchange rate becomes $1 = Rs. 20.
- After such a change our goods becomes cheap in foreign market. This is because, after devaluation, dollar is exchanged for more Indian currencies

2. Non-Monetary Measures –

- ***Export Promotion –***
- The government can adopt export promotion measures to correct disequilibrium in the balance of payments. This includes substitutes, tax concessions to exporters, marketing facilities, credit and incentives to exporters, etc.
- The government may also help to promote export through exhibition, trade fairs; conducting marketing research & by providing the required administrative and diplomatic help to tap the potential markets

- ***<u>Quotas –</u>***
- Under the quota system, the government may fix and permit the maximum quantity or value of a commodity to be imported during a given period. By restricting imports through the quota system, the deficit is reduced and the balance of payments position is improved.

- ***<u>Tariffs –</u>***
- Tariffs are duties (taxes) imposed on imports. When tariffs are imposed, the prices of imports would increase to the extent of tariff. The increased prices will reduced the demand for

Sl. No.	Item	2006-07	2007-08	2008-09	2009-10	2010-11[PR]	2010-11 H1 (April-Sept. 2010)[PR]	2011-12 H1 (April-Sept. 2011)[P]
1	2	3	4	5	6	7	8	9
I	**Current Account**							
1	Exports	128888	166162	189001	182442	250468	107331	150909
2	Imports	190670	257629	308520	300644	381061	176213	236674
3	Trade balance	-61782	-91467	-119519	- 118203	-130593	-68883	-85765
4	Invisibles (net)	52217	75731	91604	80022	84647	39283	52923
	a Non-factor services	29469	38853	53916	36016	48816	21517	31060
	b Income	-7331	-5068	-7110	-8038	-17309	-8238	-9025
	c Transfers	30079	41945	44798	52045	53140	26004	30887
5	Goods & services balance	-32313	-52614	-65603	-82187	-81777	-47366	-54705
6	Current account balance	-9565	-15737	-27914	-38181	-45945	-29599	-32842
II	**Capital Account**							
1	Capital account balance	45203	106585	7395	51634	61989	38950	41061
	i External assistance (net)	1775	2114	2439	2890	4941	3036	705
	ii External commercial borrowings (net)	16103	22609	7861	2000	12506	5674	10592
	iii Short-term debt	6612	15930	-1985	7558	10990	6937	5940
	iv Banking capital (net)	1913	11759	-3245	2083	4962	839	19344
	of which							
	Non-resident deposits (net)	4321	179	4290	2922	3238	2163	3937
	v Foreign investment (net)	14753	43326	8342	50362	39652	30836	13657
	of which							
	a FDI (net)	7693	15893	22372	17966	9360	7040	12311
	b Portfolio (net)	7060	27433	-14030	32396	30293	23796	1346
	vi Rupee debt service	-162	-122	-100	-97	-68	-16	-32
	vii Other flows (net)	4209	10969	-5916	-13162	-10994	-8356	-9145
III	**Errors and omissions**	968	1316	440	-12	-2993	-2320	-2500
IV	**Overall balance**	**36606**	**92164**	**-20080**	**13441**	**13050**	**7030**	**5719**
V	**Reserves [increase (-) / decrease (+)]**	**(-) 36606**	**(-) 92164**	**20080**	**(-) 13441**	**(-)13050**	**(-)7030**	**(-)5719**

Source : RBI. *Notes* : PR: Partially Revised. P: Preliminary.

- **This data represent that:-**
- Exports of 2006-07 is 128888 and import is 190670 which means that trade balance (BOT) is deficit means import is greater than exports. It shows that the BOP of year 2006-07 is unfavourable.
- Similarly, export of year 2007-08, 2008-09, 2008-10 is also less than import which means that BOP of these years also unfavourable. And trade balance is deficit (import>export)

Balance of Trade

- The difference between a country's imports and its exports. Balance of trade is the largest component of a country's balance of payments.
- **Debit** items include imports, foreign aid, domestic spending abroad and domestic investments abroad.
- **Credit** items include exports, foreign spending in the domestic economy and foreign investments in the domestic economy.
- When exports are greater than imports than the BOT is **favourable** and if imports are greater than exports then it is **unfavourable**

BOP vs. BOT

BOP

1. It is a broad term.
2. It includes all transactions related to visible, invisible and capital transfers.
3. It is always balances itself.
4. BOP = Current Account + Capital Account + or - Balancing item (Errors and omissions)
5. Following are main factors which affect BOP
   a) Conditions of foreign lenders.
   b) Economic policy of Govt.
   c) all the factors of BOT

BOT

1. It is a narrow term.
2. It includes only visible items.
3. It can be favourable or unfavourable.
4. BOT = Net Earning on Export - Net payment for imports.
5. Following are main factors which affect BOT
   a) cost of production
   b) availability of raw materials
   c) Exchange rate
   d)Prices of goods manufactured at home