BALANCE OF PAYMENTS

BOP Meaning:

The Balance Of Payments(BOP) of a country is a systematic record of all economic transactions between the residents of a country and the rest of the world. When we say "a country's Balance Of Payments" we are referring to the transactions of its citizens and government

BOP Definition:

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 - **Kindle Berger**

Balance of payments present a classified record of all receipts on account of goods exporter services rendered and capital received by residents and payments made by them on account of goods imported and services received from the capital transferred to non residents or foreigners - **Reserve Bank of India**

Features of BOP:

- 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 are recorded on the debit side

Importance of BOP:

- BOP records all transactions that create demand for and supply of a currency
- Judge economic and financial status of a country in a short term
- BOP may confirm trends in the economy's international trade and exchange rate of the currency. This may also indicate change or reversal in the trade
- BOP may indicate policy shift of the monetary authority (RBI) of the country
- It helps the government to analyse the potential of a particular industry export growth and formulate policy to support that growth.

Various components of BOP statement:

- Current Account
- Capital Account
- Official Reserve Account
- Errors & Omissions

1.Current Account:

- BOP on current account is a statement of actual receipts and payments in short period
- It includes the value of exports and imports of both visible and invisible goods. There can be either surplus or deficit in current account

- The current account includes; export and import of services interest profit difference and unilateral receipts/payments from/ to a abroad
- BOP on current account refers to the inclusion of three balances namely, merchandise balance, services balance, and unilateral transfer balance.

Current Account Balances:

1. Merchandise Balance*:* exports and imports of goods
2. Services Balance*:* exports and imports of services
3. Income Balance: Net investment income, net income from assets
4. Unilateral Transfers: Gifts from foreign countries minus gift to foreign countries

2.Capital Account:

- Capital account records all International transactions that involve a resident of a country concerned changing either his assets or with all his liabilities to a resident of another country.
- Transactions in the capital account reflect a change in stock either assets or liabilities
- It is the difference between the receipts and payments on the capital account. It refers to all financial transactions
- The capital account involves inflows and outflows relating to investments short term borrowing/lending and medium term to long term borrowing/lending

Capital Account Balances:

- There can be surplus or deficit in the capital account.
- It includes; private foreign loan flow, movement in banking capital, official capital transactions, reserves, gold movement etc.
- These are classified into two categories:

1. Foreign Direct Investment,
2. Portfolio investment & Other capital

3.Official Reserve Account:

- The three accounts that is IMF, SDR & reserve and monetary gold or collectively called as a reserve account
- The IMO of account contains purchases credits and repurchases debits from International monetary fund
- Special drawing rights(SDRs) for a reserved asset created by the IMF and allocated from time to time to member countries. It can be used to settle International payments between monetary authorities of different countries

4.Errors & Omissions:

- The entries under this head letter mainly two leads and lags in reporting of transactions
- Errors and omissions is of a balancing entry and is needed to offsets the overstated or understated components

Disequilibrium in the Balance of Payments:

- A disequilibrium is a balance of payment means if condition of surplus or deficit
- A Surplus in the BOP occurs when total receipts exceed total payments. Thus,BOP = CREDIT>DEBIT
- A deficit in the BOP occurs when total payments exceed total receipts. Thus, BOP = DEBIT<CREDIT

Causes of disequilibrium in the BOP:

- Cyclic fluctuations
- Shortfall in the exports
- Economic development
- Rapid increase in population
- Structural changes
- Natural calamities
- International capital movements

Measures to Disequilibrium in the BOP:

(a)Monetary Measures:

1.Monetary Policy: the monetary policy is concerned with money supply and credit in the economy. The central bank expands or contracts the money supply in the economy through appropriate measures which will affect the prices

2.Fiscal Policy: It is a government's policy on income and expenditure. Government incurs development and non development expenditure. It gets income through taxation and non tax sources. Depending upon the situation, governments expenditure may increased or decreased

3. Exchange Rate Depreciation: By reducing the value of the domestic currency, the government can correct the disequilibrium in the BOP in the economy. Exchange rate depreciation reduces the value of home currency in relation to foreign currency. As a result, import becomes costlier and export become cheaper. It also leads to inflationary trends in the economy

4.Devaluation: Devaluation is lowering the exchange value of official currency. When a country develops its currency, exports become cheaper and imports become expensive which causes a reduction in the BOP deficit

5.Deflation: Deflation is a reduction in the quantity of money to reduce prices and incomes. In the domestic market, when the currency is deflated, there is an increase in the income of the people. This puts curbs on consumption and government can increase exports and earn more foreign exchange

6.Exchange Control: All exporters or directed by the Monetary authority to surrender their foreign exchange earnings, and total available foreign exchange is rationed among the licence importers. The licence-holder can import any goods but the amount is fixed by the Monetary authority.

(b)Non-Monetary measures:
1. Export Promotion: To control export promotion the country may adopt measures to stimulate exports like: export duties may be reduced to boost exports, cash assistance, subsidies can be given to exporters to increase exports, goods meant for exports can be exempted from all types of taxes

2.Import Substitutes: steps may be taken to increase the production of import substitutes. This will save foreign exchange in the short run by replacing the use of imports by these import substitutes

3.Import Control: import check may be done through the adoption of wide variety of materials like quotas and tariffs

- Quotas: 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 portion is improved

- Tariffs: Tariffs are duties imposed on imports. When tariffs are imposed, the price of imports would increase to the extent of tariff. The increased prices will reduced the demand for imported goods and at the same time induce domestic producers to produce more of import substitutes.