

# Balance of Payment 2

Class 18

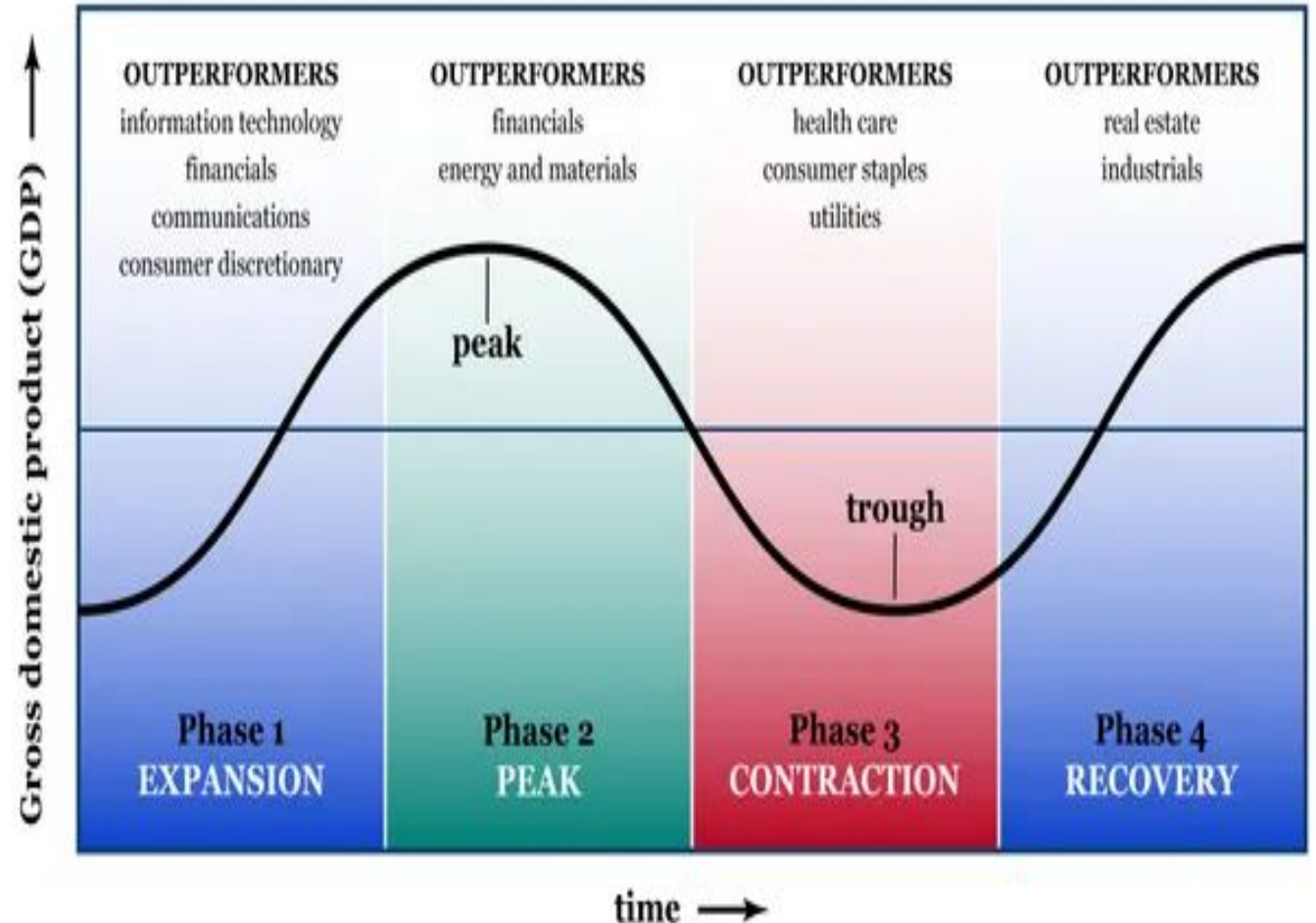
# Causes of Disequilibrium In The Bop

- □ 1. Trade Cycles or Cyclical fluctuations
- □ 2. Need for Economic Development
- 3. Short fall in the exports
- □ 4. Rapid increase in population
- □ 5. Structural Changes
- □ 6. Natural Calamities
- □ 7. International Capital Movements
- etc.....

# Causes of BOP Disequilibrium (contd.)

- **1. Trade Cycles or Cyclical fluctuations:**
- Cyclical fluctuations, their phases and amplitudes, differences in different countries, generally produce cyclical disequilibrium.

Four phases of an economic cycle



## 2. Need for Economic Development

- >> Huge development and investment programmes in the developing economies are the root causes of the disequilibrium in the BOP of these countries.
- While their propensity to import goes on increasing for want of capital for rapid industrialisation, their exports may not be boosted up to that extent as these are primary producing countries.
- Moreover, their exports quantum of primary commodities may decline as newly-created domestic industries may require them. Thus, there will be structural changes in the balance of payments and structural disequilibrium will result.

### 3. Changing Export Demand:

- A vast increase in the domestic production of foodstuffs, raw materials, substitute goods, etc. in advanced countries has decreased their need for import from the agrarian underdeveloped countries. Thus, export demand has considerably changed, resulting in structural disequilibrium in these countries.
- Similarly, advanced countries also will suffer in their exports as a result of loss of their markets in developing countries owing to the tendency of the poor nations for self-reliance and their ways and means of curtailing their imports.
- But disequilibrium (deficit) in balance of payments seems to be more persistent in the underdeveloped or developing nations than in the advanced rich nations.

Contd.

- **4. Population Growth:** A high population growth, particularly in poor countries can adversely affect their BOP position. An increase in population increases the needs of these countries for imports and decreases the capacity to export.
- **5. International borrowing and investment:** Borrowing heavily from another country will affect the BOP of the country creating a deficit.
- **6. Inflation:** If there is an excess of monetary demand for goods and services in general it will push up the price levels leading to inflation. A rise in the comparative price level certainly encourages imports and discourages exports, resulting in a deficit balance of payments.

# Contd.

- **7. Flight of Capital:**Capital flight occurs when investors move their capital out of a country due to economic or political instability, currency devaluation, or a lack of confidence in the domestic economy.This results in a deficit in the capital account of the balance of payments.
- **8. Capital Movements in the Country:**
  - Capital movements can also cause disequilibrium in the BOP of a country.
  - A massive inflow of foreign capital into a country is followed by an unfavorable Balance of payments , while a large outflow of capital, on the other hand, is accompanied by the favorable BOP as it paves the way of generation of income.

# Contd.

- **9. Changes in Exchange Rates :** This can affect the BOP by making imports more expensive and exports less expensive, leading to a deficit in the current account.
- **10. Natural Calamities:** Like floods, droughts may easily cause disequilibrium in the BOP by adversely affecting agricultural and industrial production in the country.
- The exports decline while the imports maybe go up, causing a discrepancy and the country's balance of payments.
- **11. Changes in International Economic Conditions:** Changes in global economic conditions, such as a recession or a financial crisis, can affect a country's balance of payments by reducing demand for exports and reducing foreign investment.



# Measures to correct disequilibrium in the Balance of Payments:

## •1. Promotion of Exports:

- Promotion of export is the best measure to correct an adverse balance of payments. For this all taxes on export goods be withdrawn, export industries should be provided new materials and transport facilities at reduced prices, so that prices of these goods remain low.

## •2. Increase in Production:

- Increase in production will lead to excess of final goods so a country can export the excess of final goods to different countries.

### 3. Trade Agreement:

More trade agreements should be done with foreign countries to promote our foreign trade and exports.

- 4. Encouragement of foreign investment:

- Foreign industries and MNCs are encouraged to invest their capital in India. Special facilities are provided to attract foreign capital. It leads to an inflow of foreign capital.

- 5. Attraction to foreign tourists:

- The government should spend a lot of money to develop picnic spots and resorts in different parts of the country. A large amount of foreign exchange can be earned from foreign tourists.

## 6. Devaluation of Indian Currency:

- Lowering the value of the domestic currency in terms of foreign currency in terms of foreign currencies is called devaluation.
- The exchange rate of the currency may be reduced by the government. Foreign goods will become costly and local goods will become cheap. Imports will be cut down and exports will be pushed up.

## Lets Solve Now:

- Q1. Find current account balance from the following:

- **Items(Rs in crores)**

(i) Capital account balance >> 80

(ii) Export of services >> 20

(iii) Balance of visible trade >> 50

(iv) Transfers from one country to an another country >> 5

Q2. Find the balance on the balance of payments account. Is the overall balance of payments balanced?

- Items(Rs in lakhs)
- (i) Capital account balance :  $(-)$ 400
- (ii) Value of invisible imports: -150
- (iii) Value of invisible exports: -450
- (iv) Unilateral transfers: -100
- (v) Balance of visible trade: 800

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