14. International Trade (II): Balance of Trade and Balance of Payment

Objectives

At the end of this chapter, students should be able to explain balance of trade and balance of payment in international trade. They should also be able to explain the corrective measures government takes to solve the problems of imbalance of trade and imbalance of payment.

14.1 Balance of Trade

In international trade, payment of money and receipts of money are made from one country to another because importation and exportation of goods and services are involved. For instance when goods are imported money is paid, but when goods are exported money is received. At a certain time, say at the end of one year, the country calculates the total amount of money received into the country through export and the total amount of money paid out of the country for goods imported into the country.

These calculations will show the statement of trading account between the country and the rest of the world. In commerce and in international trade this statement of account is termed balance of trade. In other words a balance of trade is the summary of the accounting showing the monetary value of goods imported into the country and the monetary value of goods exported out of the country. Where money received from export is more than that spent on import, the balance of trade is favourable, i.e. trade surplus. Conversely, where the money spent on import is more than that received from export, the balance of trade is said to be unfavourable, i.e. trade deficit or adverse balance of trade.

14.2 Balance of Payment

(a) In international trade, there are many transactions which involve money being paid out of the country or received into the country. These transactions include the purchase or sale of goods (visible trade) on one hand and tourism, shipping, insurance and banking services, maintenance of diplomatic staff employed in embassies and high commissions abroad and maintenance of troops in foreign countries (invisible trade) on the other hand. At the end of the year, the country summarizes the monetary value of all these transactions. That is, the summary will show the total money received into the country and the total money paid out of the country as a result of these transactions between it and the rest of the world.

(b) Balance of payment is arrived at by adding balance of trade to invisible export submitted from invisible import. However, there are two main accounts involved, namely balance of payments on current accounts and balance of payments on capital accounts.

(c) *Balance of payment on current accounts:* This is made up of both the balance of visible items and the balance of invisible items. The balance of visible items has to do with money received or payments made in respect of sale or purchase of physical goods like crude oil, agricultural produce, drugs, cars, etc; while the balance of invisible items deals with money received or paid in respect of items like banking services, shipping, tourism, missions abroad, etc.

(d) *Balance of payment on capital account:* This consists of (i) Capital Transfer and (ii) Capital Investments.

(i) Capital transfers include all money received or sent out by the government or country for capital projects, money lodged in foreign banks for safe-keeping, reserves of other countries held by the country's banks, etc.

(ii) Capital investments are the money invested in foreign (other) countries by banks, agencies and individuals for purposes of making profits.

(e) *Favourable balance of payment:* For a country to record a favourable balance of payments, the amount of money coming into the country must be greater than the amount of money going out of the country.

(f) *Unfavourable Balance of Payments:* For a country to record unfavourable balance (deficit) it shows that the total value of its imports is higher than the total value of its exports (visible and invisible). This is also known as adverse balance of payments.

14.3 Corrective Measures for Adverse Trading and Payment Position

For a comprehensive assessment, we shall attempt here to refer to the measures on the basis of three types of solutions which are referred to in economics as short term solutions, medium term solutions, and long term solutions.

The type of solution will depend on the length of period that the payment deficits are likely to remain. When such deficits are merely temporary, the solutions will be for a short term. If the deficits are likely to persist for months but not for years, then the medium term solution would apply. When deficits last for years or become chronic, the corrective measures should be long-term solutions. We shall now discuss the different measures and their effectiveness.

(a) Short-term Measures

(i) **Using the nations' gold and foreign currency resources:** Every country keeps a bank of gold and foreign currency reserves for payment of import bills. The higher the volume of reserves, the healthier is the state of the nation's economy, and the higher the exchange rate and value of the national currency.

(ii) **Borrowing from other central banks:** The Nigerian Central Bank, for instance, may resort to borrowing from other foreign central banks. To do this successfully, there must have been standing agreements which are often referred to as *wage agreements* among some countries. There are such tripartite agreements between the Central Bank of France, the Central Bank of England and the Federal Bank Reserve Bank of USA. Apart from the existence of an agreement, the other parties to such an agreement may not be in a position to lend to others. They may be going through or expecting a payment crisis soon. Again, this may not prove a reliable measure.

(iii) **Borrowing from overseas banks:** National governments may resort to borrowing from overseas commercial banks. Such borrowing, however, may be at a substantial cost (high interest rate), since such a measure may suggest a moment of economic crisis and the lending commercial banks may wish to exploit the situation by lending at a high interest rate.

(iv) **Selling off overseas securities:** Part of a nation's wealth consists of some revenues, securities, deposits of foreign currencies, overseas debentures (loans). These securities could be sold off to repay the deficits. Here again, the value of securities may fall short of the amount of deficits.

(v) **Exchange control:** In order to prevent a situation where excess of large outflow of funds leads to payment deficits in a country, the government could prescribe measures whereby all overseas expenditures or payments would be matched by inflow of overseas' funds into the country. This is known as an *exchange control measure.* It is usually managed by the country's Central Bank. This was introduced in the latter years of General Obasanjo's era and was left in force during the succeeding civilian government; part of this measure was the introduction of Form M.

(b) Medium-term Measures

(i) **Tariffs:** Tariffs are taxed collected by a government on goods coming into or sometimes going out of a country.

(1) Tariffs are meant to improve a country's balance of trade and payments.

(2) Tariffs are imposed on imports to prevent dumping, that is the selling of goods in foreign markets or countries at prices far below what is charged in the home market.

(3) To retaliate when any country imposes tariffs on imports from another country, e.g. if Britain imposes tariffs on Nigerian goods or products (cocoa and hides) imported in Britain, Nigeria can retaliate by imposing tariffs on cars and textile imported from Britain.

(4) Tariffs can serve as a weapon to make a country self-reliant by encouraging or forcing citizens to patronise locally produced goods instead of foreign goods which are relatively out of reach because of high price or cost resulting from the imposed tariffs.

(5) Imposition of tariffs may be politically motivated when it is used to discriminate against unfriendly countries.

(ii) **The enforcement of certain standards:** The home country may impose some standard conditions, which imported goods must meet. Import bills would fall to the extent that such standard conditions are difficult to meet. For instance, the Nigeria Federal Ministry of Health announced on 26 October, 1981 the conditions which overseas drugs must fulfill before they could be accepted for importation into Nigeria. This was to restrict indiscriminate importation of drugs into the country.

The USA once prescribed safety standards and pollution laws for imported cars, in order to reduce the large payments on imported cars.

(iii) **Public procurement policies:** Some governments may institute a policy of buying only home made goods or goods from certain countries only – such countries may be the ones with which she is having surplus balance of payments. This is known as *discriminatory trading policy.* The European countries, at the wake of large deficit payment position with USA, once insisted on buying computers only within Europe. This seriously curtailed the importation of the American computers into European markets: the importation of which had earlier on led to a fall in European foreign exchange reserves.

(c) Long-term Measures

Long-term measures are designed to cure the root cause of deficit payment, which could not be removed in one or two years. In most cases, they are caused by excess of demand in the home country which again is evidence of too much funds in the home economy. This is referred to as *inflationary economy.* The root cause could be traced to a fall-off in demand for export goods; therefore, the long-term measures are directed at mopping up excessive purchasing power at home, and at the same time, encouraging the export of goods.

(i) *Deflationary policy:* This is the exact opposite of inflationary policy. Deflationary policy has the objective of reducing purchasing power at home. Such measures include, raising personal income tax rates, imposing or increasing purchase taxes (including tariffs) – all of which are known as a *fiscal policy.* In addition, rates of interests could be raised, thereby making borrowing of money dearer. This is referred to as *monetary policy.*

(ii) *Exchange rate policy:* This may take either of two forms. *Devaluation (or depreciation) of the exchange rate.* By this, the rate by which the home currency exchanges for foreign currencies would be brought down, i.e. buying foreign currencies to pay for import becomes dearer; while overseas buyers of home goods would find it cheaper to buy with the home currency. The total effects of this policy would be to increase exports (which would now be cheaper) and decrease imports (which would now be dearer).

(iii) *Export incentives:* Consequent upon the limitations of policies of devaluation and exchange rate as mentioned above, it might prove a more positive measure to pursue policies of active promotion of exports.

(iv) *Provision of export information:* Governments' foreign embassies in co-operation with the home Ministry of Trade and industry, could act as 'export intelligence' and provide a 'bank' of information for (home) exporters and (overseas) importers with a view to accelerating the exportation of certain home made goods overseas.

(v) *Export credit guarantee schemes:* At a minimum cost to the exporters, these schemes would protect them against the possible failure of any overseas debtors to pay the exporters. In addition, the schemes would make provisions for the exporters to raise loans to finance their export trade. The totality of such schemes is to boost the export trade and improve payment position.

(vi) *Technical assistance:* This would help exporters to solve problems concerned with their exportation documents and foreign exchange requirements. In short, the cost of schemes we referred to earlier in this book as Government Export Scheme would be appropriate here.

Summary

- It is made up of visible and invisible trade, both which could be divided into export and import trade respectively. External trade could show trade or payment surplus or deficit respectively; and one country's trade or payment surplus could mean another country's trade or payment deficit.
- There is a difference between trading position and payment position of a country. In cases of adverse trading position or payment position there are corrective measures for short-term, medium-term and long-term periods

Revision Questions

A. *Essay Questions*

1. Explain five measures taken by a country to:
   (a) restrict imports *(10 marks)*
   (b) promote exports *(10 marks)*

   (WAEC June 2002)

2. Discuss two measures that could be adopted in each of these periods to correct adverse trading and payment positions.
   (i) In the short-term
   (ii) In the medium-term

3. Explain five factors that adversely affect the growth of commerce in West Africa. *(20 marks)*

   (WAEC 2000)

4. State ten of Nigeria's import goods and their countries of origin.

B. *Objective Questions*

1. Which of the following measures will government not take to promote export trade?
   A. Total elimination of export duties
   B. Reduction of freights for export
   C. High excise duties on manufactured goods
   D. Improvement on communication facilities

2. Which of the following is a method of trade restriction?
   A. Entrepôt

B. Bonded warehouse
C. Exchange control
D. Bill of lading

3. Which of the following is used to correct an adverse balance of payment?
   A. Sales of treasury bills
   B. Import restriction
   C. Export restriction
   D. Trade liberalization

(WASSCE 2001)

4. Which of the following is not used to correct an adverse balance of payment?
   A. increasing imports
   B. increasing exports
   C. decreasing exports
   D. devaluation
5. A situation where a country's export exceeds its import is referred to as
   A. a balance of trade
   B. a favourable balance of trade
   C. an unfavourable balance of trade
   D. an adverse balance of trade
6. Trading position of Nigeria is the same thing as her
   A. balance of trade
   B. desire to trade with many countries
   C. trading with friendly countries only
   D. willingness to grant credit to foreigners
7. Entrepôt trade refers to
   A. importing for industrial use
   B. importing for re-exporting
   C. counter trade
   D. importing for domestic consumption

(WASSCE 2002)

8. The difference between a country's total receipts from exports and her total payments for imports is called
   A. balance of payments
   B. terms of payment
   C. balance of trade
   D. entrepôt trade

(WASSCE 2002)

9. When a country's total visible and invisible exports are more than its visible and invisible imports, it has
   A. favourable balance of payments
   B. favourable balance of trade
   C. unfavourable balance of trade
   D. unfavourable balance of payments
10. Which id not one of the disadvantages of foreign trade?

A. over specialization
B. dependence on one product
C. tax regulation and collection
D. dumping

Project

1. Give a list of contributions made by your state towards improving the trading position of this country.
2. Mention five states in the country which you think have made the most efforts through export goods towards fostering the international trade of Nigeria. Give your reasons.