7. BALANCE OF PAYMENTS

Q:1 What do you mean by Balance of Payment? Explain difference between Balance of Trade and Balance of Payments?

(A) Balance OF Payment (BOP) :- "The Balance of Payment (BOP) of a Country is a systematic account of all economic transactions between a country and the rest of the world during a year"

Balance of Payment is the difference between all the receipts from foreign countries and all the Payments made to foreign countries.

(B) Meaning :- "According to Charles Kindle Berger-
"The BOP of a Country is a systematic record of all economic transactions between a country and the rest of world during a given Period of time"

(C) Features OF BOP :-

1. BOP is a systematic record of all receipts and Payments of a Country.
2. It is a statement for a given Period of time i.e a year.
3. It is a Comprehensive measure of Country's Position.
4. BOP is a Systematic Record of Receipts and Payments which is maintained in Double-Entry Book-Keeping method. Every Debit has a Credit.
5. It includes receipts and Payments of all items, government and non-government.

6. If there is any difference in actual receipts and Payment then there is need for adjustment.

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Balance Of Trade (BOT)	Balance of Payment (BOP)
1. Balance of Trade includes imports and exports of goods or Visible items.	1. Balance of Payment includes all kinds of imports and exports of goods and services and Capital
2. BOT is Small part of BOP	2. BOP includes BOT
3. BOT may be favourable or UnFavourable	3. BOP is always balances.
4. BOT is Less important	4) BOP is more important
5. It has narrow Scope.	5. It has wider Scope
6. BOT is not Considered while Formulating foreign Trade Policy.	6) BOP is Very important while Formulating Foreign Trade Policy.
7. Formula – BOT = Net earning on Export – Net Payment For Import	7) BOP = Current Account + Capital Account + Balancing Adjuctment (Errors and Omissions)
8) It is not a True indicator of economic Performance of an economy.	8) It is True indicator of economic Performance of an economy.

Q:2 Explain the Structure of Balance of Payments?

(A) Balance of Payment } Same from Q:1
(B) Meaning

(C) Structure of Balance of Payments:-

Balance of Payment is a systematic Record is maintained in a Standard Double-Entry book-keeping method. The Payments received from foreign countries is enter on credit side and Payment given to other countries is enter on Debit Side.

BALANCE OF PAYMENTS ACCOUNT

Receipts (credit)	Payments (Debits)
1. Export of Goods	1. Import of Goods (BOT)
Trade Account Balance	
2. Export of Services	2. Import of Services
3. Interest, Profit and Dividend received	3. Interest, Profits and Dividend Paid.
4. Unilateral receipts	4. Unilateral Payments
5. Current Account Balance (1 to 4)	
6. Foreign Investment	6. Investment in Abroad
7. Short-term borrowing	7. Short-term lending
8. Medium and Long-term borrowings	8. Medium and Long-term Lending.
9. Capital Account balance (6 to 8)	
10. Statistical Discrepency (Errors and Omissions)	
11. Over all balance = Current A/c + Capital A/c + Statistical Discrepency = 5 + 9 + 10	
12. Change in Reserves (−)	12. Change in Reserves (+)

BOP = Total Receipts ± Total Payments

1. Trade Account Balance (BOT) :-

Trade balance is the difference between Export and Import of Visible or tangible goods.

If the exports are more than Imports (X > M), there will be trade surplus.

If the imports are more than Exports (M > X), there will be trade Deficit.

Generally Developing Countries like India most of the time have Deficit trade balance.

The members of organisation of Petroleum Exporting Countries (OPEC) are in a better Position on Trade Account balance because demand of Petroleum, oil and lubricants is always increasing.

2. Current Account balance :- (1 to 4)

" Current Account balance is the difference between the receipts and Payments on account of Current A/c which include Trade A/c balalance ".

This Current Account include →
Export OF Services, Interest, Profit and dividend received and Unilateral receipts on credit side.

It include → Import of services, Interest, Profits and dividend Paid and Unilateral Payment on Debit Side.

Current Account shows surplus balance when Credit is more than Debits.

A Current Account include ⟶

1. **Services** :- Current account include international trade services like - Transport, banking, insurance, tourism education, entertainment etc. This Service Sector Plays

an important role in growth of country.

2. Investment Income :- When a country invest in abroad or invest in foreign stock market, It will receive interest, Profits and dividend. Similarly, a developing countries has to pay interest, Profits and dividend on borrowed foreign capital.

3. Unilateral Flow :- Countries give or receive donations, grants, gifts and other such payments. These payments and receipts are given on the basis of Political and humanitarian ground.

③ Capital Account balance :- "It is the difference between receipts and payments on account of capital account".

Capital Account include –

a) Foreign Investments :-

i) It include FDI mostly taken by multinationals.

ii) Portfolio Investment i.e- Purchase of financial assest for short-term and Long-term.

b) Short-term borrowings :- These borrowing are mostly for the Period of 5 years or less. To Reduce the deficit in Current A/c, countries borrow fund from Commercial banks for short-Period

c) Medium and Long term Borrowings :- Countries borrow medium and Long-term funds from government of other countries or International Financial Institutions like – IMF, world bank etc.

(4) Statistical Discrepency (Errors and Omissions)

The double entry book-keeping principle says that every credit ~~and~~ has a debit, then only Balance of Payment will be properly balanced well. But in reality, BOP may not balance due to errors and omissions.

Errors may be due to statistical differences and omissions may be due to some transactions may not get recorded.

Example :- An Indian working in abroad sent $ 50,000 to India where it is not recorded.

If the Current and capital A/c shows surplus of $ 50,000 then BOP should show increase of $ 50,000 due to error of omission.

(5) Overall balance = Current A/c + Capital A/c :-

Overall balance means sum total of Current A/c and Capital A/c.

If total payments are more than total receipts, the BOP is Negative or Deficit.

If total Receipts are more than total payments, the BOP is Positive or Surplus.

(6) Foreign Exchange Reserves :-

Foreign Exchange Reserves in BOP A/c means the reserves held in the form of Currencies like Dollars, Euro, Pound, Gold, special Drawing Rights (SDRs) etc.

A country having a Net Surplus in current and capital accounts combined will have reserves of foreign Exchange.

⑦ The basic Balance :-

Basic balance is achieved when the difference between Current A/c and Capital A/c is equal to Zero. A Surplus or Deficit Position can distrub the basic BOP balance and create Problem of disequilibrium.

⑧ Equilibrium and Disequilibrium :-

The BOP always balances in accounting sense. when Total Receipts of a country are equal to total Payment of a Country then BOP have Equilibrium Position.
When Total Receipts of Country are more than total Payments of a Country then its Surplus B.O.P.
IF total Payments of country are more than total Receipts of a Country, then it is Deficit BOP.

Q:3 Explain Autonomous and Accomodating flows

(A) Autonomous and Accomodating Flows :-

BOP of a Country is Prepared on Double Entry Book-Keeping System which always balances.
But in Reality BOP of a country shows either surplus balance of Deficit balance.
IF a country is balancing BOP by using its Reserves or by selling gold It is Deficit or disequilibrium in BOP.

There are Two types of transactions —

1. Autonomous Transactions
2. Accomodating Transactions.

1. **Autonomous transactions :-** Autonomous Flows helps to equalise BOP. All transactions in Current and Capital accounts are Autonomous items because they are undertaken for business motive or for earning Profit.

All transactions of Exports, Import of goods and services, movement of capital goods for profit making are Autonomous transactions.

2. **Accomodating Transactions :-** As BOP may be Surplus or Deficit so adjust (offset) the balance, Accomodating transactions are helpful to maintain balance.

IF Autonomous Receipts > Autonomous Payment = Surplus BOP
IF Autonomous Payments > Autonomous Receipts = Deficit BOP.

Accomodating Flows may be in the form of loan or a Gift from foreign country. A Loan can be received from foreign firm, foreign company or International organisation to balance BOP.
Any imbalance or deficit in current A/c is corrected through Adjustment in Capital Account.