INTERNATIONAL BUSINESS AND TRADE

UNIT-4

PART-I

Balance of Payment

- Balance of Payment (BoP) is a statement **that records all the monetary transactions made between residents of a country and the rest of the world during any given period.**
- This statement includes all the transactions made by/to individuals, corporates, and the government and helps in monitoring the flow of funds to develop the economy.
- When all the elements are correctly included in the BOP, it should sum up to zero in a perfect scenario.
- This means the inflows and outflows of funds should balance out. However, this does not ideally happen in most cases.
- BOP statement of a country indicates whether the country has a surplus or a deficit of funds i.e., when a country's export is more than its import, its BOP is said to be in surplus.
- On the other hand, the BOP deficit indicates that a country's imports are more than its exports.
- Tracking the transactions under BOP is something similar to the double-entry system of accounting. This means, all the transactions will have a debit entry and a corresponding credit entry.

II. Why Balance of Payment (BoP) is Important?

The Balance of Payment is important for any country due to the following reasons:

- The boP of a country reveals its financial and economic status.
- BoP statement can be used as an indicator to determine whether the country's currency value is appreciating or depreciating.
- BoP statement helps the Government to decide on fiscal and trade policies.
- It provides important information to analyse and understand the economic dealings of a country with other countries.

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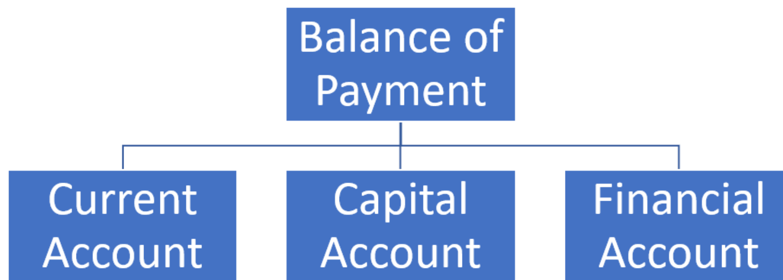
III. Components of Balance of Payment

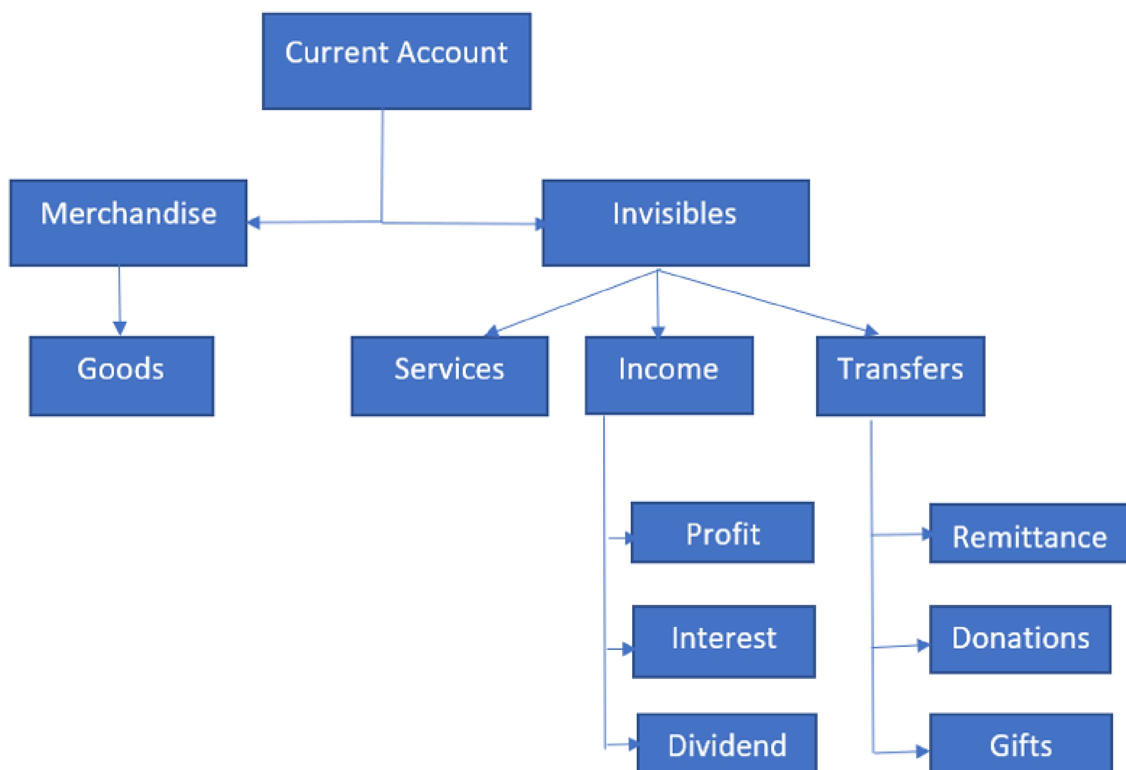
There are mainly three components of the balance of payment viz.

1.Current Account

2.Capital Account

3. Financial Account





1. Current Account

The transactions related to goods, services, and income, constituting the current account on the balance of payments.

- The current account is functionally classified into two broad categories:

1. Merchandise
2. Invisibles

- The current account is used to monitor the inflow and outflow of goods and services between countries.
- This account covers all the receipts and payments made with respect to raw materials and manufactured goods.
- It also includes receipts from engineering, tourism, transportation, business services, stocks, and royalties from patents and copyrights.
- When all the goods and services are combined, together they make up a country's Balance of Trade (BoT).
- There are various categories of trade and transfers which happen across countries.
- It could be merchandise or invisible trading, unilateral transfers, or other payments/receipts.
- Trading in goods between countries are referred to as merchandise and import/export of services (banking, information technology, etc) are referred to as invisible items.
- Unilateral transfers refer to money sent as gifts or donations to residents of foreign countries.
- This can also be personal transfers like – money sent by relatives to their family located in another country.

Balance of Trade (BoT)

- The BoT is the difference between the monetary value of a nation's exports and imports over a certain time period.
- If a country exports a greater value than it imports, it has a trade surplus or positive trade balance, and conversely, if a country imports a greater value than it exports, it has a trade deficit or negative trade balance.

Current Account Deficit (CAD)

- A current account deficit means the value of imports of goods/services /investment incomes /transfers is greater than the value of exports.

- It indicates the net outflow of foreign exchange.

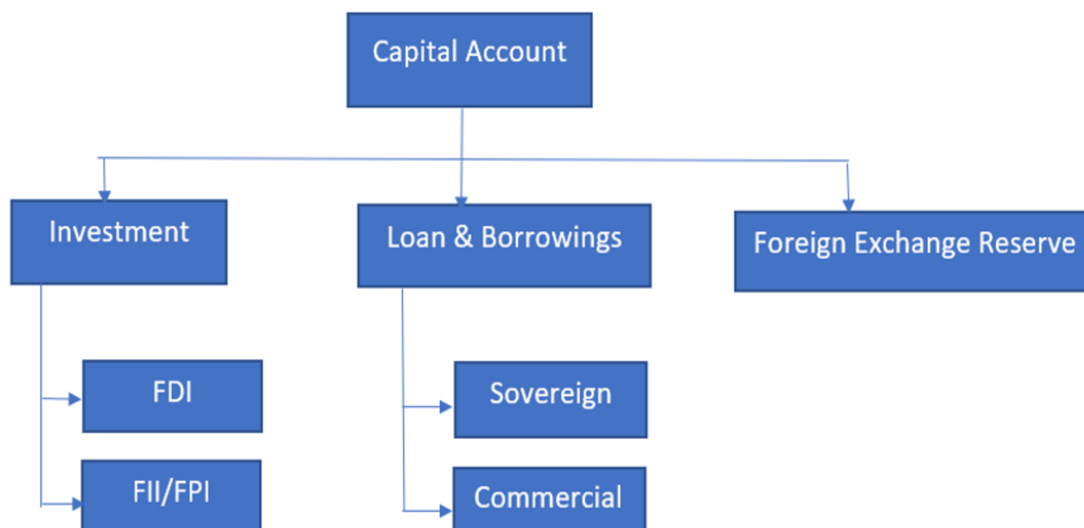
Current Account Surplus

- A current account surplus means the value of imports of goods/services /investment incomes /transfers is less than the value of exports.
- It indicates the net inflow of foreign exchange.

2. Capital Account

- All capital transactions between the countries are monitored through the capital account.
- Capital transactions include the purchase and sale of assets (non-financial) like land and properties.
- The capital account also includes the flow of taxes, purchase, and sale of fixed assets, etc by migrants moving out/into a different country.
- The deficit or surplus in the current account is managed through finance from a capital account and vice versa.
- There are three major elements of capital account –

1. Investment
2. Loans & Borrowings
3. Foreign Exchange Reserve



3. Financial Account

- In the financial account, international monetary flows related to investment in a business, real estate, bonds, and stocks are documented.
- Also included are government-owned assets such as foreign reserves, gold, special drawing rights (SDRs) held with the International Monetary Fund, private assets held abroad, and direct foreign investment.
- Assets owned by foreigners, private and official, are also recorded in the financial account.

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