

INTERNATIONAL BUSINESS AND TRADE

UNIT-4

PART-III

Importance of Balance of Payment

A balance of payment is an essential document or transaction in the finance department as it gives the status of a country and its economy. The importance of the balance of payment can be calculated from the following points:

- It examines the transaction of all the exports and imports of goods and services for a given period.
- It helps the government to analyse the potential of a particular industry export growth and formulate policy to support that growth.
- It gives the government a broad perspective on a different range of import and export tariffs. The government then takes measures to increase and decrease the tax to discourage import and encourage export, respectively, and be self-sufficient.
- If the economy urges support in the mode of import, the government plans according to the BOP, and divert the cash flow and technology to the unfavourable sector of the economy, and seek future growth.
- The balance of payment also indicates the government to detect the state of the economy, and plan expansion. Monetary and fiscal policy are established on the basis of balance of payment status of the country.

Autonomous And Accommodating Items, Deficit In Balance Of Payment And Disequilibrium In Balance Of Payment

1. Autonomous items

- (a) Autonomous items refer to those international economic transactions in the current account and capital account which take place due to some economic motive such as profit maximisation.
- (b) These transactions are independent of the state of BOP account.
- (c) These items are also known as 'above the line items'.
- (d) For example, if a foreign company is making investments in India with the aim of earning profit, then such a transaction is independent of the country's BOP situation.

2. Accommodating items

- (a) Accommodating items refer to the transactions that are undertaken to cover deficit or surplus in autonomous transactions, i.e., such transactions are determined by net

consequences of autonomous transactions.

(h) These items are also known as 'below the line items'.

(c) For example, if there is a current account deficit in BOP, then this deficit is settled by capital inflow from abroad. The sources used to meet a deficit in BOP, are: (i) Foreign exchange reserves; (ii) Borrowings from IMF or foreign monetary authorities.

3. Deficit in BOP

(a) The balance of payments of a country is a systematic record of all economic transactions between the residents of foreign countries during a given period of time.

(b) The transaction in the balance of payment account can be categorized as autonomous transactions and accommodating transactions.

(c) Autonomous transactions are transactions done for some economic consideration such as profit.

(d) When the total inflows on account of autonomous transactions are less than total outflows on account of such transactions, there is a deficit in the balance of payments account.

(e) Suppose, the autonomous inflow of foreign exchange during the year is \$500, while the total outflow is \$600. It means that there is a deficit of \$100.

4. Disequilibrium in Balance of Payments: There are a number of factors that cause disequilibrium in the balance of payments showing either a surplus or deficit. These causes are:

(a) Economic Factors

(i) Large scale development expenditure that may cause large imports.

(ii) Cyclical fluctuations in general business activity such as recession or depression.

(iii) High domestic prices may result in imports.

(b) Political Factors: Political factors instability may cause large capital outflows and hamper the inflows of foreign capital.

(c) Social Factors: Changes in tastes, preference and fashions of the people bring disequilibrium in BOP by inflowing imports and exports.

**Q.1 EXPLAIN THE MEANING OF DEFICIT IN BALANCE OF PAYMENT. HOW IS IT CORRECTED?
OR**

HOW IS BALANCE OF PAYMENT DEFICIT MEASURED?

ANSWER:

Balance of Payment deficit is a situation when autonomous receipts are less than autonomous payments.

[Current A/c + Capital A/c Receipts] < [Current A/c + Capital A/c Payments]

a) MEANING OF DEFICIT IN BOP

Autonomous transactions are those transactions which are carried out with economic motive irrespective of the present position of the BOP.

This situation arises only on account of autonomous transactions.

b) CORRECTION OF BOP DEFICIT

To correct the deficit i.e. Adverse BOP position government will:
i. Withdraw the required amount from its Foreign Exchange Reserves
or

ii. If required, it can borrow from the IMF.

These are the accommodating transactions of the government made only to bring equilibrium in the Balance of Payment.

Q.2 EXPLAIN THE MEANING OF SURPLUS IN A BALANCE OF PAYMENT ACCOUNT. HOW IS IT CORRECTED?

OR

HOW IS BALANCE OF PAYMENT SURPLUS MEASURED?

ANSWER:

a) MEANING OF SURPLUS IN BOP

Balance of Payment Surplus is a situation when autonomous receipts are more than autonomous payments.

[Current A/c + Capital A/c Receipts] > [Current A/c + Capital A/c Payments]

Autonomous transactions are those transactions which are carried out with economic motive irrespective of the present position of the Balance of Payment.

This situation arises only on account of autonomous transactions.

b) CORRECTION OF BOP SURPLUS

To remove the surplus government will:
Deposit the excess foreign exchange in its Foreign Exchange Reserves.
This is an accommodating transaction of the government made only to bring equilibrium in the Balance of Payment.

**Q.3 WHAT ARE THE CAUSES OF DEFICIT IN BOP?
OR
WHAT ARE THE CAUSES OF UNFAVOURABLE BOP?**

ANSWER:

Following are the causes of Deficit in BOP or Unfavourable BOP.

a) ECONOMIC FACTORS

i) Fast Economic Development

- For fast development, developing countries import machines, technology, and other equipment.
- This leads to a high level of outflows of foreign exchange that can result in a deficit in the BOP account.

ii) Inflation

- Inflation i.e. continuous rise in prices in a country makes foreign goods relatively cheaper.
- It increases imports which cause a deficit in the Balance of Payment.

b) POLITICAL FACTORS

i) Political Instability

- Due to uncertainty, there may be large capital outflows and lesser inflows of foreign funds. It can create an adverse position in the Balance of Payment.

ii) Political disturbances

- Frequent changes in government, unstable tax structure, etc. result in loss of trust of foreign investors and discourage inflows of capital.
- Domestic investors also prefer to invest outside the economy. As a result, an adverse position created in the balance of Payment.

c) SOCIAL FACTORS

i) Changes in taste, preferences, fashion, and style, etc.

- A favorable change for imported goods increases the demand for imported goods and lead to a deficit in the balance of payment.

ii) Demonstration effect

- Most of the developing countries get influenced by developed nations and start adopting the foreign pattern of consumption.
- This results in a sharp rise in imports leading to a deficit in the Balance of Payment.

iii) Population explosion

- Population explosion in underdeveloped nations, also generally, results in large scale imports and causes a deficit in the Balance of Payment.

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