

# Balance Of Payments its term and type

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## ARTICLE DETAILS

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## ABSTRACT

Purpose- India is now getting more integrated with the worldwide economy. In 2017-18 Indian two-way external-sector transactions gone up about 113% of the country's GDP. The cross border uncertainty in the financial markets has transmitted through the various channels such as trade, finance, and confidence. Due to globalization, the developing countries like India experiences undesirable strain on its Balance of Payment (BoP). The objective of this study is to identify and analyze the factors that influence the country's BoP. This article indicates an overview of the Balance of payments. For this article we study a number of books, magazine and research papers. Secondary data is taken from various books, magazine, research papers and official site of RBI. Many terms related to monetary policy and fiscal policy is used in this article. The main objective of this research article focuses on economic transaction and foreign exchange.

## 1. Introduction

A country's balance of payments keeps track of both its payments to and its receipts from other countries. The B.O.P. account is the measurement of all international economic transactions between the residents of a country and foreign residents. The Balance Of Payments is a book-keeping system for recording all payments that have a direct bearing on the movement of funds between a nation (private sector and government) and foreign countries. All the transactions involving payments from foreigners to Indian are entered in the "Receipts" column with a plus sign (+) to reflect that they are credits, that is, they result in a flow of funds to Indians. Receipts include foreign purchase of Indian product such as computer and wheat (exports), foreign travel India (tourists services), income earned from Indian investment abroad (investment income), and foreign payments for Indian assets (capital inflow).

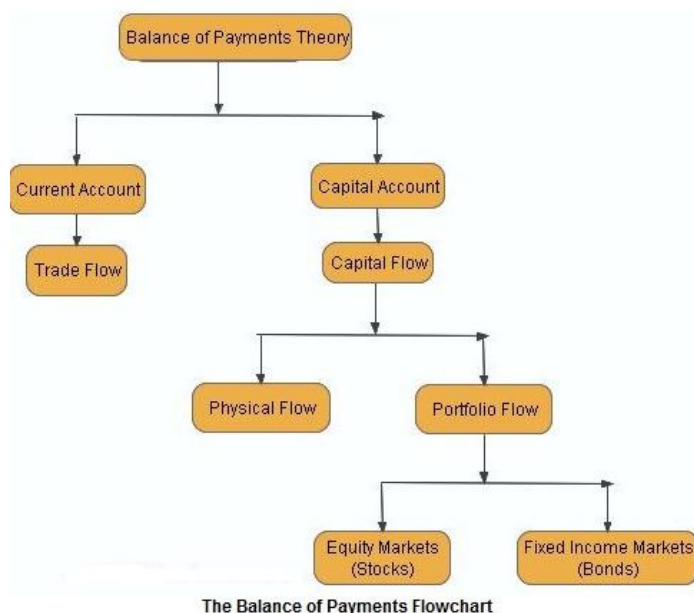
All payments to foreigners are entered in the "payments" column with a minus sign (-) to reflect that they are debit because they result in flow of funds to others countries. Payment include Indian purchases of foreign product such as French wine and Japanese car (imports), Indian travel abroad (services) income earned by foreigners from invest in India (investment income) and Indian payments for foreign assets (capital outflow).

## 2. Balance of Payments Position in India

The balance of payments position of the country reflects on its economic health. The balance of payments of any country is a comprehensive and systematic accounts of all the different transactions occurred between the residents of a country and the rest of the world during a particular period of lime.

The balance of payments maintains detailed classified records of different types of receipts against exports of goods, services and all the capital received by its residents on the one hand and also of all the payments made by the residents against imports of goods and services received along with the capital transferred to non-residents and foreigners, on the

other hand. Thus the balance of payments is much wider than the balance of trade which refers to only merchandise exports and imports.



## 3. Type's of B.O.P. accounts

The B.O.P. is composed of two primary sub-accounts, the current account and the financial or capital account. In addition, the official reserve account tracks government currency transaction and the net errors and omission account, is produced to create and keep the balance in the B.O.P.

**1. Current account:** it includes all international economic transactions with receipts and payments flows occurring within the current year. The current account consists of four categories:

**(I) Goods Trade:** This is the record of export and import of goods.

**(II) Service Trade:** service trade is the record of export and import of services.

**(III) Income:** This is the current income related with investments that were made in previous periods. For example, if a Japanese foreign firm established its subsidiary firm in India, then the profit made by this subsidiary that will be repatriated back to Japan as dividend is the current invest income. Wages and Salaries paid to non-residents workers are also included in this category.

**(IV) Unilateral Transfer:** Unilateral transfer include pension, remittance, gifts for which no specific services are rendered. They are called unilateral transfer because they represent the flow of funds in only one direction.

Therefore,

Export of goods affects the inflow of foreign exchange into the country, while import of goods causes outflow of foreign exchange from the country.

**Calculation of the balance of current account:** Balance of Trade + Net earnings on invisible (i.e. invisible refer to trade in services, investment income and unilateral transfers).

Balance of Trade = Exports of goods – Imports of goods.

**2. Capital and Financial account:** Capital and Financial account measures all international economics transaction of financial assets. It is divided into two major components, the capital and the financial account.

**(I) Capital account:** Capital account is a part of B.O.P statement showing flow of foreign loan /investment and banking funds. The three major sub-categories of India's capital account balance are direct investment, portfolio investment and other long term and short term capital.

**(I.I) Direct Investment:** Direct investment is the net balance of capital flow into and out of a country for the purpose of exerting control over assets. For example, if an Indian firm either builds a new automotive part facility in other country or purchases a company in other country, this would fall under direct investment in India's B.O.P accounts.

**(I.II) Portfolio Investment:** It is the capital invested in activities that are purely motivated by returns. Investments that are purchases of debt securities, bonds, interest-bearing bank accounts to earn a return.

**(I.III) Other Investment asset/liabilities:** It includes short term and long term trade credits, cross-border loan from all types of financial institution, currency deposits and bank deposits and other accounts receivable and payable related in cross-border trade.

**Calculation of Balance of Capital account =** Foreign exchange inflow – foreign exchange outflow (on account of foreign investment, foreign loan, banking transactions and other capital flows).

**Error and omission:** which is also termed as “**statistical discrepancy**” is an important item on the B.O.P statement, is taken into account for arriving at the overall balance. It may be noted that the statistical discrepancy arises on different accounts.

1. It arises because there are different sources of data which sometimes differ in their approach.
2. The movement of funds may lead or lag the transactions that funds are supposed to finance.
3. Certain figures are derived on the basis of estimates.
4. Error and omission are explained by unrecorded illegal transaction that may be either on the debt side or on the credit side or on both sides. Only the net amount is written on the B.O.P.

**Overall B.O.P (Balance of Payment):** **Balance of current account + Balance of capital account + Statistical discrepancy:** If the overall balance of payment is in surplus, the surplus amount is used for repaying the borrowing from IMF and then rest is transferred to the official reserve account. On the other hand, when the overall balance is found in deficit, the monetary authorities arrange for capital flow to cover up the deficit. Such inflow may take the form of drawing down of foreign exchange reserve or official borrowing from the IMF.

#### 4. Determinants of Balance of Payments

It may be further noted that when there is a deficit in the current account, it has to be financed either by using foreign exchange reserves with Reserve of Bank, if any, or by capital inflows (in the form of foreign assurance, commercial borrowing from abroad, non-residential deposits). There are several variables which determine the balance of payments position of a country, viz., national income at home and abroad, the prices of goods and factors, the supply of money, the rate of interest, etc. all of which determine exports, imports, and demand and supply of foreign currency.

The main cause of disequilibrium in the balance of payments arises from imbalance between exports and imports of goods and services that is, deficit or surplus in balance of payments. When for one reason or another exports of goods and services of a country are smaller than their imports, disequilibrium in the balance of payments is the likely result.

Exports may be small due to the lack of exportable surplus which in turn results from low production or the exports may be small because of the high costs and prices of exportable goods and severe competition in the world markets.

Important causes of small exports are the inflation or rising prices in the country or over-valued exchange rate. When the prices of goods are high in the country, its exports are discouraged and imports encouraged. If it is not matched by other items in the balance of payments, disequilibrium emerges.

#### 5. Causes and kinds of B.O.P Disequilibrium

1. **Change in Price level and fundamental disequilibrium:** Change in the price level may be

inflationary or deflationary. Inflation causes a deficits and disinflation causes a surplus balance in the B.O.P. deficits B.O.P resulted in increased indebtedness, depletion of gold reserve, loss of employment, distortions in the domestic economy. Surplus in B.O.P leads to wasteful expenditure and misallocation of resources.

2. **Business cycle and cyclical disequilibrium:** As Lawrence W. Towel points out; depression always brings about a drastic shrinkage in world trade, while prosperity stimulates it. A country enjoying a boom all by itself of decrease in foreign demand.
3. **Long run disequilibrium:** The B.O.P disequilibrium persists for long periods to certain secular trends in the economy. The high aggregated demand and higher domestic prices may result in the imports being much higher than the export.
4. **Short run disequilibrium:** It is also known as Temporal Disequilibrium. It includes disequilibrium or crop failures, rapid growth in population, and development progress increase domestic demand for imports.
5. **Structural disequilibrium:** Structural disequilibrium refers to some changes in the economy. It includes the development the alternate source of supply, development of better substitutes, exhaustion of productive resource or change in transport routes and cost etc.

## 6. Measures to correct Adverse B.O.P

There are basically two measures of correcting the adverse B.O.P:

**Income related measures:** Income related measures include the two policy tools to change disposable income are monetary policy and fiscal policies. Monetary policy operates on the demand for and supply of money while fiscal policy operates on the disposable income of the people.

**Monetary policy:** To solve the problem of B.O.P deficit, a tight or dear monetary policy is followed. Under it, central

monetary authority raises the interest rate. Consequently, under the normal conditions, the demand for bank credit for investment consumer durable decreases. With a fall in investment and through its multiplier effect, the income of the people decreases. If marginal propensity to consume is greater than zero, demand for goods and services decreases. The fall in demand implies also a decrease in imports. The tight monetary policy is also combined with open market operation, i.e. sales of government bonds and securities.

**Fiscal policy:** Fiscal policy includes taxation and public expenditure. Taxation reduces household disposable income and result fall in both domestic and imported demand. The government can reduce income and demand by adopting a policy of surplus budgeting i.e. the government keeps its expenditure less than its revenue. When the government adopts a surplus budget policy, it increases tax rates and reduce public expenditure.

## 7. Conclusion

After the study of this article we can say that the overall balance of payment is in surplus, the surplus amount is used for repaying the borrowing from IMF and then rest is transferred to the official reserve account. In the era of globalization, the country has both opportunity and threat. The trade among the countries results trade imbalances for the domestic country. Export and import are the two significant factors for trade imbalances. The gap between the export and import creates trade imbalance. It may cause trade surplus or trade deficit. Due to factors like exchange rate volatility, currency devaluation, economic disequilibrium, global crisis the trade deficit gets wider. It also reduces the growth of the country. To improve this situation the government and RBI has taken corrective measures. They announce new policies, cut the rates, promoted the export and discourage the export. The result of these policies has reflected in the trade balance of 2017-18, in which the trade deficit has narrow down.

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