

WELCOME



BALANCE OF PAYMENTS - 1

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Balance of Payments

- A systematic , statistical and itemized record / account of all economic transactions between residents of a given country and of the residents of the rest of the world in an accounting period(year).
- Payments here implies International Transactions(both payments and receipts) and Balance implies balance sheet of receipts and payments having an accounting balance and not situation of comfortable equilibrium.
- It follows a double book entry system of account keeping.(i.e. Debit and credit).
- Here, Receipts from and payments to foreigners are called as credit and debit respectively.

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- It is a statistical record of character and dimension of country's economic relationship with rest of the world showing its :
- Trading position
- Changes in its net position as foreign lender or borrower
- Change in its official reserve holding

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- The BoP transactions include all the foreign receipts of and payments by a country during a given year.
- The receipts include all the earnings and borrowings of foreign exchange and they are recorded as credit items
- The payments include all the spending and lending of foreign exchange and are recorded as debit items

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- All the financial receipts are financial inflows and all the foreign payments are financial outflows in a year
- As the BoP is a schedule of debit and credit transactions which must necessarily be equal hence in accounting or book keeping sense the BoP must be balanced. Credit (receipt) is left hand side of statement and debit(payment) is right hand side of Statement.
- However BoP equilibrium is not guaranteed and Accounting balance is consistent with BoP disequilibrium i.e. Deficit and Surpluses in the BoP.

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- BoP comprises of the following:
 1. Transactions in the goods and services and income between an economy and rest of the world
 2. Changes of ownership and other changes in that country's monetary gold , special drawing rights and claims on and liabilities to the rest of the world
 3. Unrequited transfers and counterpart entries that are needed to balance in accounting sense any entries for the foregoing transactions and changes which are not mutually offsetting

Purpose of BoP

1. To find the impact of the inflows and outflows of capital from foreign trade on the economy.
2. To keep taking stock of international transactions to tide over BoP deficit crisis and consequential international indebtedness.
3. SWOT analysis and Benefit cost ratio analysis of international trade

Components/Structure of Balance of payments

1. Current Account (Visibles and Invisibles)

- Visibles/Merchandise (Export and Import of Goods)
- Export is called credit and import is called debit.
- Invisibles as : (Non Factor Service , Investment Income and Private Transfer)
- Non factor service like travel transportation insurance interest royalty financial software news agency dividend business service etc.
- Income
- Unilateral transfer payment like gift aid grant remittance from Govt and private source having no quid pro quo.

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2. Capital Account : Record of capital transactions (inflow and outflow).
 - Generally Long Term As short term is called errors and omissions accounted separately.
 - Export of capital is debit and import of capital is credit . As export reduces and import increases the foreign exchange.
 - Long term(FDI , FII (in financial and real assets) , Amortization of capital i.e. Repurchase and resale of financial capital with foreigners done earlier)
 - Short term(sale and purchase of short term securities, speculative purchase of foreign currency , cash balance held by foreigners(Generally called Errors and Omissions.)
 - Govt. , private and Banking
 - Debt and Equity
 - Loan , investment and Banking capital(NRI Deposit Foreign currency deposit viz. FCNR NRER)
 - Investment (FDI,FII) as Non Debt liability
 - Debt Liability as (banking capital , ECB , trade credit , external assistance , Loan

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3. Official Reserve Account

- Settlements account
- Account of Financing
- International liquidity account
- Change in International reserve position
- Change in SDR level
- Change in stock of Gold and Forex Reserve
- Implicitly a part of capital account as it is a type of capital transaction.

4. Balancing account(Errors and Omissions).

- Generally a type of private short term capital transaction.

Balance of All Accounts

- Balance of Trade: Net balance of merchandise/visible trade. (Export / Import). Also called Current Trade Balance.
- Current Account Balance: The trade balance net of receipts and payments on account of invisibles and unilateral transfers.
- Capital Account Balance: Net of all types of capital transactions.

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- Overall Balance of Payments: Capital Account Balance + Current Account Balance. It considers all the monetary transaction of the reporting economy with rest of the world. There is no distinction between long term and short term capital
- Basic Balance : BoP on Current Account + Long term Capital Account. It excludes short run capital movement.
- Deficit in Current Account is balanced by Surplus in Capital Account and vice versa hence in pure accounting sense of double entry accounting system the Overall BoP is always in balance or equilibrium in accounting sense but it is rarely in actual sense in real world.

Autonomous and Accommodating Transactions

- Autonomous Transaction
- Above the line
- Cause of Balance of Payment situation
- Regardless of size of transactions
- Current account trade and long term capital account trade.
- Accommodating Transaction
- Below the line
- Result of Balance of Payment Situation
- Official Reserve Account and Errors and Omissions

BoP Disequilibrium and Overall BoP Equality

- BoP Balance: Autonomous Receipt = Autonomous Payment in accounting sense with the help of accommodating transactions. Does not necessarily means BoP Equilibrium.
- BoP Equilibrium: Autonomous Receipt = Autonomous Payment without the help of accommodating transactions. Automatically implies BoP Balance. Here sum of accommodating transactions being zero.
- BoP Disequilibrium : Deficit or surplus of Autonomous Transaction
- BOP Equality : BoP Disequilibrium + accommodating Transaction making BoP overall Balance.

BoP Settlement VS BoP Adjustment

- BoP Settlement: Correcting BoP Disequilibrium by accommodating transactions temporarily
- BoP Adjustment: Correction in BoP Disequilibrium by autonomous transactions permanently by controlling the forces behind BoP Disequilibrium.

Full Employment Equilibrium or True Balance

- BoP Equilibrium caused :
- Without internal imbalance of inflation or unemployment or any other inflationary or deflationary gaps in the economy.
- Without imposing trade and payment restrictions or any other commercial policy.
- Such Equilibrium of BoP called Full Employment or True balance where External Balance is consistent with Internal Balance on one hand and free trade in goods, service and factor flows on the other.

Major Accounts	Credit (Receipts)	Debit (Payments)	Net Surplus (+) or Deficit (-)
1. Goods Account	200	180	+20
2. Services Account	100	250	-150
A. BALANCE OF TRADE (1+2)	(300)	(430)	(-130)
3. Unilateral Transfers Account	300	120	+180
B. BALANCE OF PAYMENTS ON CURRENT ACCOUNT (1+2+3)	(600)	(550)	(+50)
4. Long Term Capital Account	150	120	+30
C. BASIC BALANCE (1+2+3+4)	(750)	(670)	(+80)
5. Short Term Capital Account	50	40	+10
D. BALANCE OF PAYMENTS ON CAPITAL ACCOUNT (4+5)	(200)	(160)	(+40)
E. OVERALL BALANCE OF PAYMENTS (B+D)	(800)	(710)	(+90)
6. International Liquidity Account Net Changes in External Reserves		90	
F. BALANCE OF PAYMENTS ACCOUNTING BALANCE	(800)	(800)	(0)

Credits (+)
(Receipts)

Debits (-)
(Payments)

1. Current Account

Exports

Imports

- | | |
|-----------------------|-----------------------|
| (a) Goods | (a) Goods |
| (b) Services | (b) Services |
| (c) Transfer Payments | (c) Transfer Payments |

2. Capital Account

- | | |
|---|---|
| (a) Borrowings from Foreign Countries | (a) Lending to Foreign Countries |
| (b) Direct Investments by Foreign Countries | (b) Direct Investments in Foreign Countries |

3. Official Settlements Account

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|---|---|
| (a) Increase in Foreign Official Holdings | (a) Increase in Official Reserve of Gold and Foreign Currencies |
|---|---|

Errors and Omissions

THANK YOU