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Department/ faculty _ Department
Mobile No. _ 9415992431
Email. _ ms9602859@gmail.com
College name _ Jagatpur P.G College
E-content creator _ Dr. Manoj Kumar Srivastava



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Dr. Manoj Kumar Srivastava

(Assistant Professor)

Meaning of Balance of payment

The balance of payments of a country is a systematic record of all economic transactions between its resident and residents of foreign countries. Each country has got to enter into economic dealings with other countries of the world as a result of these dealings. It receives payments from and makes payments to other countries.

Ordinarily, a country has to deal with other countries in respect of three types of items:

- Visible items which include all types of physical goods imported and exported,
- Invisible items which include all those services such as transport banking insurance etc whose import and exports are not visible and
- Capital transfers which are concerned with the capital receipts and capital payments.

Definitions:

“The balance of payments of a country is a systematic record of all economic transaction between the residents of the reporting country and the residents of foreign countries during a period of time” - Kindle Berger

“Balance of payments of a country is a record of all the monetary transactions over a period with the rest of the world”
— Venham

Balance of trade

Balance of trade is a narrower concept, as it refers only to visible items like materials (such as machines, cloth, sugar, etc.) which can be physically seen, counted, measured, and weighted and which are to be recorded at the custom barriers. These are visible items i.e., the process of proper recording of visible items in respect to measuring the values of the difference between exports and imports

Balance of trade (BOT) = export of visible goods - import of visible goods

Difference between the balance of trade and balance of payment

The main difference between the balance of trade and balance of payments may be described as under:

- **Meaning-** Balance of trade refers to the difference between exports and imports of goods by a country in a year while the balance of payments is a statement of all economic transactions between the residents of a country and the rest of the world during a year.
- **Nature of concept-** Balance of trade is a narrow concept as it is a part of the balance of payments. On the other hand balance of payments is a wider concept as it includes every type of transaction of one country with the rest of the world.
- **Nature of items:** Balance of trade deals with only visible and material goods. On the contrary balance of payments deals with both visible and invisible goods.
- **Favorable or unfavorable-** Balance of trade can be favorable or unfavorable for a country while the balance of payments is always balanced even if the balance of trade is unfavorable.

Features of the balance of payments

- The basic features of the balance of payments are as follows
- Systematic record: It is a systematic record of all economic transactions between the residents of one country and the rest of the world.
- A fixed period of time: It is related to a given period of time usually one year.
- Comprehensiveness: Comprehensiveness comprises of all the three items that are visible invisible and capital transfers.
- Double-entry system: In the double-entry system both receipts and payments are recorded.
- Self-balanced: From the point of view of the accounting double entry system keeps automatically debit and credit sides of the accounts in balance.
- Adjustment of differences: Whenever there is a difference in actual total receipts and payments need is felt for necessary adjustment.

Causes of an unfavorable balance of payments

- Payment of interest on foreign debts
- Increase in the price of petrol
- Import of liberalization
- Foreign competition
- Price disequilibrium
- Embassies
- Increase in price of crude oil
- Import of machinery
- Import of gold
- Less growth in exports.

Suggestions for correcting the adverse balance of payment

Following specific measures are suggested to correct this equilibrium in the balance of payments:

- Import substitution
- Export promotion
- Restriction on domestic demand
- Price stability
- Self-sufficient economy
- Exploration of mineral resources
- Devaluation of Indian currency
- Deflation
- Attraction to foreign tourists
- Bilateral and multilateral agreements
- Effective import and export policy
- Sale of gold
- Trade agreement

Steps were taken by the government for correcting the balance of payment problems

- Liberalization of foreign investment policy
- Steps were taken for import substitution and export promotion
- Fully convertibility of rupiah in the current account.
- Rebate for Indian investment in foreign countries
- Latest government measures:

- Increase in import fees
- Increase in the limit of foreign direct investments
- The high rate of interest
- Single window

Questions

Short

1. What do you mean by the balance of payments?
2. What is the difference between the balance of payments and balance of trade?

Long

1. What is the Balance of payment? Explain the causes of an unfavorable balance of payments.
2. What measures have been taken to improve the balance of payments situations?

Keywords

1. Equilibrium
2. Liberalization
3. Bilateral
4. Multilateral

References

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Publications

THANKS
