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B.A. Part - 2
Paper-1
Topic - Balance of Payment
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Balance of Payment :-

Balance Of Payment (BOP) is a statement which records all the economic 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.

A 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.

X>M = Surplus in BOP

On the other hand, the BOP deficit indicates that a country's imports are more than its exports. i.e;

X<M = Deficit in BOP

According to the RBI, balance of payment is a statistical statement that shows

1. The transaction in goods, services and income between an economy and the rest of the world,

2. Changes of ownership and other changes in that economy's monetary gold, special drawing rights (SDRs), and financial claims on and liabilities to the rest of the world, and

3. Unrequited transfers.

Importance of BOP

- The BOP of a country reveals its financial and economic status.
- A BOP statement can be used as an indicator to determine whether the country's currency value is appreciating or depreciating.
- The BOP statement helps the Government to decide on fiscal and trade policies.
- It provides important information to analyze and understand the economic dealings of a country with other countries.
- By studying its BOP statement and its components closely, one would be able to identify trends that may be beneficial or harmful to the economy of the county and thus, then take appropriate measures.

Elements of BOP

There are three components of balance of payment viz current account, capital account, The official reserve account. The total of the current account must balance with the total of capital and financial accounts in ideal situations.

Elements of balance-of-payment

Current Account

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 to a country's **Balance Of Trade (BOT).**

There are various categories of trade and transfers which happen across countries. It could be **visible** or **invisible trading, unilateral transfers or** other **income payments/receipts.** Trading in goods between countries are referred to as visible items 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.

Brief description of components of current account

- **Visible trade –** This is the net of export and imports of goods (visible items). The balance of this visible trade is known as the trade balance. There is a trade deficit when imports are higher than exports and a trade surplus when exports are higher than imports.

- **Invisible trade –** This is the net of exports and imports of services (invisible items). Transactions mainly consist of shipping, IT, banking, and insurance services.

- **Unilateral transfers to and from abroad –** These refer to payments that are not factor payments – for example, gifts or donations sent to the resident of a country by a non-resident relative.

- **Income receipts and payments –** These include factor payments and receipts. These are generally rent on property, interest on capital, and profits on investments.

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 the finance from the capital account and vice versa. There are 3 major elements of a capital account:

- Loans and borrowings – It includes all types of loans from both the private and public sectors located in foreign countries.
- Investments – These are funds invested in the corporate stocks by non-residents.
- Foreign exchange reserves – Foreign exchange reserves held by the central bank of a country to monitor and control the exchange rate does impact the capital account.

The official reserve account:

The category of official reserve account covers the net amount of transactions by government. This account covers purchases and sales of reserve assets (such as gold, convertible foreign exchange and special drawing rights) by the central monetary authority.