Course Name:-B.A.LLB-IVth Sem

Subject:-Economics-IV

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Topic: - Balance of Payments

Balance of Payments

The Balance of Payments or BoP is a statement or record of all monetary and economic transactions made between a country and the rest of the world within a defined period (every quarter or year). These records include transactions made by individuals, companies and the government. Keeping a record of these transactions helps the country to monitor the flow of money and develop policies that would help in building a strong economy

In a perfect scenario, the Balance of Payments (BoP) should be zero. That is, the money coming in and the money going out should balance out. But that doesn't happen in most cases. A country's BoP statement correctly indicates whether the country has a surplus or a deficit of funds. A BoP surplus indicates that a country's exports are more than its imports. A BoP deficit, on the other hand, indicates that a country's imports are more than exports. Both scenarios have short-term and long-term effects on the country's economy.

Components of BoP

Now let's understand the different components of the BoP. The BoP consists of three main components—current account, capital account, and financial account. As mentioned earlier, the BoP should be zero. The current account must balance with the combined capital and financial accounts.

Current Account

The current account monitors the flow of funds from goods and services trade (import and export) between countries. Now this includes money received or spent on manufactured goods and raw materials. It also includes revenue from tourism, transportation receipts, revenue from specialized services (medicine, law, engineering), and royalties from patents and copyrights. In addition, the current account includes revenue from stocks.

Capital Account

The capital account monitors the flow of international capital transactions. These transactions include the purchase or disposal of non-financial assets (for example, land) and non-produced assets. The capital account also includes money received from debt-forgiveness and gift taxes. In addition, the capital account records the flow of the financial assets by migrants leaving or entering a country and the transfer, sale, or purchase of fixed assets.

Financial Account

The financial account monitors the flow of funds pertaining to investments in businesses, real estate, and stocks. It also includes government-owned assets such as gold and Special Drawing Rights (SDRs) held with the International Monetary Fund (IMF). In addition, it includes foreign investments and assets held abroad by nationals. Similarly, the financial account includes a record of the assets owned by foreign nationals.

Importance of Balance of Payment:

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

- It examines the transaction of all the export and import 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 tariff. The government then takes measure 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 plan 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 establish on that