

UNIT VIII INTERNATIONAL BUSINESS

CHAPTER

28

BALANCE OF TRADE AND BALANCE OF PAYMENTS



பொறையொருங்கு மேல்வருங்கால் தாங்கி இறைவற்கு
இறையொருங்கு நேர்வது நாடு.

-குறள் 733

Couplet:

A kingdom is that which can bear any burden that may be pressed on it (from adjoining kingdoms) and (yet) pay the full tribute to its sovereign.

Learning Objectives

To enable the students to

- explain the meaning, definition, and structure of balance of payments
- explain the meaning, definition, and structure of balance of trade

Balance of trade and balance of payment are important aspects in international trade. The various aspects of the both the terms have been briefly dealt with in this chapter

28.01 Balance of Payments (BOP)

Meaning

Balance of payment refers to a systematic record of all economic transactions between the residents of one country and the residents of foreign countries during a particular period of time. For example, one year.

It contains a classified record of all receipts and payments arising from goods exported,

services rendered and capital received by residents in a country and payment made by them on account of goods imported, services rendered and capital transferred to non residents or foreigners out of the country.

Purpose of Preparing Balance of Payments

Balance of payment is the principal tool for analyzing the monetary position of international trade of a country just like Receipts and Payments account of enterprise revealing the net effect of cash movements happening in an enterprise during a particular period.

Balance of payments help in framing monetary, fiscal and trade policies of country. Government keenly observes balance of payment position of its important trade partners in making policy decisions. It reveals whether a country produces enough economic output to pay for its growth. It is

reported either for every quarter or for a year.

Net Result Revealed by BOP

A Balance of Payment surplus indicates that country's exports are more than its imports and its government and residents are savers. They are in position to have enough capital to pay for its domestic production. The country can even lend to other countries which in turn buy its products. As a result it boosts the economic growth in the short term. The country achieves higher economic growth due to higher exports in the long run. It builds strong domestic market. This protects the economy from exchange rate fluctuations.

A Balance of Payment deficit points to the fact that country's import is more than the export. This situation forces the country to borrow from other countries to pay for its imports. It creates economic development in the short term. It is just similar to taking an educational loan from bank to pay school fees of children expecting their salary in the future which would help repay the loan.

Definition

According to International Monetary Fund, "The balance of payments for given period is a systematic records of all economic transactions taken place during the period between residents of the reporting countries."

In the words of Domini Salvatore

"The Balance of payment is a summary statement in which principle all the records of the resident of a nation with the resident of all other nations are recorded during a

particular period of time, usually a calendar year."

Features of Balance of Payments

The main features of balance of payments are as follows.

1. It is a systematic record of all economic transactions between one country and certain other countries of the world
2. It is prepared for a period of three months or twelve months, i.e., usually 12 months
3. It contains all receipts and payments both visible and invisible
4. It includes all economic transactions both recorded on current account and capital account
5. Economic transactions are recorded according to double entry principle of book keeping. Accordingly receipts are recorded on credit side and payments are recorded on debit side
6. It indicates a country's position in foreign trade
7. BOP shows a favourable or surplus position when the total receipts from foreign countries exceed the total payments to foreign countries. When the receipts from foreign countries are less than the payments to foreign countries, BOP is said to be unfavorable or in deficit
8. BOP position shows the economic health of nation just like the thermometer indicates the temperature of human body. Favourable BOP indicates economic prosperity while unfavourable balance of payments shows economic weakness of a country.

28.02 Balance of Trade

Meaning

Balance of trade denotes the difference between the value of import and the value of export during a year. If the export of a country exceeds its imports, it shows favourable balance of trade. If the import exceeds the exports, it shows unfavorable balance of trade.

Difference Between Balance of Payments and Balance of Trade

Points of difference between balance of trade and balance of payments are briefly explained in the following Table.

Structure of Balance of Payments

The balance of payments consists of four components namely, current account, Capital account, They are highlighted briefly.

Current Account

The current account balance includes two items

1. Visible trade - Import and export of goods
2. Invisible trade - Invisible service items like, banking, shipping, insurance, travel and transportation

Difference Between Balance of Payments and Balance of Trade

Nature	Balance of Payment	Balance of Trade
1. Meaning	It is a systematic record of all economic transactions happened between the resident of one country and resident of foreign countries during a particular period.	Balance of trade is statement showing the net effect of export and import of a country
2. Nature of Transactions recorded	It records both the transactions relating to goods and services	It records only transactions relating to merchandise , i.e. goods transactions
3. Capital Transactions	It records capital transactions	It does not record capital transactions
4. Structure	It includes balance of trade, balance of services, balance of unilateral transfer and balance of capital transactions	It is part of current account of BOP
5. Net Position	It always remains balanced in the sense that receipt side is made equal to payment side	It may be at favorable or unfavourable or in equilibrium state.
6. Indicator Economic Status	It is true indicator of economic performance of an economy	It is not true indicator of economic prosperity or economic relations of country.
7. Correcting Unfavourableness	Unfavourable balance of payment leads to deficit in balance of payment situation.	Unfavourable balance of trade can be converted into favorable balance of payment



Current Account

Credit Items	Debit Items
1. Goods Export(visible)	1. Goods Import
2. Invisible Exports	2. Invisible Imports
1. Transport service sold abroad	1. Transport services purchased from foreign countries
2. Banking service sold abroad	2. Banking services purchased from foreign countries
3. Insurance service sold abroad	3. Insurance services purchased from foreign countries
4. Income received on loan and investment made in foreign countries	4. Visit of our tourists to foreign countries
5. Expenses incurred by foreign tourists in India	5. Other services purchased from foreign countries
	6. Interest paid on loan in home country

CAPITAL ACCOUNT

Capital account consists of three components

1. Private Capital
2. Banking Capital
3. Official Capital

1. Private Capital

Private capital consists of foreign investments, long term loan and foreign currency deposits

2. Banking Capital

Banking capital includes movement into external financial asset and liabilities commercial and co-operative banks authorized to dealing in foreign exchange

3. Official Capital

It includes RBI's holdings of foreign currency and special drawing rights (SDR) held by the Government

Key Terms

1. Balance of Payments
2. Balance of Trade
3. Current Account
4. Capital Account



For Future Learning

1. Impact of Balance of Payments and Trade
2. Necessary for Global Village concept



For Own Thinking

1. Balance of Payment is key to economic development
2. Importance of BOP and BOT



Exercise

I. Choose the Correct Answer

1. **The Statement which discloses a record of transactions between the residents of one country and residents of foreign country.**
 - (a) Balance of Payment
 - (b) Balance of Trade
 - (c) Statement of Receipts and Payments
 - (d) Accounting Statement



2. The Balance of Payments councils consists of

- (a) Current Account
- (b) Capital Account
- (c) Receipts and Payments Account
- (d) Both Current Account and Capital Account

3. Foreign capital long- term loan and foreign currency reserve are recorded under

- (a) Official Capital
- (b) Private Capital
- (c) Banking Capital
- (d) Both Private and Official Capital



4. The term official capital includes

- (a) RBI holdings of foreign currencies
- (b) Special Drawing Rights held by the Government
- (c) Both A and B
- (d) Foreign Investment

5. Balance of payments surplus indicates

- (a) Exports are more than the Imports
- (b) Imports are more than Exports
- (c) Exports and Imports are at Equilibrium
- (d) Exports and Imports are above Equilibrium

Answer

1. (a) 2. (d) 3. (b) 4. (c) 5. (a)

II. Very Short Answer Questions

- 1. What do you mean by Balance of Payments?
- 2. What do you mean by Balance of Trade?

III. Short Answer Questions

- 1. What are the credit items shown in current accounts? (any 3)
- 2. State the components of Capital account.

IV. Long Answer Questions

- 1. Write any five features of Balance of Payments.
- 2. Distinguish between balance of payment and balance of trade. (any 5)

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- 2. ISC Commerce by S B Gupta - S Chand's Company Ltd New Delhi.2017
- 3. International Trade by Jingon-Sulthan Chand- 2017