Concept of Balance of Payment for Banking & SSC

A developing country like India generally experiences a deficit balance of payments situation. This is because such a country requires imported machines, technology, and capital equipment in order to successfully launch and carry out the Industrialization. It is a very important topic for several exams such as Banking (IBPS SO, IBPS PO, Bank Clerk etc.), UPSC, SSC, and so on. Find out all you need to know about Balance of Payment for Banking in order to strengthen your General Knowledge.

Balance of Payments for Banking - Introduction

Balance of payments is an overall statement of a country's economic transactions with the rest of the world over some period – usually one year. It includes all outflows and inflows (payments and receipts). Countries have either balance of payment surplus or a balance of payment deficit. Balance of Payment for Banking is a way of listing receipts and payments in international transactions of a country.

Why do we have Balance of Payment for Banking?

A country has to deal with other countries in respect of the following:

- **Visible items:** which include all types of physical goods exported and imported.
- **Invisible items:** which include all those services whose export and import are not visible e.g. transport services, medical services, etc.
- **Capital transfers:** which are concerned with capital receipts and capital payment.

In order to acquire these goods, a country will accommodate some capital deficit, and this is called Balance of Payment for Banking.

Types of Balance of Payments

Balance of Payment for Banking can be broken down into:

1. **The Balance of Trade** (export and import of goods)
2. **A Balance of Current Account** (includes the balance of trade, the balance of services and remittances)
3. **Capital Account** (investment and borrowing): The capital account of a country consists of its transaction in financial assets in the form of short-term and long-term lending and borrowing.

CURRENT ACCOUNT

- Trade in Goods (BoT=Export Import)
- Factor Trade in Services (Compensation - Investment)
- Non-Factor Trade in Services (Shipping, Banking, Software etc.)
- Private Transfer Payments (Gifts, Remittances, Grants etc.)
- Official Transfer Payments

CAPITAL ACCOUNT

- Foreign Investment (FDI, FII, Euro Equities)
- External Assistance
- Commercial Borrowings
- IMF
- NR Deposits
- Rupee Debt Services
- Other Flows

Trade is a part of the current account. Capital account deals with investment and borrowings and the rest of the BOP is the current account of which foreign trade is a part.

Balance of Trade V/S Balance of Payment

Balance of Payment	Balance of Trade
1. It is a broad term	1. It is a narrow term
2. Includes all transactions related to visible, invisible and capital transfers	2. Includes only visible items
3. Always balances itself	3. Can be favorable or unfavorable
4. BOP = Current Account + Capital Account + or – Balancing item (Errors and Omissions)	4. BOT = Net Earning on Export – Net payment for imports
5. Following are the main factors which affect BOP a. Conditions of foreign lenders b. Economic policy of Government c. All the factors of BOT	5. Following are the main factors which affect BOT a. Cost of production b. Availability of raw materials c. Exchange rate d. Prices of goods manufactured at home

Invisibles and Remittances

Balance of payments and Invisibles: Invisibles in international trade, is used as a synonym for service. Invisibles trade is a trade-in service. Visible in international trade is used as a synonym for goods. Visible trade is a trade in goods. Invisibles are in three parts i.e. services, transfers and incomes.

Remittances: In recent months, the rupee has weakened considerably Vis – a – Vis the dollar, and a surge in remittances is expected as non – resident Indians take advantage of cheaper goods, services and assets back home. Indian diaspora which is one of the most prosperous in the world is sending money home. Controls are lifted and so there are greater inflows. The government has progressively reduced the red tape. Interest rates are high. RBI increased the amount that can be remitted home.

Convertibility of Rupee

Convertibility refers to the freedom of the holder of domestic currency to freely convert it into any other foreign currency. It has three dimensions:

1. Freedom to convert
2. Convert at market rate
3. Removal of restrictions for conversion on current and capital account

Equilibrium & Disequilibrium

Equilibrium: When demand for and supply of foreign currency in a nation in a given period are equal it is viewed as Equilibrium Position in BOP.

Disequilibrium: Disequilibrium in the balance of payment means its condition of surplus or deficit. A surplus in BOP occurs when total receipts exceed total payments and a deficit in BOP occurs when total payments exceed total receipts.

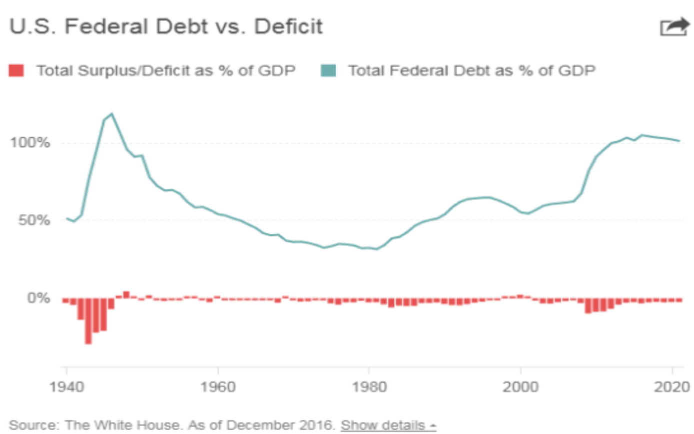
Causes of Disequilibrium

- **Natural causes**: Floods, earthquakes, etc.
- **Economic causes**: Cyclical fluctuations, Inflation, Demonstration effect, etc.
- **Political causes**: International relation, Political instability, etc.
- **Social factors**: Change in taste and preferences etc.

- **Population growth**
- **Development Programmes**
- **Demonstration Effect**
- **Poor Marketing Strategies**
- **Flight of capital**
- **Globalization**

Balance of Payments in the 1990s

The decade began with a crisis caused both by the immediate gulf war and the cumulative problems of the Indian economy. It led to an IMF – sponsored bail out. The Gulf crisis of 1990 – 1991 and the subsequent rise in crude prices rudely exposed the inadequacy of reserves. The consequent rise in India's import bill depleted reserves. International rating agencies downgraded India. The rupee was devalued substantially, foreign portfolio investments were welcomed, and the Indian companies were allowed to raise capital from the international markets.



How to correct the Balance of Payment?

1. **<u>Monetary measures</u>**
    1. Monetary policy
    2. Fiscal policy
    3. Deflation
    4. Exchange rate Depreciation
    5. Devaluation
    6. Exchange control
2. **<u>Non – Monetary measures</u>**
    1. Export Promotion
    2. Import Substitutes
    3. Import Control
        → Quotas
        → Tariffs

Now that you are well aware of what Balance of Payment for Banking is, you can also Check out the links given below:

Everything You Need to Know About Basel Norms

Highlights of Union Budget 2018

Economic Survey India 2018

Things to Know About World Bank

Now that you have gone through Balance of Payment for Banking, you can solve practice Exams for free!

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