



V-LRN

VIRTUAL LEARNING NETWORK

International Business Environment



Block - 1

UNIT – 3

BALANCE OF PAYMENTS

Virtual Learning Network



Topics to be Covered


- Introduction
- Definition of BOP
- Underlying Principles and Conceptual Framework
- Balance of Payment Accounting
- Components of the Balance of Payment
- Deficit and Surplus in Balance of Payments
- Balance of Payment Disequilibrium
- Factor Affecting balance of Payments
- Summary

Introduction


- Balance of payments statistics affect the exchange markets and are therefore, of concern to every one concerned with foreign exchange. Developments in foreign exchange markets may necessitate entailing changes in the relevant policies. The continuous deficits of BOP is an important indicator in credit rating of countries. Therefore, corporate managers must monitor balance of payments data on a regular basis, not only of their country but also of their trading partners. BOP situation is a key element in macroeconomic environment which is a major concern for the companies.

Balance of Payments

Balance of payment is an accounting record of the transactions between the residents of one country and the residents of the rest of the world over a given period of time.

A large, light blue downward-pointing arrow connecting the first text box to the second.

The balance of payments classifies transactions in two accounts – the current account and the capital account.

A large, light blue downward-pointing arrow connecting the second text box to the third.

It is basically a statement of inflow and outflow payments for a particular country.

Balance of Payments (Contd.)

There are two basic concepts in the balance of payments definition:

Economic
Territory

Residence

“Economic
territory”
corresponds
to a
geographic
territory
administered
by a
government

“Residence”
refers to the
institutional unit
or an individual
who regularly
resides and
engages in
economic
activities in an
economic
territory for more
than one year.

Balance of Payments (Contd.)

Balance of Payments (US\$ millions)

Year	05-06	06-07	07-08	08-09	09-10	10-11*	Apr-Sep 2010
(I) CURRENT ACCOUNT							
Merchandise	-51904	-61782	-91467	-118650	-117328	-140572	-66939
Invisibles	42002	52217	75731	89923	78917	82021	39058
Total Current Account	-9902	-9565	-15736	-28727	-38411	-58551	-27881
(II) CAPITAL ACCOUNT							
Foreign Direct Investment	3034	7693	15893	17498	19729	11225	5340
Portfolio Investment	12494	7060	27433	-14030	32396		23797
Loans	7909	24490	40653	8669	12222		15716
Banking Capital	1373	1913	11759	-3245	2084		834
Rupee Debt Service	-572	-162	-122	-100	-97		-17
Other Capital	1232	4209	10969	-1545	-12732		-9009
Total Capital Account	25470	45203	106585	7247	53602		36661
(III) ERRORS & OMISSIONS							
	-516	968	1316	1401	-1746		-1750
(IV) OVERALL BALANCE							
	15052	36606	92165	-20079	13445		7030

Balance of Payments (Contd.)



Major Items of India's Balance of Payments (US\$ million)

	(2007-08) (PR)	(2008-09) (P)	April-December (2008-09) (PR)	April-December (2009-10) (P)
Exports	166163	175184	150520	124473
Imports	257789	294587	248967	213988
Trade Balance	-91626	-119403	-98446	-89515
Invisibles, net	74592	89587	70931	59185
Current Account Balance	-17034	-29817	-27516	-30330
Capital Account*	109198	9737	7136	41630
Change in Reserves # (+ indicates increase; - indicates decrease)	-92164	20080	20380	-11330



Underlying Principles and Conceptual Framework

Balance of payment is concerned with economic transactions.

Five Basic types of economic transactions may be distinguished as:

Barter

Purchases and sales of goods and services against financial items

The interchange of financial items against other financial items

The provisions or acquisition of goods & services without requital

The provision or acquisition of financial items without requital

Balance of Payment Accounting

The balance of payment is a standard double entry accounting record and subject to all the rules of double entry book-keeping

Credit(+) and Debit(-) &

leaving aside errors and omissions.

All international transactions can either be classified as debit or credit entry.

Debit: involves payments to foreigners

Credit: involves receipts of payments from foreigners

Cont.....

Simple accounting rules followed in BOP are:

- All the transactions which lead to an immediate or prospective payment from the rest of the world to the country should be recorded as credit.
- All transactions which result in an actual or prospective payment from the country to the rest of the world should be recorded as debits.
- A transaction which results in an increase in demand for foreign exchange is to be recorded as debit entry while a transaction which results in an increase in the supply of foreign exchange is a credit entry.





Components of Balance of Payment

The Current Account:

- **Under** this are included imports and exports of **goods and services** and **unilateral transfers**, which reflect government and private gifts and grants.

The Capital Account:

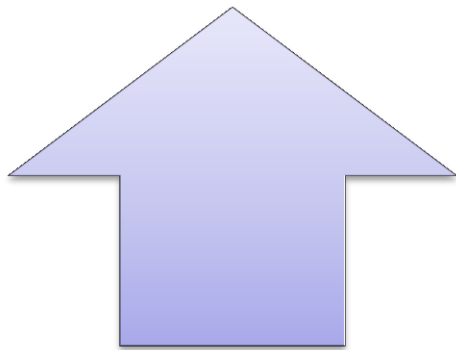
- Under this are grouped transactions leading to **changes in foreign financial assets and liabilities** of the country.

The Reserve Account:

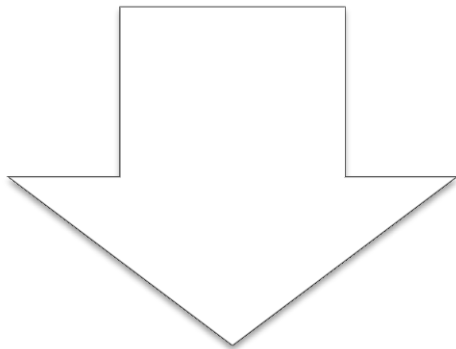
- These are the assets which the central bank of the country **uses to settle the deficits and surpluses** that arises in the other two categories.

Deficits & Surplus in BOP

- BOP account always balances.
- The difference between aggregate debit and credits is called balance.



When the credits exceed debits, the balance is positive or surplus.



In case, debits exceed credit, balance is negative or deficit.

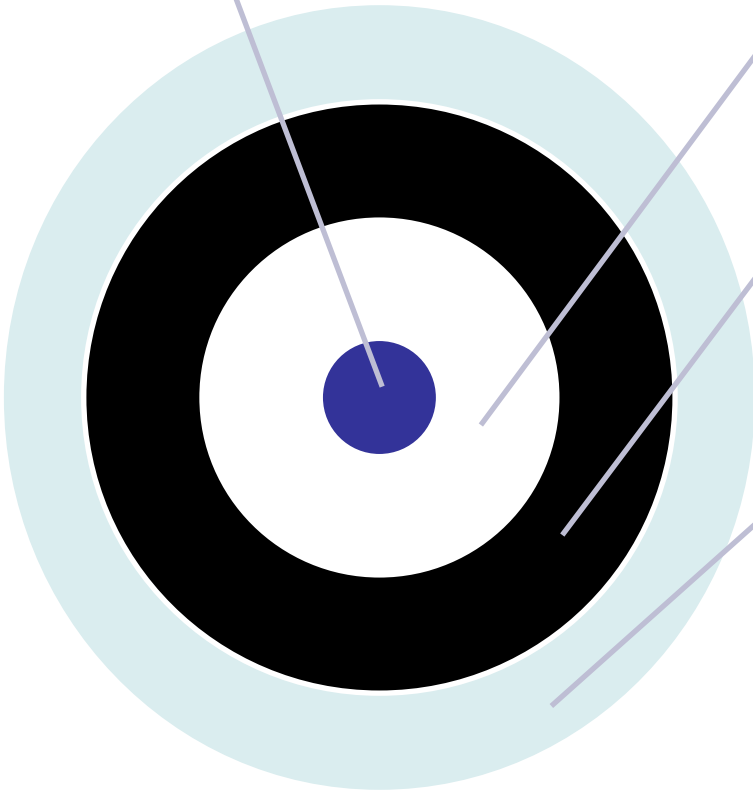
There are several concepts of 'Balance' in BOP:

Trade Balance- This is the balance on the merchandise trade account, item in the current account.

Balance on goods & services- It is the balance between the export & imports of goods and services.

Current Account balance- It is the net balance on the entire current account items.

Balance on current account and long term capital- It is also called basic balance. This is supposed to indicate the long term trends in BOP.



Balance of Payment Disequilibrium



Balance of Payment is equilibrium when it is neither drawing upon its international reserves to make excess payments nor accumulating such reserves as a result of its receipts.



When a country is not able to pay for its imports of goods and services from its export earnings, on accumulating reserves year after year, a disequilibrium in Balance of Payment sets in.

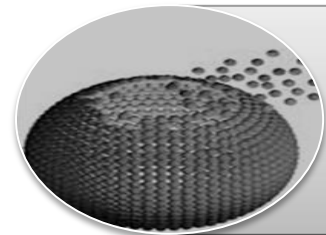
Factors affecting BOP



Inflation



National Income

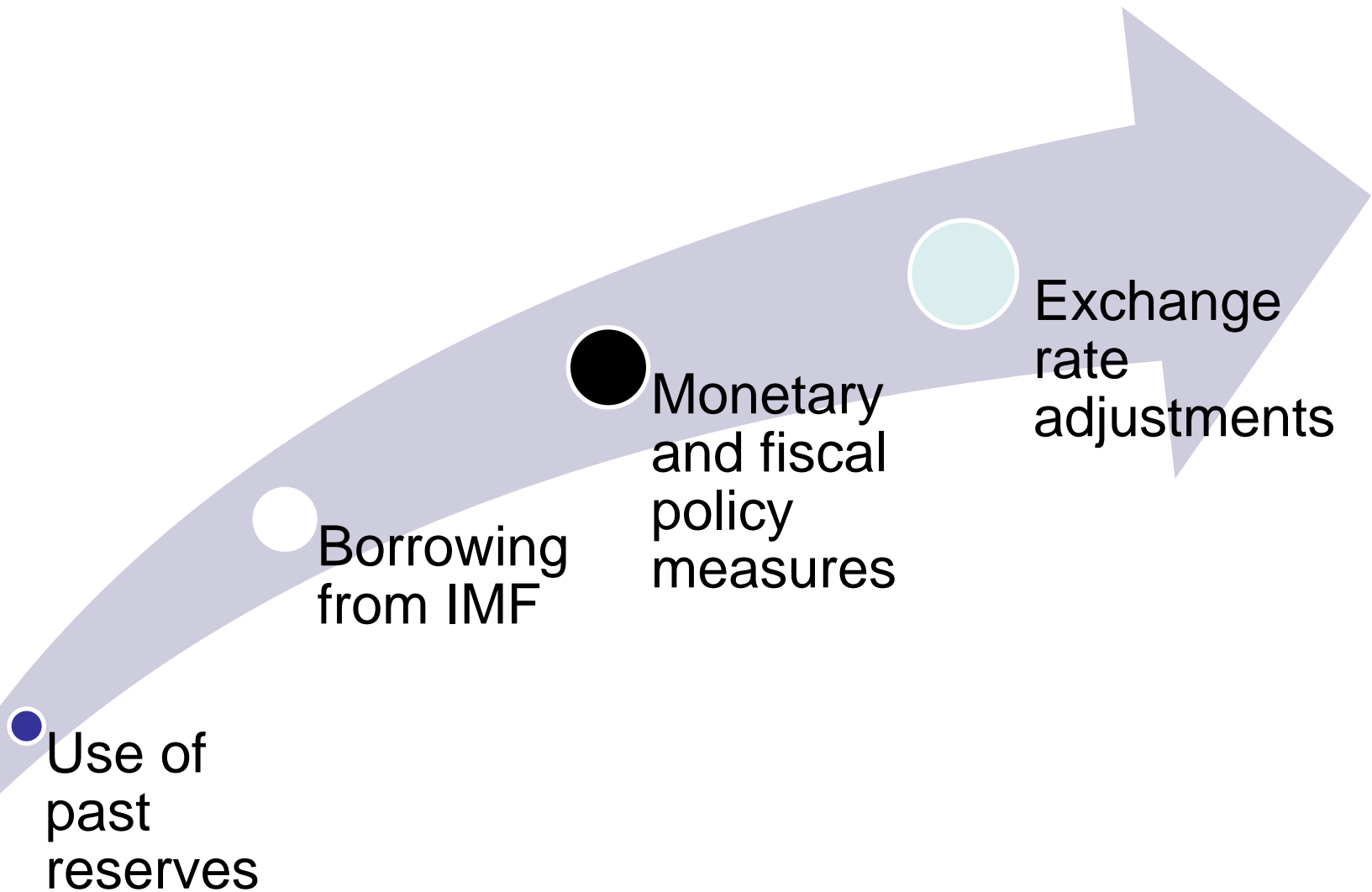


Government Restrictions



Exchange rates

Methods of Correcting Dis-equilibrium



Summary

- Balance of payment is an accounting record of the transactions between the residents of one country and the residents of the rest of world over a given period of time. It is a standard double entry accounting record and as such subject to all the rules of double entry book- keeping.
- All transactions which lead to an immediate or prospective payment from the rest of the world to the country should be recorded as a credit entry. Conversely all transactions which result in an actual or prospective payment from the country to the rest of the world are debit.

Thank
You