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BALANCE OF PAYMENTS ACCOUNTS

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ABSTRACT

The balance of payments records the flow of economic transactions between the residents of a given country and the residents of other countries during a certain period of time. It is a statistical statement for given period showing transactions in goods, services and income between an economy and rest of the world, changes of ownership and other changes in that economy's monetary gold. Special Drawing Rights and claims on the liabilities to the rest of the world, capital transfers and unrequited transfers and counterpart entries that are needed to balance, in the accounting sense, any entries for the foregoing transactions and changes which are not mutually offsetting.

Keywords: Concept of BOP, Difference between BOP data and customs data, BOP and international economic linkages, Macroeconomic Management, etc.

INTRODUCTION

The balance of payments is a comprehensive record of economic transactions of the residents of a country with the rest of the world. The record is so prepared as to provide meaning and measure to the various components of the country's external economic transactions. Thus, it aims at presenting an account of all receipts and payments on account of goods exported, services rendered and capital received by residents of the country and goods imported, services received and capital transferred by residents of the country

Residents of a country are defined as persons who are normally resident, and whose center of interest lies, in the country. Residents of a country would, thus, cover nationals as well as non-nationals residing in the country. The term "persons" used here covers not only individuals, but also business institutions, non profit organizations, Government and official bodies. There are a few exceptions to this rule. Foreign students, tourists and other travelers in the given country are not treated as residents of that country but of the country from where they hail. Similarly diplomatic offices and armed forces of the country, stationed abroad, are threaded as residents not with standing their physical location in the foreign country. By the same token, international institutions are not considered to be residents of the country in which they are located. All foreign controlled companies whether they are subsidiary companies or branches are, however, treated as residents, unless they are merely agents and their contribution to the economy of the country of location is negligible.

Methodology

The present study primarily based on Secondary information. The required secondary data were collected from *International Business Environment and Management* and various sources internet, etc.

CONCEPT OF BALANCE OF PAYMENT

The balance of payments record the flow of economic transactions between the residents of a given country and the residents of other countries during a certain period of time. It is a statistical statement for given period showing transactions in goods, services and income between an

economy and rest of the world, changes of ownership and other changes in that economy's monetary gold. Special Drawing Rights and claims on the liabilities to the rest of the world, capital transfers and unrequited transfers and counterpart entries that are needed to balance, in the accounting sense, any entries for the foregoing transactions and changes which are not mutually offsetting.

Transactions that enter balance of payments are usually between a resident and a non resident. A notable exception to this are transactions in gold between a central monetary Authority and other residents, both being residents. Certain transactions involving claims on and liabilities to the rest of the world also get covered here even if they are between two residents or between two non residents. The transactions relating to claims on and liabilities to the rest of the world involve financial flows and these flows are recorded under different economic sectors under capital account. A sale of foreign exchange by the central bank to a commercial bank in the same country would be recorded as a reduction in the foreign assets of the official sector matched by a corresponding increase in banking sectors foreign assets. The other types of transactions which form part of balance of payments are the unrequited transfers referred to above imputed transactio0ns for undistributed income of direct investment enterprises attributable to direct investors.

DIFFERENCE BETWEEN BALANCE OF PAYMENTS DATA AND CUSTOMS DATA

There have all along been difference in the data on merchandise trade between the balance of payments statistics published by the reserve bank of India and the customs data on trade published by the Directorate General of Commercial Intelligence and Statistics. The RBI figures, particularly of imports, tend to be higher than those of the DGCI&S. These difference arise due to differences in coverage, valuation and timing.

Coverage. For various reasons, the coverage of transactions in the two sets of data is not the same. For example, the Reserve Bank of India data cover exports by parcel post fully while these exports are not fully covered by the DGCI&S. Similarly, trade with Nepal and Bhutan is covered

by the DGCI&S while it is not covered under the RBI data as India does not maintain a balance of payments record in respect of Nepal or Bhutan.

Valuation. Relates mainly to the conversion procedure adopted in the two sets of data for converting trade data invoiced in foreign currencies into rupees. In the RBI data, both for exports and imports, values in foreign currencies are converted at average exchange rate for the respective month, while in the DGCI&S data they are converted at rates notified by the Ministry of Commerce which are revised as and when there occurs a change o0f five percentage or more in the exchange rate of the rupee.

Timing. Difference in timing between the two sets of figures arise because a given set of transactions does not enter the two records at the same time. In the customs data, exports are recorded on the basis of shipment of goods while imports are recorded on the basis of arrival of goods and their clearance from the customs. In the RBI data, exports are booked on the basis of GR/PP original forms which are exports declarations. There is always a timing difference of around three to four weeks between the export declarations and actual shipment of goods in respect of those declarations. In the RBI data imprts are booked on the basis of payments made. Payments for goods and the arrival of goods may not take place at the same time.

BALANCE OF PAYMENTS AND INTERNATIONAL ECONOMIC LINKAGES

The analytical framework that links the international flow of goods, services and capital to domestic economic behavior consists of a set of basic macroeconomic accounting identities. These basic identities linking national economic activity with balance of payments account shows that a nation produces more that it spends will save more that it invests, export more that it imports, and wind up with a capital outflow. A nation that spends more than it produces will invest more than it saves, import more than it exports and wind up with a capital inflow.

USES OF BALANCE OF PAYMENTS

In recent years, the balance of payments has emerged as a major branch of economic enquiry. The interest n this subject is in part, a reflection of the complex payments problems of the postwar years and in part the result of a greater appreciation of the implications of national economic measures of the external financial position of a country. Developments in the balance of payments are, therefore, of special concern to all those interested in the formulation of correct national economic policies.

The practical uses of a balance of payments are may. Apart from lending precision to a country's external transactions, it gives an idea of the historical influences governing the balance of payments. Data presented over a period of time provide a reliable basis for estimating the kind of relationship that exists between the balance of payments and the national income, and help to provide answers to such other questions as the seasonal and cyclical trends, and regional features of the transactions. The usefulness of a balance of payments statement as a guide to monetary, fiscal, trade and other policies cannot, therefore, be over emphasized. A decision to raise the bank rate, for instance, inevitably involves an examination of the balance of payments. A tax measure on exports or on imports may affect the balance of payments similar to direct regulations of trade. Public investment policies too, have an important bearing on, and are, therefore, framed with reference to balance of payments. A decision to expand the capacity of an export industry has necessarily to be based, inter alia, on the foreign exchange earnings of the industry. Similarly, development of facilities for foreign tourists requires a knowledge of their expenditure patterns and the contribution of tourism to the economy of the country providing the facilities. The balance of payments also assists in assessing a country ability to pay for current goods and services and of its credit worthiness to borrow abroad and repay the loans.

A major contribution to the development of standard compilation techniques for balance of payments statistics came from the International Monetary Fund, a specialized agency of the UN operating in the monetary and exchange field. India is one of the members of the IMF. Among the various obligations imposed by the membership of the institution is one which requires every member to submit periodic reports on the balance of payments to the IMF. To

facilitate a consistent system of international reporting, the IMF, has also developed a “Balance of Payments Manual.”

MACRO ECONOMIC MANAGEMENT

While increased financial integration may provide substantial macro economic benefits for developing countries, the integration process also carries with it some difficult macroeconomic challenges. Policymakers in these countries have been concerned with three types of problems.

1. The potential for macroeconomic overheating, in the form of an excessive expansion of aggregated demand as a consequence of capital inflows.
2. The potential vulnerability to large, abrupt reversals of capital flows because of changes in creditor perceptions.
3. The more general, long term implications of financial integration for the conduct mange the enhanced macroeconomic volatility that may prevail when the economy becomes more exposed to external shocks. In addition, policymakers will need to face these and other shockers with reduced policy autonomy.

CAPITAL INFLOWS AND OVERHEATING

The key short run macroeconomic concern associated with a surge in capital inflows is that of an excessive expansion of aggregate demand that is, macroeconomic overheating. This outcome can be produced through the following transmission mechanism.

1. If a country maintains an officially determined exchange rate, the commitment to defend the parity causes the central bank to intervene in the foreign exchange market to purchase the foreign exchange generated by the capital inflow. To do so, the central bank creates high powered domestic money.
2. This expansion of the monetary base creates a corresponding expansion in broader measures of the money supply, lowering domestic interest rates and raising domestic asset prices.
3. This action in turn triggers an expansion of aggregate demand. If the economy possesses excess capacity, the short run implications may be to increase domestic economic activity and cause the current account of the balance of payments to deteriorate. Eventually,

however excess capacity will be absorbed and the expansion in demand will trigger an acceleration in domestic inflation.

4. If the exchange rate peg is maintained, rising domestic prices will cause the real exchange rate to appreciate, abetting the current account deterioration associated with the expansion in aggregate demand.

POLICIES TO CONTROL OVERHEATING

To avoid potential overheating, developing countries can and have intervened at every step in this transmission process. Policy can attempt tpo reduce the required scale of intervention in the foreign exchange market, restrict the monetary expansion associated with a given magnitude of intervention, and offset through other means the effects on aggregate demand of a given magnitude of monetary expansion. These policies are not exclusive, and most countries have brought a wide variety of these instruments into play.

Some policies have restricted the required scale of intervention in the foreign exchange market, either through reducing the capital account surplus of the balance of payments or through an offsetting increase in the current account deficit. The main instruments available to the authorities are the following:-

1. The magnitude of gross capital inflows can be reduced by imposing a variety of direct or indirect controls on inflows.
2. Even if gross inflows are freely allowed, the liberalization of capital outflows or the accelerated repayment of public debt can be undertaken to attempt to reduce net inflows.
3. The implications of a net capital account surplus on the foreign exchange market can be counteracted by accelerating trade liberalization to increase the current account deficit.
4. The most extreme option in this category would be to eliminate all foreign exchange market intervention by floating the exchange rate. The resulting appreciation of the domestic currency would both reduce net inflows through the capital account and create a current account offset.
5.

STERILIZATION THROUGH TRANSFERS OF PUBLIC SECTOR DEPOSIT

Consider the effects of a capital inflow triggered by a shift in private sector (Domestic or Foreign) preferences from foreign to domestic interest bearing assets. To effect this portfolio

reallocation, the private sector has to sell foreign exchange to the domestic central bank. When the public sector offsets a purchase of foreign exchange by transferring public sector deposits from commercial banks to the central bank, it leaves the stock of base money unchanged by exchanges a claim on the domestic banking system for an external claim. At the same time the private sector changes its portfolio in the opposite direction.

There are two ways that the macroeconomic equilibrium can be affected by this transaction, even if the monetary base is unchanged. First, interest bearing deposits in the domestic banking system are imperfect substitutes in private portfolios for other domestic interest bearing assets, then private portfolio equilibrium will be disturbed unless the domestic ass\et for which there is increased demand happens to be deposits simply exchange claims on the banking systems. If that is the case, then the private sector and government simply exchange claims on the banking system and there are no price implications to the transaction. But if it is not the case, then relative domestic asset shift was toward domestic securities, for instance, the yield on such securities would presumably have to fall and interest rates on bank assets and liabilities would have to rise.

The second effect is a fiscal one. To the extent that the yield on domestic deposits differs from the yield on domestic deposits differs from the yield on foreign exchange reserves, the solvency of the domestic public sector will be affected by the transaction. In the particular case of sterilization through shifts in public sector deposits, the liquidity services provided by such deposits suggest that the public sector's net interest receipts could rise or fall as a result of the sterilization operation.

STERILIZATION THROUGH OPEN MARKET OPERATIONS.

Open market sterilized intervention requires the central ban to sell enough domestic bonds to purchase the foreign exchange associated with the inflow, thereby leaving the monetary base unchanged but increasing the stock of outstanding domestic public sector debt. The amount of new debt is therefore equal to the increase in demand for interest bearing claims on the domestic economy. The effect of the transaction on the central bank's balance sheet is to leave its

liabilities unchanged, but to change the composition of its assets, reducing its claims on the domestic government and increasing its international reserves. From the standpoint of the nonfinancial public sector as a whole, sterilized intervention amounts to a portfolio transactions in which the domestic nonfinancial public sector issues interest bearing debts denominated in domestic currency in order to acquire a foreign interest bearing claim.

Sterilized intervention through open market operations is not likely to be costless however, the portfolio reallocation implied for the public sector involves issuing a high yielding liability in exchange for a lower yielding asset. This interest differential leaves the public sector in a weakened financial position. The net adverse effect of such transactions on the public sectors solvency is overstated by the interest differential, however, because this differential presumably exists in part of compensate creditors for the currency and country risk associated with holding domestic public debt. By issuing such debt in exchange for reserves, the public sector is receiving a benefit that partly offset the interest penalty that is, the option of reduce the real value of its obligation by devaluing or defaulting. Nonetheless, these benefits may be worthless to a government that never intends to exercise these options. In this case, Sterilized intervention carries a fiscal burden, the cost of which depends on the ease with which an offsetting fiscal adjustment can be effected.

STERILIZATION THROUGH RESTRICTIONS ON DOMESTIC CREDIT GROWTH

Sterilized intervention through transfers of public sector deposits and open market bond sales operates by fixing the size of the monetary base. An alternative is to allow the base to expand as a result of central bank intervention in the foreign exchange market, but to restrict expansion of the money supply by raising reserve requirements on banks, thus causing the money multiplier to contract.

However, bank borrowers squeezed out of credit markets by higher reserve requirements may not have access to securities markets and thus may be unable to supply the assets that are in higher demand. Borrowers with low net worth who lack other forms of collateral are able to obtain credit only from institution that are highly specialized in evaluating and monitoring loans. Such borrowers cannot securities their liabilities. If this is the case then there is a prima facie

case for imperfect substitutability among the relevant domestic assets when sterilization is pursued through the policy of altering reserve requirements suggesting that insulation of the domestic economy is less likely to be achieved under this policy than through open market operations.

CONCLUSION

In the context of financial integration, vulnerability refers to the possibility that a country may find itself confronted with a sudden, large, and relatively long lasting reduction in net capital inflows. The challenge to policymakers is to identify and implement policies that can minimize vulnerability to external financial shocks. The creditors can be expected to take their capital out of a country when they think that a policy change could impair the value of their investment, then vulnerability will arise when the perception is created that a devaluation, nonpayment of public sector debt, or the imposition of restrictions on capital outflows is about to occur, Such expectations are likely to arise when the real exchange rate is perceived to be out of line, the government's debt obligations are large, fiscal adjustment id perceived as politically or administratively unfeasible, or the country growth prospects are bleak. From the perspective of creditors, therefore, a high share of investment is absorption and a strong record of growth, a low stock of government obligation s coupled with demonstrated fiscal flexibility and a real exchange rate broadly perceived to be in line with fundamentals all augur well for future debt services. These characteristics are most directly associated with a country ability to avoid vulnerability. From a policy perspective, countries need to have an active exchange rate policy that avoids substantial appreciation of the real exchange rate and responsible fiscal policies.

Reference *: International Business Environment and Management V.K. BHalla, & other Electronic source (Internet).*