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CLASS – 12

ECONOMICS

Introductory Macroeconomics

CH-6 : Open Economy Macroeconomics

Part – 3

Balance of Payment

Vaishnavi Agrawal

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OVERVIEW

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1. Introduction to Foreign Exchange Market
2. Determination of Exchange Rate
3. Balance of Payment

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BALANCE OF PAYMENT (BOP)

Accounting summary statement of all Economic transactions between the residents and Rest of The World during a particular period of time.



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RESIDENTS

Individual, firms and government agencies.



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ECONOMIC TRANSACTIONS

Refers to those transactions which involve transfer of the title or ownership of goods, services, money and assets.

Includes

1. Visible Items — GOODS
2. Invisible Items — SERVICES
3. Unilateral Transfers — ONE-SIDE
4. Capital Transfers

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Visible Items

- All tangible goods. GOODS
- Example : Raw material, products, etc.

Invisible Items

- All the services. Intangible in nature.
- Example : Banking, Shipping etc.



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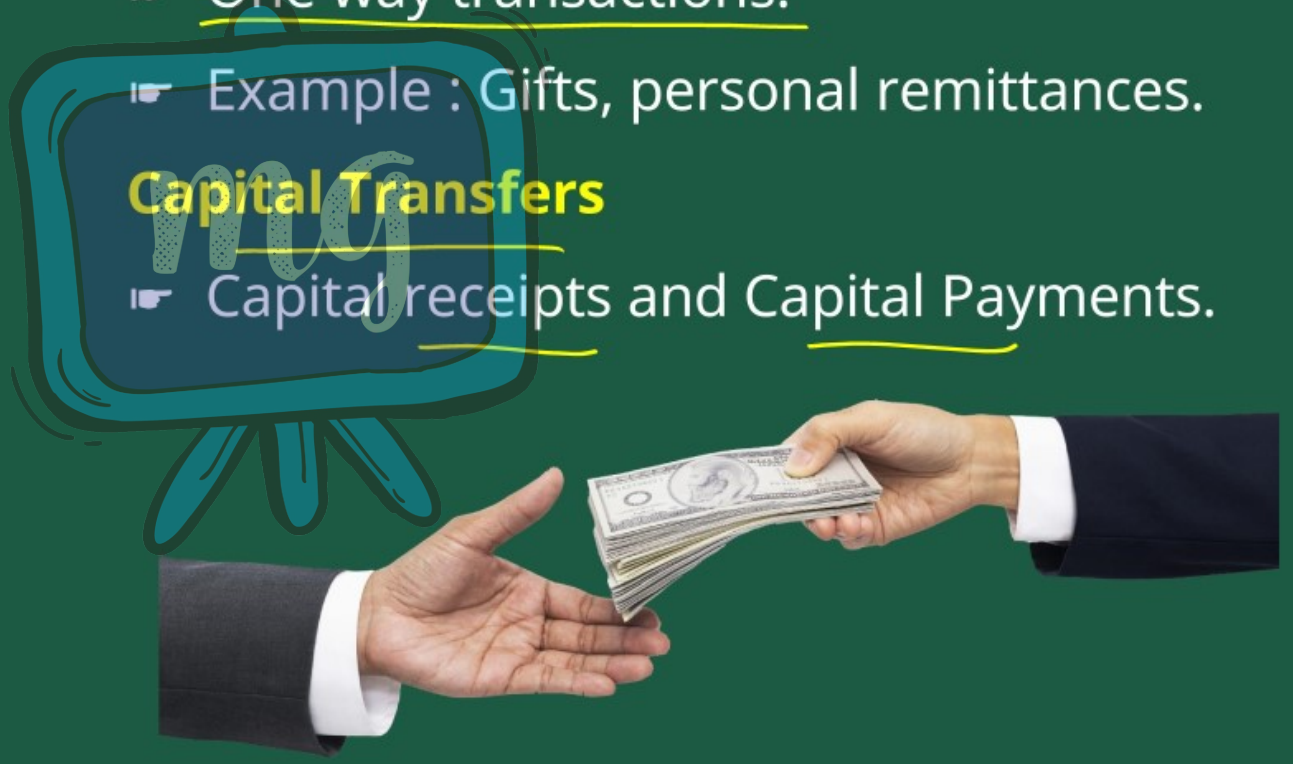
Unilateral Transfers

- One way transactions.
- Example : Gifts, personal remittances.

Capital Transfers

- Capital receipts and Capital Payments.



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- Trade in Goods (Balance of Trade (BOT)) *
- Trade in Services
- Unilateral Transfers
- Capital Transfer

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BALANCE OF TRADE (BOT)

Difference between the amount of Exports and amount of Imports of visible goods (Goods).

BOT = Exports of goods – Imports of goods

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BALANCE OF TRADE (BOT) VS BALANCE OF PAYMENTS (BOP)

Basis	Balance of Trade (BOT)	Balance of Payments (BOP)
Meaning	Difference between amounts of exports and imports of visible items.	Accounting statement of all economic transactions, between residents of a country and rest of the world in a given period of time.

invisible
Unilateral
Capital.

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BALANCE OF TRADE (BOT) VS BALANCE OF PAYMENTS (BOP)		
Basis	Balance of Trade (BOT)	Balance of Payments (BOP)
Components	Includes only visible items.	Includes visible items, invisible items, unilateral transfers and capital transfers.
Settlement	Unfavourable BOT can be met out of favourable BOP	Unfavourable BOP cannot be met out of favourable BOT

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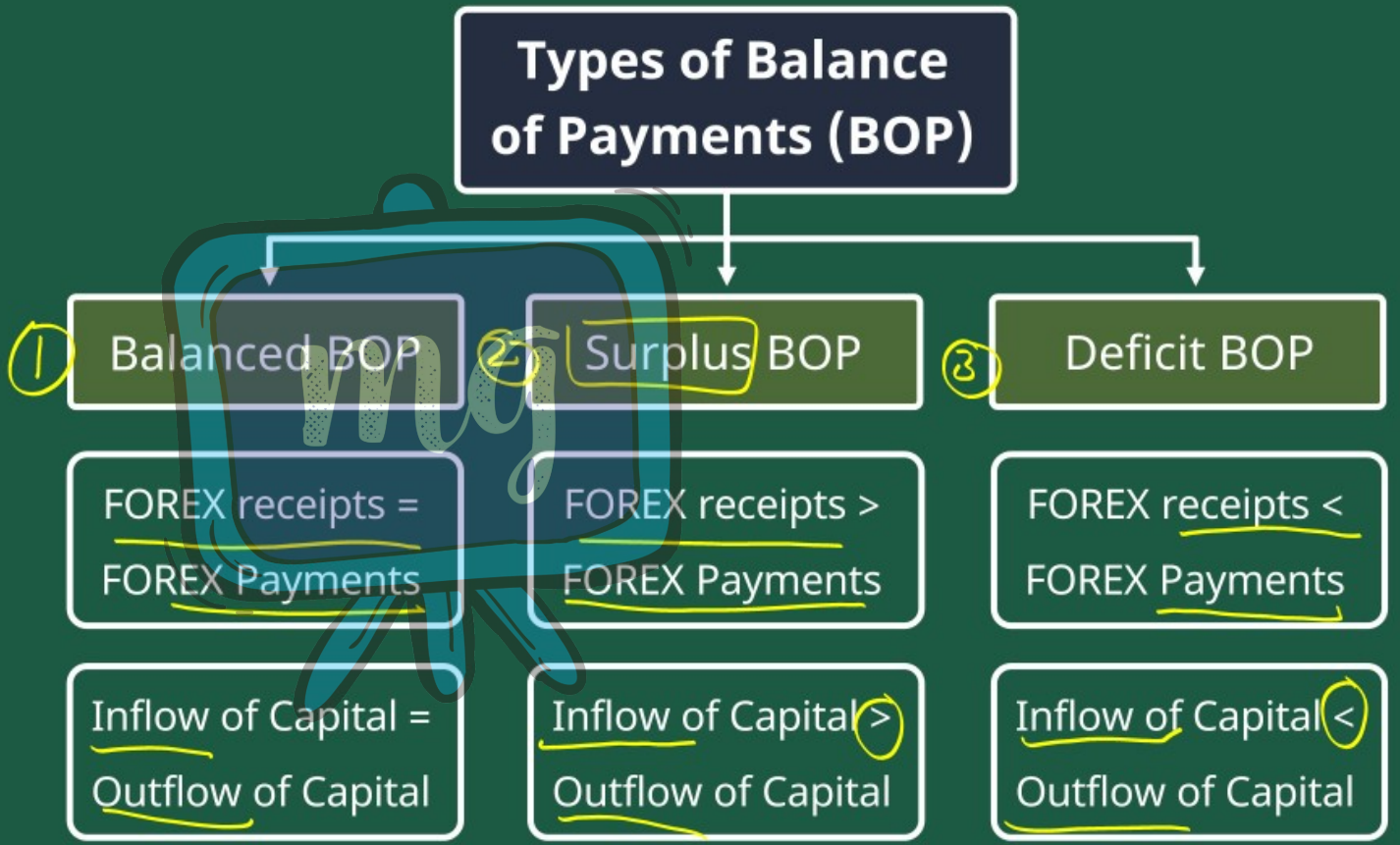

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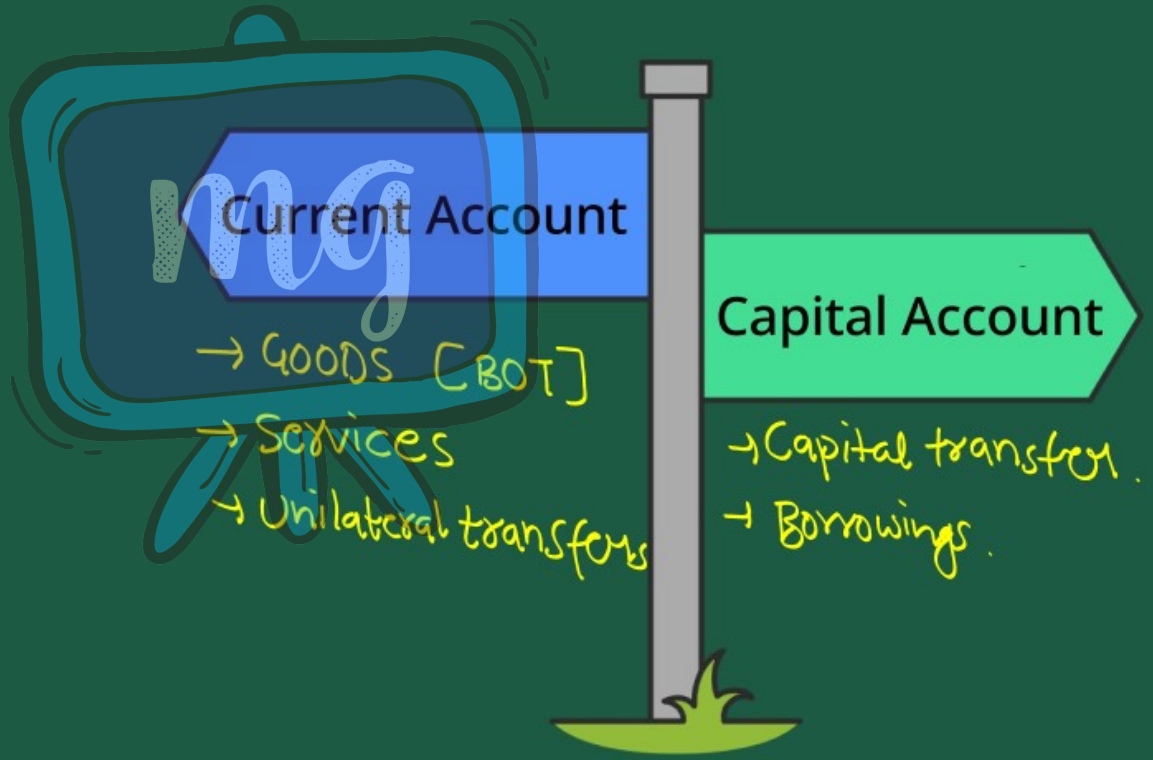
COMPONENTS OF BOP



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CURRENT ACCOUNT

- Current Account is the record of trade in goods and services and transfer payments.
- Trade in goods includes exports and imports of goods. BOT
- Trade in services includes factor income and non-factor income transactions.

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- Transfer payments are the receipts which the residents of a country get for ‘free’, without having to provide any goods or services in return.



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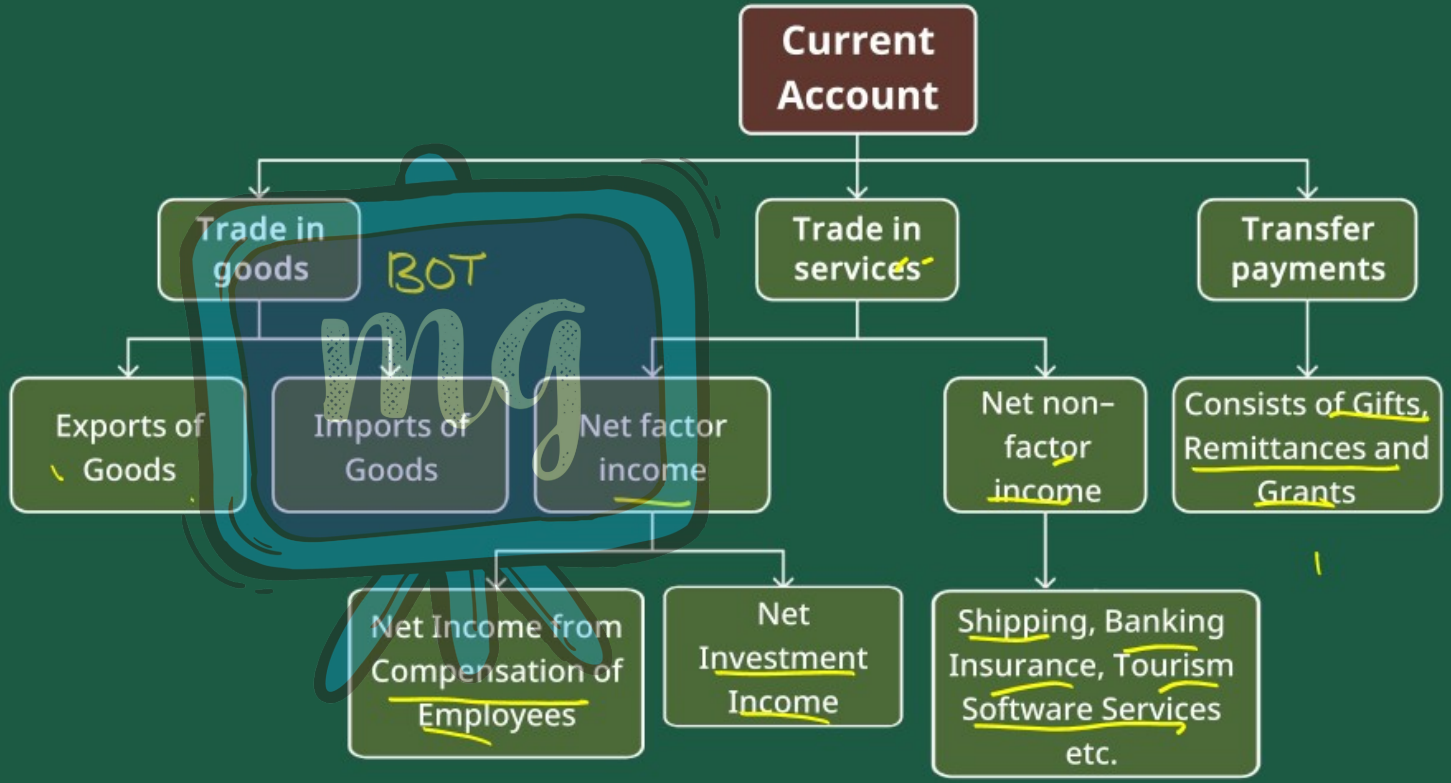

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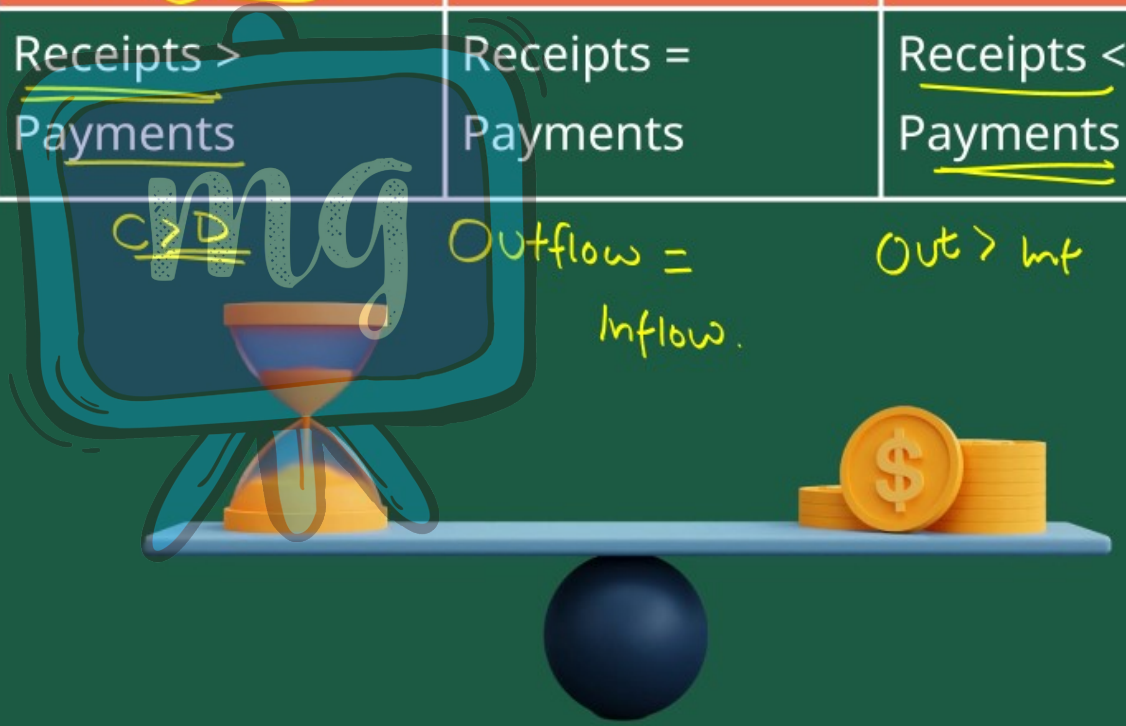
Current Account Surplus	Balanced Current Account	Current Account Deficit
Receipts > Payments	Receipts = Payments	Receipts < Payments

C > D

Outflow = Inflow.

Out > Inf



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CAPITAL ACCOUNT

- Capital Account records all international transactions of assets.
- An asset is any one of the forms in which wealth can be held.
- Example : Money, stocks, bonds, Government debt, etc.
- Purchase of assets is a debit item on the capital account.

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- Sale of assets like sale of share of an Indian company to a Chinese customer is a credit item on the capital account.



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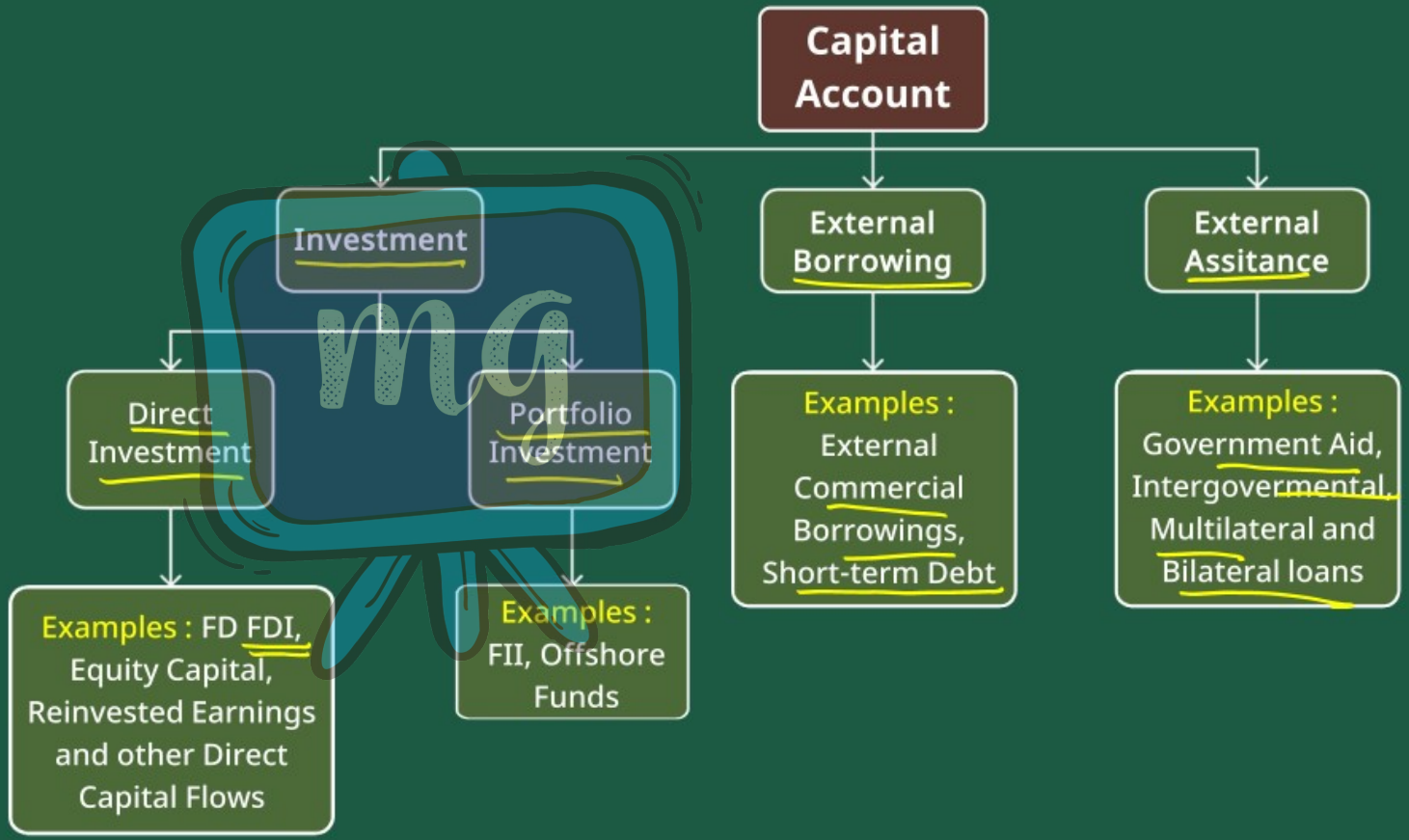

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Balanced Capital Account	Surplus Capital Account	Deficit Capital Account
Capital Inflow = Capital Outflow	Capital Inflow > Capital Outflow	Capital Inflow < Capital Outflow



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AUTONOMOUS ITEMS VS ACCOMMODATING ITEMS		
Basis	Autonomous Items	Accommodating Items
Meaning	The international economic transactions, which take place due to some economic motive. (profit maximization)	The transactions that are undertaken to cover deficit or surplus in autonomous transactions.
Alternate Name	Above the line items.	Below the line items.

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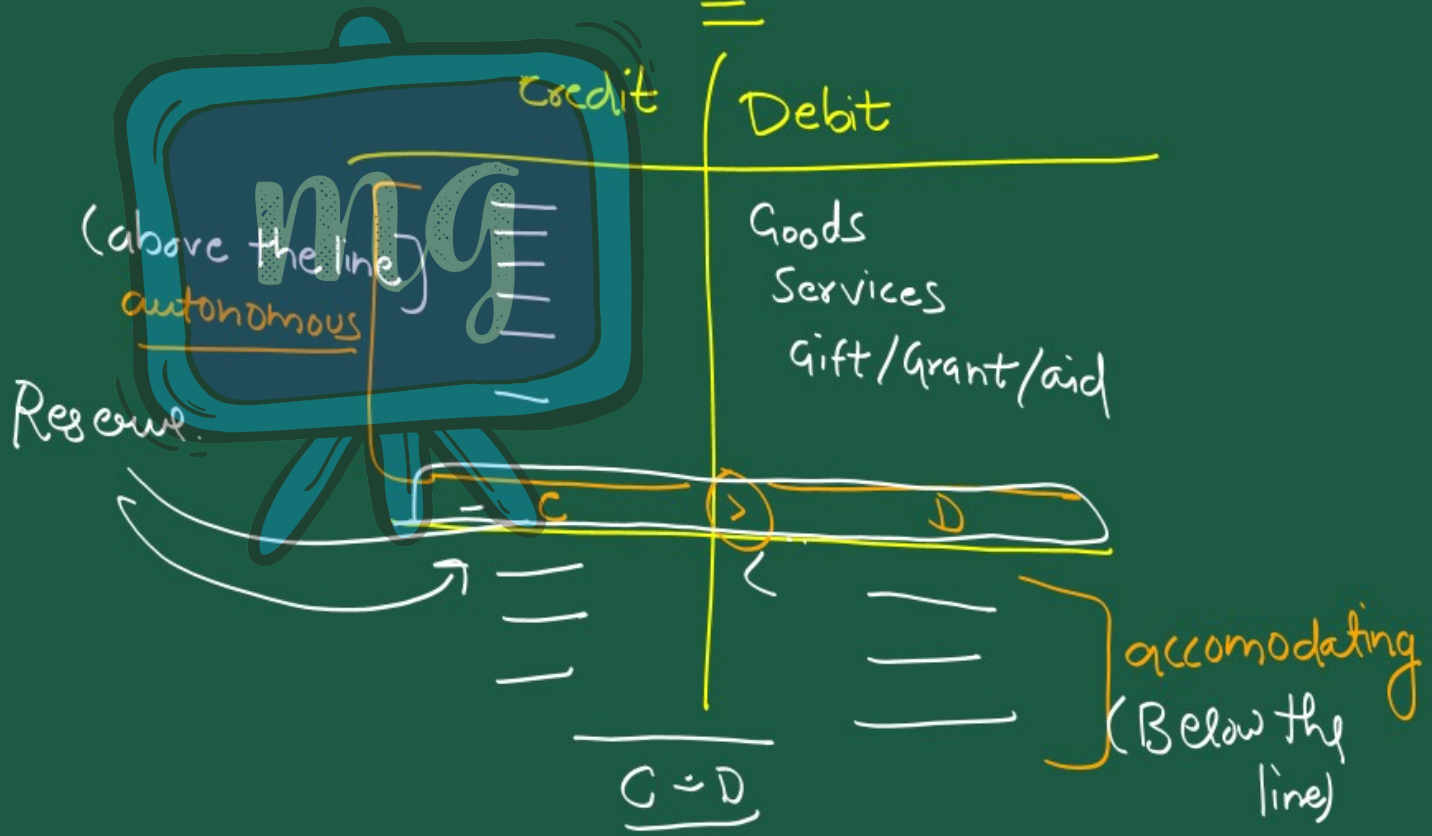

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AUTONOMOUS ITEMS VS ACCOMMODATING ITEMS

Basis	Autonomous Items	Accommodating Items
Effect on BOP account	Independent of the state of BOP account.	Undertaken to maintain the balance in BOP account.
Current/ Capital Account	It takes place on both current and capital accounts.	It takes place only on capital account.

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BOP is always Balanced in Accounting Sense

- BOP is based on the principles of double entry system.
- Any deficit or surplus created through autonomous transactions is corrected by the corresponding surplus or deficit in the accommodating transaction by monetary authority.

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LEARNING OUTCOME

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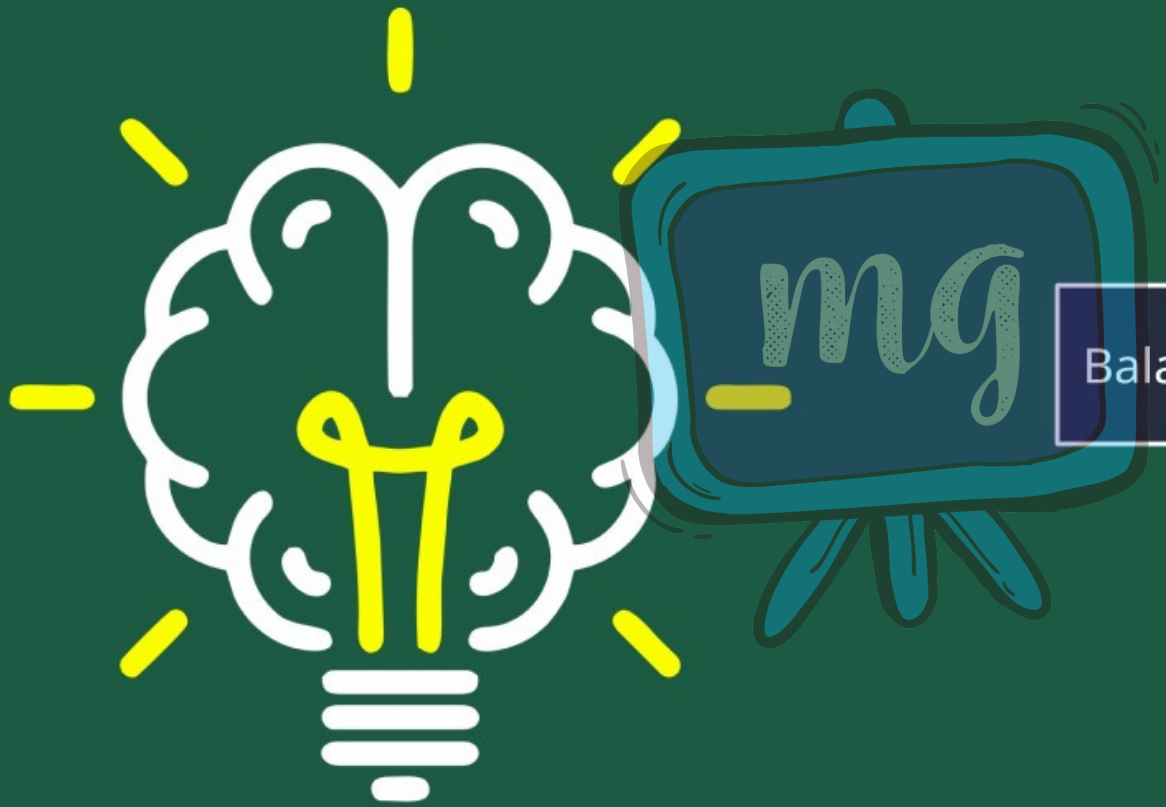

Balance Of Payment (BOP)

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ASSESSMENT

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1 What is the term for the difference between the value of exports and imports of goods?

A Balance of Trade

B Balance of Payment

C Current Account Deficit

D Capital Account Surplus



2 Which of the following is not a component of the balance of payment?

A Current Account

B Capital Account

C National Income Account

D Official Reserve Account



3 What is the term for the statistical statement that records all economic transactions between a country and the rest of the world?

A Balance of Trade

B Balance of Payment

C National Income Account

D International Trade Account



4 Which of the following is a capital account transaction?

A Export of goods

B Import of services

C Foreign investment in India

D Borrowing from abroad



5 Which of the following is a component of the current account of the Balance of Payment?

A Foreign investment

B Import and export of goods

C Borrowing from abroad

D Accommodating transaction