7 Balance of Payments

The international financial flows establish the character of economic relations that a country has with the rest-of-the-world. The true index of economic prosperity or disparity of a country in relation to the other countries of the world is provided by international payments account or the balance of payments account. In the present chapter, we shall study different concepts related to balance of payments accounts of a country and its consequences for the domestic economy.

1. MEANING OF BALANCE OF PAYMENTS

The balance of payments is a summary of all the international transactions of a country and its citizens during a specified period of time.[1] This period is usually of one year, though many countries have now started preparing the quarterly accounts for the purposes of forecasting. Harvey and Johnson have defined these accounts in these words, "The balance of payments accounts for a country set out, in summary form, all the current and capital transactions which have taken place between the residents of that country and the rest of the world in a given period of time."[2] The word 'residents' does not only mean the persons, but also business firms, governments, and international agencies located in a particular country. The residents are not necessarily always citizens of the country. In the words of Peterson, "A nation's international economic balance involves all the international economic transactions that residents of one nation enter into with the residents of all other nations of the world during some specific period of time."[3] The United States Department of Commerce has defined it as, "the balance of payments of a country consists of the payments made, within a stated period of time between the residents of that country and the residents of the foreign countries."[4] According to the IMF, "The Balance of Payments is a statistical statement for a given period showing :

1. Transactions in goods and services and income between an economy and the rest of the world;
2. Changes of ownership and other changes in that country's monetary gold, Special Drawing Rights (SDR's) and claims on and liabilities to the rest of the world; and
3. Unrequired 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."

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1. W.L. Smith : *Macroeconomics*, (1970), P. 452.
2. T. Harvey and M. Johnson : *Introduction to Macro-Economics*. (1971), P. 246.
3. W. C. Peterson : *Income, Employment and Growth*, (1962), P. 304.
4. U.S. Department of Commerce : *The Balance of Payments is the United States*, (1937), P.1.

It may be defined in a statistical sense as an itemized account of transactions involving receipts from foreigners, on the one hand, and payments to foreigners, on the other. Since the former relate to the international income of a country, they are called '*credits*', and since the latter have to outgo, they are called '*debits*'.

The balance of payments of a country may be expressed through the following relation:

$$B = R - P$$

Here B denotes the balance of payments; R, total receipts; and P, total payments. Both total receipts and payments can be subdivided into domestic and foreign receipts and payments. Assuming that domestic receipts and domestic payments are equal, the balance of payments can be stated as

$$B = R_f - P_f$$

If $R_f > P_f$, there will be a balance of payments surplus. If $R_f < P_f$, it denotes a deficit in international payments. An equality between receipts and payments ($R_f = P_f$) signifies equilibrium in international payments.

2. STRUCTURE OF BALANCE OF PAYMENTS ACCOUNTS

The balance of payments account of a nation follows the procedure known as *double-entry book-keeping*. Each international transaction is recorded twice, once on the credit side and once on the debit side, of an equal amount. It is done because every transaction has two sides. Suppose a country exports goods