alance of payments
sts of :

t

t

ncing

***r balance of trade*:**
imports and exports
iven year.

nt **:** The current
nce, net non-monetary
t of invisible exports
exports and imports
ipts or payments due
rtation, insurance,
ernment receipts and
ewhere and transfer
private.

The capital account
nts account includes
short term and long
yments, net banking
ding those of R.B.I.
ernment receipts or

cing **:** The surplus
ent account, capital
sions is financed or
l assistance (loans),
allocation of SDR's
(+) in reserves.

3. Tra

4. Invisibles (net)
   A. Non-factor services
   B. Income
   C. Transfers
5. Goods and Services Balance
6. Current Account Balance

II. Capital Account

1. Capital Account Balance
   (*i*) External Assistance (net)
   (*ii*) External commercial Borrowings (ne
   (*iii*) Short Term Debt
   (*iv*) Banking Capital (net)
   (*v*) Foreign Investment (net) of which
   A. FDI (net)
   B. Portfolio (net)
   (*vi*) Other Flows (net)

III. Errors and Omissions

IV. Overall Balance.

V. Reserves Change [Increase(–) / Decrease (+)]

3. BALANCE OF TRADE AND BALANCE OF PAYMENTS

In the preceding discussion, we came acros
two fundamental concepts—the balance of trad
and the balance of payments.

(*i*) *Balance of trade* **:** Balance of trad
is traditionally defined as the difference betwee
the value of merchandise (or goods) exports an
the value of merchandise (or goods) imports
In other words, it is the balance of goods or th

omic Survey 2013-14 issued by Govt. of India, P. 108.

balance of merchandise trade. The writers like J. E. Meade and W.M. Scammel have interpretted the balance of trade in a wider sense. According to these writers, the balance of trade is the difference between the value of goods and services exported by the home country in exchange of imports of goods and services by it from abroad. It is, of course, true that the balance of merchandise trade is of much significance, but the balance of trade as defined by Meade is of much greater significance as it takes into account both goods balance and services balance. In the LDC's like India, the goods balance is generally favourable but the excessive dependence of these countries on import of services, renders it invariably unfavourable. As a result, the balance of current account, which is equivalent to Meade's conception of balance of trade, is also rendered unfavourable for the reporting (home) country. The balance of trade in Meade's sense, can be expressed through the familiar equation $Y = C + I + G + (X - M)$ where Y = national income, C = consumption expenditure, I = gross domestic investment, G = government expenditure, X = the exports of goods and services and M = import of goods and services. The expression, $(X - M)$ therefore, denotes the balance of trade in Meade's sense. It this sense it amounts to an injection to the circular flow of income (Y) in a given country. If $X = M$, there is an equilibrium in the balance of trade. If $X > M$, there is a balance of trade surplus or balance of trade is favourable to the home country. If $X < M$, there is a balance of trade deficit or the balance of trade is unfavourable to the home country.

(ii) Balance of payments : The concept of balance of payment is a wider concept than the balance of trade. It is the statement of all transactions related to goods, services and capital which the home country makes with the rest-of-the-world. Balance of payment is the net aggregate of balance of current account and balance of capital account. Tables 1 and 2 clearly show that the balance of trade is only a part of the balance of payments of a country.

There are two concepts related to the balance of payments. These are : the basic balance and the overall balance of payments.

(a) The basic balance : Basic balance in the balance of payments is comprised of the balance of payments on current account and long term capital account. The short term capital account balance remains excluded from the basic balance. It is probably because of the following reasons : *Firstly*, unlike long term capital movements or flows, the short term capital movements are relatively volatile and unpredictable. The long term capital movements are of durable and more predictable character and, therefore, can be rightly treated along side the current account transactions. *Secondly*, in many countries, there is no separate short term account. In such cases, the short term capital transactions constitute a part of the term 'Errors and Omissions. For the sake of equal international comparison, it is appropriate to keep the short term capital transactions excluded from the basic balance.

A positive basic balance is a good sign whereas a negative basic balance is a bad sign for the reporting (or home) country.

(b) The overall balance of payments : The overall balance of payments takes into account all the monetary transactions which the reporting country makes with the rest-of-the-world. It is comprised of the balance on current account and the balance on capital account. It makes no distinction between the short term and long term international flows of capital. A relevent question is whether an overall surplus or deficit is a good or bad sign for the economy. This question can be properly answered if it has been determined whether the overall surplus or deficit in the balance of payments has arisen from the current account or the capital account. In this connection, the generalisation on the following two lines can be made :

Firstly, if the overall balance of payments surplus is caused by the current account surplus but not the capital account surplus, then the surplus may be a good sign for the home country.

Secondly, if the overall balance of payments deficit has occurred on account of current account deficit rather than capital account deficit, then the deficit may be considered as a bad sign for the home country.

A favourable or unfavourable balance of payments does not necessarily mean that the balance of trade too is favourable or unfavourable accordingly. India, for instance, maintained for a long time, a balance of trade surplus with England. Her balance of payments with that country, however, remained in deficit, since England's export of invisible items, investments and home charges etc. were more than enough to off-set India's surplus balance of trade with her. So it is the surplus or deficit in balance of payments which is of greater fundamental importance in international economic relations among the different countries than a mere surplus or deficit in balance of trade.

The balance of payments of a country is often termed as the economic barometer of country's economic life. It reveals to the government the true international economic position of the country. The government, in the light of the changes in current account, capital account and the account of financing, can take appropriate monetary and fiscal decisions to rectify any undesired effect of payments surplus or deficit on the economic system. It is also possible to measure through the changes in the payments position, the influence of international transactions on the level of national income and expenditure. In the case of an under-developed economy, the balance of payments deficit will show the extent to which its development programme has to depend upon the financial assistance from the advanced capital-lending countries.

No doubt, the balance of payments account serves as an economic barometer, yet it is not appropriate to draw any conclusion concerning the prosperity or poverty of a country merely on the basis of it. A balance of payments surplus is not a sound proof of the economic prosperity of a country. Nor is the balance of payments deficit a sign of competitive inadequacy of a country in the international market or of the economic insolvency of a country. A poor country may have a balance of payments surplus on account of a very sizeable inflow of foreign loans and equity capital. Similarly, an economically strong country like the United States may have a balance of payments deficit not because its competitive capacity has deteriorated or that its exports of visibles and invisibles have dwindled but because the country might have underaken a massive assistance programme for the poverty-stricken countries of the world.

It is thus unsafe to derive any conclusion concerning the prosperity or disparity of a nation simply on the basis of balance of payments statistics. We will have to probe deeper and find out the reasons for the prosperity and poverty of the country in the fundamental economic and social structure of the economic system. Such conclusion must also be based upon another important consideration as to how long the balance of payments deficit persists. A short run imbalance of international payments need not cause an unnecessary alarm. However, the persistance of the balance of payments deficit will have serious repercussions on the international trade in particular and the economic circumstances of the country in general unless an appropriate action is taken in this regard.

4. IS BALANCE OF PAYMENTS ALWAYS IN BALANCE ?

The balance of payments is a statement of international transactions expressed in terms of debits and credits based on double entry system of book-keeping. If all the entries are made