BOP Correcting Methods

Trade Policy Measures & Expenditure reducing Policies

Methods of correcting Adverse Balance of Payments

1. ***Trade Policy Measures***

- *Expanding Exports and Restraining Imports*

2. ***Expenditure Reducing Policies***

- *Tight Monetary Policy*
- *Concretionary Fiscal Policy*

3. ***Expenditure Switching Policies***

- *Devaluation*
- *Income Absorption Approach to Devaluation*

4. ***Exchange Control***

Trade Policy Measures

These measures are adopted to promote exports and discourage imports

- ***Expanding Exports***: To *correct disequilibrium in the Balance of payments*, it is necessary that exports should be increased, the government may adopt *export programs* for this purpose. Export promotion programs include *subsidies, tax concession to exporters, marketing facilities, incentives for exporters, reducing export duties*, etc.

- ***Restraining Imports***:

- Imports may be reduced by imposing or *raising tariffs/ import duties* on imported goods.*Under this policy*, import traffic tariff duties are imposed so as to make the import dearer with an overall aim of checking imports. Imports get reduced and *Balance of payments* becomes favourable.

- *Import quotas* can also be imposed to restrain imports.Under this mechanism, the *government fixes a maximum quantity* or value of a commodity to be imported. This in turn *reduces the imports* and the deficit is reduced and thereby the Balance of payments, the position is improved.

Expenditure Reducing Policies

- The Important way to reduce imports and thereby reduce deficit in balance of Payments is to adopt monetary and fiscal policies aiming at reducing aggregate expenditure in the economy

- ***Tight Monetary Policy-*** Monetary policy may be used to *correct a deficit* in the balance of payments of a country. The deficit occurs because of high import and exports. This is to be reversed. In this regard, the country may adopt deflationary or dear money policy by raising the bank rate and restricting credit. Under deflation, prices fall which makes exports attractive and imports relatively costlier. This eventually leads to a rise in exports and a fall in imports.

- ***Contractionary Fiscal Policy-*** Appropriate Fiscal policy is also an important means of reducing expenditure. An increase in direct taxes such as income tax will reduce aggregate expenditure. Indirect taxes such as excise duties and sales tax will also cause reduction in expenditure. Reduction in Government expenditure, especially unproductive or non developmental expenditure will also help in correction of BOP

- It may be noted that if tight monetary and contractionary fiscal policies succeed in *lowering aggregate expenditure* which causes *reduction in prices or lowering the rate of inflation*, they will work in two ways to improve balance of payments.

- First, fall in domestic prices will *induce* people to buy *domestic products* rather than imported goods.
- Secondly, lower domestic prices will *stimulate exports.*
- Fall in imports and rise in exports will help in *reducing deficit* in balance of payments
- Although theses measures are *not without limitations*, if reduction in aggregate expenditure demand *lowers investment*, this will *adversely affect economic growth*

Thank You