

Methods of Correcting Adverse of Payment



BOP Corrective Methods

Equilibrium and Disequilibrium of BOP

- ❖ The Balance of Payments of a country is said to be in *equilibrium* when the demand for foreign exchange is exactly *equivalent* to the supply of it
- ❖ The BOP is in *disequilibrium* when there is either a *surplus* or a *deficit* in the Balance of payments.
- ❖ When there is *deficit* in the balance of payments, the *demand* for foreign exchange *exceeds* the *supply* for it

Why Disequilibrium?

Various reasons are for the disequilibrium of BOP, Some are:

- ❖ *Cyclical Disequilibrium*- This is caused due to fluctuations in business/trade cycles
- ❖ *Secular/ Long Run Disequilibrium*- Due to long and *deepen change* in the economy brings this kind of Disequilibrium, mainly because of change from *1 stage to another*, changes in several dynamic forces or factors such as *capital formation, population growth, technological changes, the growth of markets, changes in resources, etc*

- ❖ *Structural Disequilibrium*- Structural disequilibrium arises from *structural changes* occurring in few sectors of the economy at home or abroad which may alter the *demand for supply conditions* for *exports or imports or both*
- ❖ *Technological Disequilibrium*- It occurs due to *technological changes*. Technological changes involve *inventions or innovations* of new goods or new techniques of production
- ❖ *Temporary Disequilibrium*- A country's Balance of payments is of a temporary nature lasting for a *short period* which may occur once in a while. Any factor which temporarily causes *one-sided movement* in the items constituting the Balance of payments is sufficient to cause a disequilibrium. This is *subject to reversal* within a limited period

Correction of Disequilibrium

- ❖ If there is *persistent disequilibrium* in the country's BOP, it should be corrected
- ❖ The changes induced by the balance of payments in the *flows of income and expenditure affect*, in turn, the *demand for imported* as well as home produced goods and so react on the balance of payments to bring it into *equilibrium*
- ❖ However, if the disequilibrium in the BOP is *serious and deeper*, automatic measures do not work, under these circumstances, some *concrete measures* are required to be taken restore the equilibrium in the balance of payments.
- ❖ If a country suffers from *payments deficits*, the equilibrium adjustments can be possible through the suitable variations in *exchange rates*

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

Thank You