BALANCE OF PAYMENTS

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Balance of Payments

– By Prof. *Simply* Simple

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- **Just like individuals, countries also have to maintain an account of all their dealings with the rest of the world.**
- **A record of all transactions of money moving in or out of a country over a period of time is what we call a BoP account.**
- **Broadly, we can divide a BoP account into two components: current account and capital account.**

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So let's understand the constituents of the current account

1. **The current account first of all includes all transactions relating to exports and imports of physical goods, called visible trade.**
2. **The current account includes receipts and payments in respect of services such as banking, tourism and intangible properties such as patents and copyrights, which is called invisibles**
3. **The current account includes private transfers such as money sent by expatriate workers, dividends and interest payments, etc**
4. **The current account includes all official transfers between governments such as international aid.**

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Now what comprises the capital account

1. **The capital account includes all transactions related to long-term capital flows between different countries, such as investment of money for purchasing land and factories, known as FDI.**
2. **It also includes short-term capital flows such as investments in the stock market by FII or borrowing of money by firms (ECB -external commercial borrowings) & government.**
3. **In short, the capital account includes all transactions related to investment in either physical assets or financial assets of one country by the residents of another country.**

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Now let me tell you the significance of a surplus or deficit in the BOP components

- **A surplus or deficit in different components of the BoP account can provide a snapshot of a country’s economy.**

- **A surplus in the current account may mean that the country is receiving more money by exporting its goods and services to other countries whereas a deficit indicates that the country is importing more goods and services from the outside world, for which it has to pay money.**

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- All surplus in the capital account indicates that foreign investors are investing more in the assets of the country than what the residents of that country are investing in the assets of other countries.
- A deficit in the capital account indicates that Indian investors are investing more in international markets as compared to foreign investors investing in India
- In general, we can say that a surplus in the capital account means international investors have confidence in the domestic economy whereas a deficit could be due to lack of confidence.

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Always keep in mind that after taking all surpluses and deficits of current and capital account, ultimately it is the overall balance in the BoP account that matters. …

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