UNIT-5

Chapter- BOP

Topic- Causes of Disequilibrium in BOP,

policy measures taken to improve BOP

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Causes of Disequilibrium In The Bop

- Cyclical fluctuations
- Short fall in the exports
- Economic Development
- Rapid increase in population
- Structural Changes
- Natural Calamites
- International Capital Movements

STEPS TO CORRECT BOP DEFICIT

Monetary measures

Non – monetary measures

I. Monetary measures.

- Deflation
- Devaluation of currency
- Exchange control
- Increase in Direct and Indirect Tax

II. Non Monetary measures

- 1.Export promotion
- 2. Import substitution
- 3.Quota

Measures To Correct Disequilibrium in the BOP

1. **Monetary Measures :-**

   a) *Monetary Policy*

   The monetary policy is concerned with money supply and credit in the economy. The Central Bank may expand or contract the money supply in the economy through appropriate measures which will affect the prices.

   b) *Fiscal Policy*

   Fiscal policy is government's policy on income and expenditure. Government incurs development and non - development expenditure,. It gets income through taxation and non - tax sources. Depending upon the situation governments expenditure may be increased or decreased.

Measures To Correct Disequilibrium in the BOP

c) Exchange Rate Depreciation

By reducing the value of the domestic currency, government can correct the disequilibrium in the BoP in the economy. Exchange rate depreciation reduces the value of home currency in relation to foreign currency. As a result, import becomes costlier and export become cheaper. It also leads to inflationary trends in the country,

d) Devaluation

devaluation is lowering the exchange value of the official currency. When a country devalues its currency, exports becomes cheaper and imports become expensive which causes a reduction in the BOP deficit.

Measures To Correct Disequilibrium in the BOP

e) *Deflation*

Deflation is the reduction in the quantity of money to reduce prices and incomes. In the domestic market, when the currency is deflated, there is a decrease in the income of the people. This puts curb on consumption and government can increase exports and earn more foreign exchange.

f) *Exchange Control*

All exporters are directed by the monetary authority to surrender their foreign exchange earnings, and the total available foreign exchange is rationed among the licensed importers. The license-holder can import any good but amount if fixed by monetary authority.

Measures To Correct Disequilibrium in the BOP

II. **Non- Monetary measures :-**

a) *Export Promotion*

To control export promotions the country may adopt measures to stimulate exports like:

- ✓ export duties may be reduced to boost exports
- ✓ cash assistance, subsidies can be given to exporters to increase exports
- ✓ goods meant for exports can be exempted from all types of taxes.

b) *Import Substitutes*

Steps may be taken to encourage the production of import substitutes. This will save foreign exchange in the short run by replacing the use of imports by these import substitutes.

Measures To Correct Disequilibrium in the BOP

c) *Import Control*

Import may be kept in check through the adoption of a wide variety of measures like quotas and tariffs. Under the quota system, the government fixes the maximum quantity of goods and services that can be imported during a particular time period.

1. Quotas – Under the quota system, the government may fix and permit the maximum quantity or value of a commodity to be imported during a given period. By restricting imports through the quota system, the deficit is reduced and the balance of payments position is improved.

2. Tariffs – Tariffs are duties (taxes) imposed on imports. When tariffs are imposed, the prices of imports would increase to the extent of tariff. The increased prices will reduced the demand for imported goods and at the same time induce domestic producers to produce more of import substitutes

Policy measures taken to improve the BOP

- Import Substitution
- Export Promotion
- Tapping Invisibles(export of Invisibles should be encouraged)
- Increase Efficiency
- Encouragement of Tourist Traffic
- Bilateral Aggrements
- Exchange inflow of Foreign Capital
- Effective implementation of FEMA,2000(FEMA,2000 replaced FERA,1973)

Thankyou