International Liquidity Account

This account records net changes in foreign reserves. Thus, it includes internationally acceptable means of settling international obligations. International Liquidity Account can be explained using the following table which shows balance of payments surplus. It is seen that the sum of the first five accounts exceed the total payments on the same five accounts by a sum of $ 90 million. The total receipts are $ 970 million and total payments are $ 880 million (200+300+80+50+250). Thus, there is a net balance of payment surplus equal to $ 90 million (970-880). This sum of $ 90 million is entered into International Liquidity Account as debit. The reason for entering in debit side is that it represents either purchase or import of gold worth $ 90 million or net addition to accumulation of foreign reserves of $ 90 million or capital lending to other countries on short or long tern basis.

	Credit (Receipts) in $ million	*Debit (Payments) in $ million*
1. Goods Account	500	200
2. Services Account	100	300
3. Unilateral Transfers Account	70	80
4. Long-Term Capital Account	100	50
5. Short-term Capital Account	200	250
6. International Liquidity Account		90
7. Balance of payments	970	970

In case of deficit balance of payments, $ 90 million will be entered into International Liquidity Account as credit. This is because it represents either selling or exporting gold worth $ 90 million or drawing upon the past accumulated foreign reserves equal to $ 90 million or borrowing capital equal to $ 90 million on short or long term basis from other countries or international financial institutions. Thus, a debit entry in the International Liquidity Account shows that there is a surplus in the balance of payments of the country for that year and a credit entry, shows a deficit.

We have explained above the six major accounts of a balance of payments. A sample schedule of balance of payments based on hypothetical figures is shown under.

From the above table, we can derive the important concepts related to balance of payments such as Balance of Trade, Balance of Payments on Current and Capital account, Basic Balance, Accounting Balance of Payments and Overall Balance of Payments. These concepts are explained briefly as under:

Major Accounts	*Credit (receipts)*	*Debit (payments)*	*Net surplus (+) Deficit (–)*
1. Goods Account	20	18	+2
2. Services Account	10	25	–15
(A) Balance of Trade (1 + 2)	30	43	–13
3. Unilateral Transfers Account	30	12	+18

Contd....

(B) BOP on current Account (1 + 2 + 3)	60	55	+5
4. Long Term Capital Account	15	12	+3
(C) Basic Balance (1 + 2 + 3 + 4)	75	67	+8
5. Short Term Capital Account	5	4	+1
(D) BOP on Capital Account (4 + 5)	20	16	+4
(E) Overall BOP (B + D)	80	71	+9
6. International Liquidity account		9	
(F) BOP Accounting balance	80	80	0

Balance of Trade

Balance of trade (BOT) is defined as the difference between the value of goods and services sold to foreigners by the residents and firms of the home country and the value of goods and services purchased by them from foreigners. In simple words, it is the value of goods and services exported minus the value of goods and services imported by a country. When imports and exports value of goods and services are equal, the balance of trade is said to be in equilibrium. When imports value is more than exports value of goods and services, there is deficit balance of trade. And when imports value is less than the exports value of goods and services, there is surplus balance of trade.

Balance of Payments on Current Account

It consists of three balances—merchandise balance, services balance and unilateral transfers balance. It is also referred to as net foreign investment because the sum of the three elements represents the contribution of foreign trade to GNP. It is to be noted here that balance of payments on current account contains all the receipts due to earnings and all the payments which emerged due to spending.

Balance of Payments on Capital Account

Balance of payments on capital account comprises of the long and short term capital accounts. Thus, it includes transactions which involve inward or outward movement of capital and investment.

Basic Balance

This is the sum of balance of payments on current account and long-term capital accounts. The short-term capital account balance is not included here because these are relatively volatile and unpredictable. Moreover, many countries do not have separate short-term capital accounts.

Overall Balance of Payments

This is a sum of balance of payments on current accounts and on capital accounts. It includes all international monetary transactions of a country with the rest of the world.

Accounting Balance of Payments

Accounting balance of payments means equality of balance of payments debit and credit entries.

Balance of payments must always be in balance in the book-keeping sense. The adjustments of International Liquidity Account either in the credit side or debit side in the balance of payments schedule brings about this balance.

AUTONOMOUS AND ACCOMMODATING TRANSACTIONS

Autonomous transactions are those which take place regardless of the size of other items in the balance of payments. Take for example, the export of goods to a foreign country. It is an autonomous transaction and its value results in payments by foreigners to the home country, which is entered as credit item. All transactions which take place either in goods account or the service account or the unilateral transfer account or the long-term and short-term capital account of a country are considered as autonomous transactions. These arise out of autonomous economic activities as credit or debit transactions, which take place independent of balance of payments situation.

The accommodating transactions, on the other hand, take place due to balance of payments situations of a country. For example, if a country is bound to export gold worth $ 100 million to settle its balance of payments deficits, then we say that this gold export is an accommodating transaction, which has taken place to solve its balance of payments problem. The export of gold transaction is entered into the country's balance of payments account as credit item.

In short, all credit and debit entries in the balance of payments current and capital accounts are regarded as autonomous transactions and all credit and debit entries in the International Liquidity accounts are regarded as accommodating transactions. Accommodating transactions are undertaken for deliberate purpose of correcting any imbalance in autonomous transactions.

Deficit and Surplus Balance of Payments

A deficit in the balance of payments occurs when the autonomous payments (debits) are more than the value of autonomous receipts (credits) and surplus results when the autonomous payments (debits) are less than the value of autonomous receipts (credits). In case autonomous payments (debits) are equal to the value of autonomous receipts (credits), then there is balance of payments equilibrium. In terms of accommodating transactions, if an amount is entered as credit in the International Liquidity account, it is called as deficit balance of payments. On the other hand, if an amount is entered in the debit side, it is the measure of surplus in the balance of payments of a country. If International Liquidity account has no entry either on debit or credit side, then there is equilibrium in the balance of payments. A deficit in the balance of payments is regarded as unfavourable and a surplus a favourable situation in the balance of payments.

Questions for Review

1. Define balance of trade.
2. What are current and capital accounts?
3. What do you mean by autonomous and accommodating transactions?
4. Define basic balance.
5. What do you mean by deficit and surplus in the balance of payments of a country?
6. Define balance of payments.

7. Explain the six categories of classifying transactions of balance of payments.
8. Why are items in Services Account regarded as 'invisible items' in the balance of payments?
9. What does Short-term capital account include?
10. What is deficit balance of trade?
11. What is meant by Accounting balance of payments?
12. Explain International Liquidity Account with the help of an example.
13. What do you mean by Private portfolio investments?
14. What do you mean by Private direct investments?
15. Give an example each of government and private transfers.
16. What transactions are included in Services Account?
17. Why must balance of payments be always in balance?
18. Where do we record receipts of foreign exchange in balance of payments account?
19. What does 'payments' in the balance of payments refer to?

APPENDICES

I
SOLVED QUESTIONS FROM NBSE EXAM. PAPERS
[Only questions relevant to new syllabus have been included.]

1. *What is a closed economy?*

Ans: A closed economy is one, which has no economic relations with the rest of the world.

2. *What is an open economy?*

Ans: An open economy has all types of relations with the rest of the world.

3. *Explain the meaning of per capita income.*

Ans: It is the average annual income of all residents of a country. It can be calculated by dividing the national income by the total population.

4. *What is net investment?*

Ans: Net investment or net capital formation is gross capital formation minus depreciation value.

5. *What do you understand by normal resident of a country?*

Ans: A normal resident of a country is a person or institution that normally resides in a country and whose center of economic interest lies in that country. It includes the following:

(i) All production units operating in the country;

(ii) Nationals and the foreign nationals who stay for more than a year in the country;

(iii) Nationals who have gone abroad but returned within a year;

(iv) Nationals working in the foreign embassies and international institutions located in the country;

(v) Students and patients of a country who have gone abroad and stay there even for more than a year.

6. *What is a stock?*

Ans: A stock is quantity measurable at a particular point of time. A stock has no time dimension. Water in a tank at a particular point of time, say, at 10 am is a stock.

Ref – Intro to Economics, By *Dutta*, New Age Pub

7. *Define flow concept.*

Ans: A flow is quantity measurable over a period of time. It changes over time. Water flowing out from a tank between 10 am and 11 am, is a flow concept.

8. *What is financial capital?*

Ans: Financial capital is a sort of expression used to convey securities, bonds etc. It is also known as Paper claims.

9. *Define consumption.*

Ans: It is an activity, which is directed to satisfy, wants. It refers to using up of a good.

10. *Give one example of people who are staying abroad but are residents of India.*

Ans: Students staying abroad for their studies.

11. *Define gross domestic capital formation.*

Ans: It is the sum of investment in domestic fixed capital and inventory investment in a country in a year.

12. *When will domestic factor income be greater than national income?*

Ans: When net factor income from abroad is negative.

13. *Name the two categories into which gross fixed capital formation is divided for measuring expenditure.*

Ans: The two categories are: (*i*) Investment in fixed capital and (*ii*) Inventory investment.

14. *Explain briefly the concept of domestic territory.*

Ans: Domestic territory has special meaning in economics. It includes the following besides the geographical or political boundary:

(i) Territorial waters of the country;

(ii) Ships and aircrafts owned and operated by the residents of the country between two or more countries;

(iii) Fishing vessels, oil rigs, and floating platforms operated by the residents in the international waters;

(iv) Embassies, consulates, high commissions and military establishments of the country located in foreign lands.

15. *Define consumption of fixed capital.*

Ans: The wear and tear of capital equipment is known as depreciation, or consumption of fixed capital.

16. *What are capital goods?*

Ans: Capital goods are used for the production of final consumer goods. These goods do not directly satisfy human wants but help in their production.

17. *Define single-use consumer goods.*

Ans: The goods that can be used for once only are called single – use consumer goods.