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Content of the Paper :-

International Economics

Module :- 4

TOPIC :- DISEQUILIBRIUM IN THE
BALANCE OF PAYMENTS

When we discuss about the equilibrium and disequilibrium in the balance of Payments, we refer to the balance in those parts of account which do not include the accommodating items such as borrowings from the IMF, use of SDRs, drawing from the reserves of foreign currencies held by the central banks. When excluding these accommodating items there is neither deficit nor surplus in the overall balance of Payments, it is said to be in equilibrium. When in this sense, there is either deficit or surplus, the balance of Payments is said to be in disequilibrium.

A disequilibrium in a country's balance of Payments position arise either for a short period or for a long period. Any disequilibrium in the balance of Payments arising owing to a large number of causes or factors operating simultaneously. Types of disequilibrium differ from country to country, while the different kinds of disequilibrium and their causes in the same country will differ at different times.

Causes of Disequilibrium :-

Following are the important causes producing a disequilibrium in the balance of Payments of a country :-

(1) Trade cycles :-

Cyclical fluctuations, their phases and amplitudes, differences in different countries, generally produce cyclical disequilibrium.

(II) Huge Developmental and Investment Programmes :-

Huge development and investment programmes in the developing economies are the root causes of the disequilibrium in the balance of Payments of these countries.

(III) Changing Export Demand :-

A vast increase in the domestic production of foodstuffs, raw materials, substitute goods etc. in advanced countries has decreased their needs for import from the agrarian underdeveloped countries. Hence, export demand has considerably changed resulting in structural disequilibrium in these countries.

(IV) Population Growth :-

High population growth in poor countries also had adversely affected their balance of Payments position. It is easy to observe that an increase in population increases the needs of these countries for imports and decreases the capacity to export.

(V) Huge External Borrowings :-

An important reason for a surplus or deficit in the balance of Payments arises out of international borrowing and investment. A country may tend to have an adverse balance of Payments when it borrows heavily from another country, while the lending

Country will tend to have a favourable balance and the receiving country will have a deficit balance of Payments.

(VI) Inflation :-

Owing to rapid economic development, the resulting income and price effects will adversely affect the balance of Payments position of a developing country.

(VII) Demonstration Effect :-

When people of underdeveloped nations come into the contact with advanced countries, there will be a demonstration effect on the life of the people of underdeveloped countries. This demonstration effects causing deficit in the balance of Payments of those countries.

(VIII) Reciprocal Demands :-

Since intensity of reciprocal demand for products of different countries differs, terms of trade of a country may be set differently with different countries under multi-trade transactions which may lead to disequilibrium in a way.

Types of Disequilibrium :-

Following are the main types of disequilibrium in the balance of Payments :-

(I) Cyclical Disequilibrium:—

Cyclical fluctuations cause disequilibrium in the balance of Payments because of cyclical changes in income, employment, output and price variables. Deficit and surplus take place during the period of depression and prosperity respectively due to cyclical fluctuations. Hence, such type of disequilibrium is known as cyclical disequilibrium.

(II) Structural Disequilibrium:—

Structural disequilibrium emerges on account of structural changes occurring in some sectors of economy at home or abroad which may alter the demand or supply relations of exports or imports or both.

(III) Short-run Disequilibrium:—

A short-run disequilibrium in a country's balance of Payments will be a temporary one, lasting for a short period, which may occur once in a while.

(IV) Long-run Disequilibrium:—

The long-run disequilibrium refers to a deep-rooted, persistent deficit or surplus in the balance of Payments of a country. It is caused by changes in dynamic forces such as capital formation, population growth, territorial expansion, technological advancement, innovations etc.