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Content writer:-

Dr. Ashay Kumar Pathak
Dept. of Economics,
Marwari College,
Darganga (LNU)

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Paper - IV

Content of the Paper:-

International Economics

Module:- 4

TOPIC:- MEASURES TO CORRECT DEFICI
IN THE BALANCE OF PAYMENTS

Any deficit in balance of Payments when it persists continuously is certainly because of its disastrous effects on the country's economy and orderly world trade. A deficit or adverse balance of Payments is more harmful to a country's economic growth and has, therefore, to be corrected sooner than later. For many reasons, an adverse balance of Payments has to be corrected by encouraging exports and discouraging imports.

The various measures that may be used for correcting the adverse balance of Payments are of two kinds namely as monetary and non-monetary measures. Following are the details of measures which are used to correct the deficit of the balance of Payments:—

Monetary Measures:—

Following are the monetary measures for correcting deficit in balance of Payments:—

(1) Deflation:—

A deficit in the balance of Payments occurs due to high imports and low exports. This is to be reversed. In this regard, traditionally, it has been suggested that the country may adopt deflationary or dear money policy by raising the bank rate and restricting credit. Under deflation, prices

of domestic goods fall which makes exports attractive and imports relatively costlier.

(II) Exchange Depreciation :-

Another important method of correcting an adverse balance of payments is to depreciate the external value of home currency. This device obviously assumes that the country has adopted a flexible exchange rate policy. Exchange depreciation of a country will lead to cheaper its domestic goods for the foreigners so that its exports will be boosted, while its imports will be costlier, so that they will lead to decline.

(III) Devaluation :-

Devaluation of currency is a most commonly adopted method to correct the deficit of balance of payments. When a country's currency is devalued, the impact would be relative cheapness of its exports to the foreigners and relative dearthness of its imports. Consequently exports will rise and imports decline. This will help removal of the deficits in the balance of payments.

(IV) Exchange Control :-

Restrictions on the use of foreign exchange by the central bank are called "exchange control." When an exchange control is adopted, all the exporters have

to surrender their foreign exchange earnings to the central bank. Under exchange control, the central bank releases foreign exchanges only for essential imports and conserves the rest of the balance. This is the most direct method of curbing imports.

Non-Monetary Measures:-

Following are the non-monetary measures to correct the deficit of the balance of payments:-

(i) Tariff or Import Duties:-

Tariff is a fiscal device which may be used for correcting an unfavourable balance of payments position. A schedule of duties levied upon the importation of commodities into a given nation from abroad is called a tariff. It refers to custom duties levied on imports. Imposition of import duties will raise the prices of imported goods. This may lead to a contraction of demand for imports. Check on imports helps in improving the position of the balance of payments.

(ii) Import Quotas:-

Fixing of import quotas is an important device used for correcting an adverse balance of payments. Under the quota system, the government may fix or permit the maximum quantity or value

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of a commodity to be imported during a given period. By restricting imports through the quota system, deficit is reduced or eliminated and thereby the balance of payments position is improved.

(iii) Export Promotion:-

To correct disequilibrium in the balance of payments, it is necessary that exports should be increased. Government may adopt export promotion programmes for this purpose. An export promotion programme includes subsidies, tax concessions to exporters, marketing facilities, incentives for exports, loan priority to the export sector under the credit policy of central bank etc. By adopting these programmes, exports can be promoted.

The above mentioned monetary and non-monetary measures are useful for correcting the deficit of balance of payments of a country. Which measure may be adopted, is, depend upon the situation and time of international trade scenario.