# 1.BALANCE OF PAYMENTS (BOP):

## 1.1.What Is the Balance of Payments (BOP):

The balance of payments (BOP) is the method countries use to monitor all international monetary transactions in a specific period. The BOP is usually calculated every quarter and every calendar year.

All trades conducted by both the private and public sectors are accounted for in the BOP to determine how much money is going in and out of a country. If a country has received money, this is known as a credit, and if a country has paid or given money, the transaction is counted as a debit.

Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should balance, but in practice, this is rarely the case. Thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming.

## 1.2.How the Balance of Payments (BOP) Is Divided:

The BOP is divided into three main categories: the current account (which includes a goods and services account, a primary income account, and a secondary income account), the capital account, and the financial account. Within these three categories are subdivisions, each of which accounts for a different type of international monetary transaction.

### 1.2.1.The Current Account:

The current account is used to mark the inflow and outflow of goods and services into a country. Earnings on investments, both public and private, are also put into the current account.

Within the current account are credits and debits on the trade of merchandise, which includes goods such as raw materials and manufactured goods that are bought, sold, or given away (possibly in the form of aid). Services refer to receipts from tourism, transportation (such as the levy that must be paid in Egypt when a ship passes through the Suez Canal), engineering, business service fees (from lawyers or management consulting, for example), and royalties from patents and copyrights.

Goods and services together make up a country's balance of trade (BOT). The BOT is typically the biggest bulk of a country’s balance of payments, as it makes up total imports and exports. If a country has a BOT deficit, it imports more than it exports, and if it has a BOT surplus, it exports more than it imports.

Receipts from income-generating assets such as stocks (in the form of dividends) are also recorded in the current account. The last component of the current account is unilateral transfers. These are credits that are mostly workers’ remittances, which are salaries sent back into the home country of a national working abroad, as well as foreign aid that is directly received.

### 1.2.2. The Capital Account:

The capital account is where all international capital transfers are recorded. This refers to the acquisition or disposal of nonfinancial assets (for example, a physical asset such as land) and non-produced assets, which are needed for production but have not been produced, such as a mine used for the extraction of diamonds.

The capital account is broken down into the monetary flows branching from debt forgiveness, the transfer of goods, and financial assets by migrants leaving or entering a country, the transfer of ownership on fixed assets (assets such as equipment used in the production process to generate income), the transfer of funds received to the sale or acquisition of fixed assets, gift and inheritance taxes, death levies, and, finally, uninsured damage to fixed assets.

### 1.2.3. The Financial Account:

In the financial account, international monetary flows related to investment in business, real estate, bonds, and stocks are documented. Also included are government-owned assets, such as foreign reserves, gold, special drawing rights (SDRs) held with the International Monetary Fund (IMF), private assets held abroad, and direct foreign investment. Assets owned by foreigners, private and official, are also recorded in the financial account.

### 1.2.4. Net Errors and Omissions:

In balance of payments statements, the standard practice is to show separately an item for net errors and omissions. Labeled by some compilers as a balancing item or statistical discrepancy, that item is intended as an offset to the overstatement or understatement of the recorded components. Thus, if the balance of those components is a credit, the item for net errors and omissions will be shown as a debit of equal value, and vice versa.

### 1.2.5. Reserves and Related Items:

Reserve assets consist of those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes.

## 2. How the BOP Is Balanced:

The current account should be balanced against the combined capital and financial accounts; however, as mentioned above, this rarely happens. We should also note that with fluctuating exchange rates, the change in the value of money can add to BOP discrepancies.

If a country has a fixed asset abroad, this borrowed amount is marked as a capital account outflow. However, the sale of that fixed asset would be considered a current account inflow (earnings from investments). The current account deficit would thus be funded.

When a country has a current account deficit that is financed by the capital account, the country is actually foregoing capital assets for more goods and services. If a country is borrowing money to fund its current account deficit, this would appear as an inflow of foreign capital in the BOP.

**3.Liberalizing the BOP:**

The rise of global financial transactions and trade in the late 20th century spurred BOP and macroeconomic liberalization in many developing nations. With the advent of the emerging market economic boom, developing countries were urged to lift restrictions on capital- and financial-account transactions to take advantage of these capital inflows.

Many of these countries had restrictive macroeconomic policies, by which regulations prevented foreign ownership of financial and nonfinancial assets. The regulations also limited the transfer of funds abroad.

With capital and financial account liberalization, capital markets began to grow, not only allowing a more transparent and sophisticated market for investors but also giving rise to foreign direct investment (FDI).

For example, investments in the form of a new power station would bring a country greater exposure to new technologies and efficiency, eventually increasing the nation’s overall gross domestic product (GDP) by allowing for greater volumes of production. Liberalization can also facilitate less risk by allowing greater diversification in various markets.

**4.What Is the Balance of Payments (BOP) Used for?**

The BOP looks at an economy’s transactions with the rest of the globe. It is an important indicator of an economy’s health.

**5.What Are the Main Components of the BOP?**

There are three main components of the BOP: the financial account, the capital account, and the current account. The combination of the first two should balance with the third, but that doesn’t always happen.

**6.What Is the Most Important Part of the BOP?**

The balance of trade (BOT), which is the combination of goods and services (aka the total of imports and exports), is the biggest part of the BOP. It makes it clear whether a country has a trade surplus or deficit.

**7.Importance of Balance of Payment:**

A balance of payment is an essential document or transaction in the finance department as it gives the status of a country and its economy. The importance of the balance of payment can be calculated from the following points:

-It examines the transaction of all the exports and imports of goods and services for a given period.

- It helps the government to analyse the potential of a particular industry export growth and formulate policy to support that growth.
- It gives the government a broad perspective on a different range of import and export tariffs. The government then takes measures to increase and decrease the tax to discourage import and encourage export, respectively, and be self-sufficient.
- If the economy urges support in the mode of import, the government plans according to the BOP, and divert the cash flow and technology to the unfavourable sector of the economy, and seek future growth.

-The balance of payment also indicates the government to detect the state of the economy, and plan expansion. Monetary and fiscal policy are established on the basis of balance of payment status of the country.