

Disequilibrium in Balance of Payments:Types, Causes

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27/07/2020

A country's balance of payment can be favourable or unfavourable.If there is a trade surplus and net inflow of capital the balance of payments would be favourable and show a surplus.

Surplus in balance of payments is an indicator of soundness of the economy.

If, on the other hand, there is trade deficit and net capital outflow from the economy, the balance of payments is unfavourable and there is a deficit in the balance of payments. Both surplus and deficit are disequilibrium in balance of payments which arise out of certain factors.

Types of disequilibrium

Cyclical disequilibrium

Disequilibrium in balance of payments caused by the ups and downs of business cycles is called cyclical disequilibrium.

Secular disequilibrium

When balance of payments deficit or surplus is long term, it is called secular disequilibrium.

Structural disequilibrium

Such disequilibrium is caused due to changes in the international demand or supply of a product or changes in the institutions of the economy.

Factors responsible for disequilibrium in Balance of Payments

1 Elasticity of demand for exports and imports

If the demand for imports is inelastic, there may arise trade deficit which may give rise to balance of payments deficit. If the demand for exportable goods is elastic, there may be a fall in exports. As a result, trade deficit and balance of payments deficit may occur.

Similarly, if the demand for exportable commodities of a country is inelastic, there may be trade surplus and balance of payments surplus. Elastic demand for importables may prevent trade deficit from arising.

2 Stage of economic development

A country in the initial stages of economic development may require imports for a long period. This may result in the balance of payments turning adverse for long period or secular disequilibrium in balance of payments.

If an economy moves towards maturity and starts to export more than imports a long term surplus in balance of payments is built up.

3 Business cycles

Such disequilibrium arises from business cycles. A boom may coincide with inflation, declining exports, rising imports and the resultant deficit in balance of payments. A recession may coincide with falling prices, rising exports, declining imports and the resultant surplus in balance of payments.

3 Terms of trade

A country having adverse terms of trade may experience balance of payments deficit. A developing economy generally exports primary goods and imports manufactured goods. Thus the terms of trade are against the economy.

4 Capital outflow

War or natural calamities may force a country to borrow excessively. This may result in drain of capital when the repayment of foreign debt is due.

5 Demonstration effect

Economic development may give rise to luxury imports if the income distribution is skewed. The affluent section of population indulges in import of luxury items. This turns the balance of payments adverse for a country. _

6. Protectionist policies

High degree of protectionism in developed economies give rise to balance of payments surplus. Developed countries impose tariff and non-tariff restrictions on imports from developing countries. As a result, the exports of developing countries do not grow enough to cover their imports.

7 Population growth

Developing economies having high growth rate of population, are dependent on imports for meeting the requirements of its population. Sustained demand for imports and sluggish exports give rise to balance of payments deficit.