CHAPTER - 2

BALANCE OF PAYMENT - A CONCEPTUAL FRAMEWORK
The very objective of research is to critically evaluate FCNR scheme with reference to its contribution in correcting disequilibrium in Balance of Payment. The proposed research work aims to study relationship of FCNR deposits and Balance of Payment. The study of FCNR scheme in isolation would leave research work incomplete. It would therefore, be more proper to study scheme against background of Balance of Payment. The present chapter is intended to create necessary background of Balance of Payment.

2.1 Balance of Payment Accounts - Definition :-

The principal tool for the analysis of monetary aspects of international trade is the Balance of International Payment Statement or simply 'Balance of Payment' (B.O.P.).

A] Kindleberger's Definition :-

The Balance of Payment of a country is a systematic record of all economic transactions between residents of reporting country and residence of foreign countries during a given period of time. The transactions entered into BOP are ofcourse international transactions constituting transfer of assets and liability, the creation or reduction of claims, or receipts and payment of funds, which takes place between residents of one country and residents of other countries.

In the above definition of Kindleberger - (a) by term "Resident" means : Apart from those who actually reside in the country, tourists, diplomats, military personnel, temporary
migratory workers and branches of domestic companies are regarded as residents of the countries from which they come, rather than the country where they are (b) by an economic transaction means: An exchange of value, an act in which there is transfer of title to an economic good, the rendering of an economic service or transfer of title to assets from one party to another. An international economic transaction involves such transfer of title or rendering of services from residents of one country to residents of another.

B) Elsworth's Definition :-

"A Country's Balance of International Payments is a summary statement or account of all the transactions of its residents with the residents of the rest of world".

Elsworth has put this in the form of an equation by introducing set of "National Accounts" which reflect the activities and transactions of different sectors of economy and thereby expresses important economic relations between one nation and rest of the world as precisely and clearly as possible in the form of an equation.

The equation is arrived at by adding together or by consolidating the net results of current activities (the consolidated Income Statement) and capital transactions (the consolidated capital account).
Consolidation of the Income Accounts :-

Here income statement or current accounts of the three sectors of economy viz. (a) Productive Sector, (b) Private Sector and (c) Government Sector are consolidated so that complementary transactions are cancelled out.

This consolidation brought to light an important conclusion that a communities net savings are equal to net domestic investment plus net balance of current foreign receipts and payments.

In an equation form it can be written as -

\[ S = \text{Id} + X-M \]  \hspace{1cm} (A)

where \( S \) = Net domestic saving

\( \text{Id} \) = Net domestic investment

\( X \) = Total current receipts from foreigners

\( M \) = Total current payment to foreigners

Consolidation of Capital Accounts :-

To record changes in the communities assets and liabilities a separate set of accounts known as capital accounts is formed.

A similar operation of consolidation brings to light a significant economic fact that the communities net savings must be equal to net domestic investment plus net capital transactions with foreigners. In an equation form it can be written as -
S = Id + If  

where S = Net domestic saving
Id = Net domestic investment
If = Net foreign investment

**Consolidation of Total Sectoral Accounts :-**

If we consolidate net results of current activities (consolidated income statement) and of capital transactions (consolidated capital account) i.e. -

\[ \text{Id} + (X - M) = \text{Id} + \text{If} \]
\[ \text{Id} + X - M - \text{Id} - \text{If} = 0 \]
\[ X - M = \text{If} \]

In this final equation 'C' what is left is all foreign transaction of economy which is an expression of 'Balance of Payment' as per Elsworth's definition.

**C] I.M.F. Definition :-**

The I.M.F. has prepared its "Balance of Payment Manual" (B.O.P.Manual) to provide guidelines for its members in order to ensure intercountry comparability in terms of presentation and compilation of BOP statistics. This BOP manual provided useful guidance to have BOP data for India as comparable as possible with those for other countries.
The Balance of Payment manual (Edition-4) defines the "Balance of Payment" as a statistical statement for a given period showing -

a) transactions in goods, services and Income between an economy and the rest of world.

b) changes of ownership and other changes in that economies monetary gold, SDRs and claims and liabilities to the rest of world.

c) 'Unrequited—Transfers' and counterpart entries that are needed to balance in the accounting sense, any entries for the foregoing transactions and changes that are not mutually offsetting.

The term "transaction" according to IMF manual refers to any sort of flow or change which by convention is to be included in Balance of Payments. The most important and numerous types of transactions covered by BOP, include those in which a transactor provides something of an economic value to another transactor and receives in return equal value. These are characterised as "Exchanges". In definition the term "Monetary Gold" is used. When gold is held by Central Monetary Authorities as part of international reserves, it is referred to as 'Monetary Gold'. When it is held by any other party including the Central Monetary Authorities as a "Non-Monetary Asset", it is treated as any other commodity. The 'Unrequited Transfers' are
transactions such as gifts, grants, taxes etc. where one transactor provides something of economic value to another but does not receive a quid pro-quo on which economic value can be assigned in return. The economic value that is lacking on one side has to be balanced by entry referred to as "Unilateral Transfers".

2.2 Purpose of Balance of Payment :-

The comparison of a pair of BOP of a country covering a given period shows changes in the country's trading position i.e. in relative movement of exports and imports. Such information is significant for the determination of trade and commercial policies of country. The effect of such changes on employment and production will also be relevant to monetary and fiscal policy of country. The major purpose of keeping the Balance of Payment Accounts is to inform Governmental Authorities of international position of the country and help them in taking decisions on monetary and fiscal policy on the one hand and trade and payment matters on the other.

2.3 Double Entry System of Accounting :-

All the transactions that enter into Balance of Payments are recorded systematically according to "Double Entry System" similar to that used in "Business Accounting" e.g. Exports like sales of business are recorded as "Credits" and imports like purchase of business are recorded as "Debits". The fundamental rule is to charge or debit owner of an account, for everything he gets, and to credit him, for everything he gives up.
Under the internationally accepted convention of the double entry system, credit entries are used to record -

a) Export of goods and services
b) Income receivables
c) Financial transactions involving either reduction in country's foreign financial assets or an increase in country's foreign financial liabilities.

Conversely, debit entries are used to record -

a) Import of goods and services
b) Income payable
c) Financial transactions involving either increase in foreign financial assets or decrease in country's foreign liabilities.

The transaction in 'Double Entry Accounting System' are recorded in pairs of credit and debit entries of equal value e.g. an export transaction for which money is received through banking system involves credit entry for export and debit entry for increase in foreign exchange assets. Similarly, the repayment of foreign loan through the banking system involves debit for reduction in foreign liabilities and credit entry for decrease in foreign exchange assets.

Most countries in the Balance of Payments refer to transactions in which economic values are provided or acquired in exchange for other economic values. Any entries that are not automatically paired are matched by offsetting entries. Such offsetting entries are necessary in case of 'Unrequited Transfers'.
2.4 **Errors and Omissions** :-

As a result of adoption of Double Entry Recording System, the sum of all credit entries should in principle exactly equal the sum of debit entries for a given period. In practice different sources are used for recording different transactions. Some transactions are not measured accurately (errors) while others may not be measured at all (Omissions). The equality between the sum of debit and credit entries is therefore brought about by inclusion of balancing items that reflect net errors and omissions. Thus in order to strike a balance between two sides of the accounts it is necessary to put an item known as "Errors and Omissions".

2.5 **Valuation** :-

It is necessary to have a uniform system for pricing all BOP transactions. Each transaction in BOP has a credit and debit aspect because of the adoption of double entry system. Now if the debit and credit entries of each transaction are not valued at same price, the sum of debit and credit entries in the BOP statement will not be equal. Uniform valuation is also necessary because credit and debit aspects are derived independently from separate sources. To make different items in BOP comparable with eachother uniform valuation is necessary. In addition, BOP statements of different countries will not be comparable, unless, two partner countries adopt uniform valuation principles for recording entries in their respective BOP statement.
It is recommended internationally that for BOP purposes, the market price be used for valuation of transactions. The fourth edition of IMF manual conceives this market price as "the amount of money a willing buyer pays to acquire something from a willing seller, when such an exchange is one between independent parties into which nothing but commercial transactions enter". In regard to valuation of merchandise transactions the rule adopted by IMF is, export and import transactions be valued at F.O.B., at the customs frontier of the exporters country. In case of India, while exports are valued on F.O.B., imports are valued on C.I.F. basis.

2.6 **Timing** :-

Just like uniform system of valuation, a uniform time of recording BOP transactions is recommended. The both sides of transactions are required to be recorded in the same period in BOP. In accordance to this principle, the time of recording current account transactions is conceived as the time when legal ownership of goods change, when services (insurance, transport) are rendered. Interests and dividends are to be recorded at the time when they are due for payment. Unrequited transfers are to be recorded when goods/services to which they are offsets, change ownership. In case of capital account transactions the time of change of ownership is by convention taken as the time at which transactions are effected through banking channels and are recorded when parties involved effect transactions which result in claim or liability to rest of the world. The entries
for loan drawings are based on actual disbursements and not on commitments. The entries for loan repayments are recorded at the time these are actually effected. In India's BOP statistics, exports are recorded since 1st October, 1983, when they are cleared by customs authorities for shipment. Prior to this date, exports were recorded when export documents were negotiated or sent for collection by Authorised Dealers, which represented the change in ownership of goods. Imports are recorded when payments are made.

2.7 Concept of Resident:

The BOP records transactions between residents of Economy and those of the rest of world. In compiling BOP it is necessary to determine the economic entities which are residents of an economy and those which are non-residents. For this purpose IMF manual has prescribed criteria and conventions.

An economic entity that has a closer association with the territory of a given economy than with any other territory is considered to be resident of that economy. An economic entity which is not determined to be a resident in accordance with this convention is treated as a non-resident.

The entities which are thus regarded as residents are classified into four sectors. These comprise of-

a) General Govt. Institutions
b) Individuals
c) Pvt. Non-Profit bodies serving individuals
d) Enterprises
a) **General Govt. Institutions** :-

It includes all departments, establishments and bodies of central, state and local governments, that are located in the territory of a given economy. The embassies, consulates and other entities of a given economy though located abroad are treated as residents of that economy. Correspondingly similar entities of foreign countries located in the territory of a given economy are treated as Non-Residents.

b) **Individuals** :-

The concept of resident adopted by IMF manual in the case of individual covers all persons who may be expected to consume goods and services, participate in production or engaged in territory of a given economy on other than temporary basis. These are the persons whose general centre of interest is considered to rest in that economy. In other words, a conceptual basis for determining residential status of individual is whether he is regarded to have been involved in the productive and consumptive process of a given economy with some degree of permanence. The rule of thumb prescribed by IMF manual for recognition of permanence is a stay for one year. Thus all persons living in the territory of a given economy for twelve months or more than are to be considered as residents for BOP purpose. It implies that persons visiting territory of a given economy for less than twelve months should be regarded as Non-Residents.
The exception to the general rule, that stay abroad for more than twelve months implies Non-Resident status, are given economy's diplomatic and consular representatives and government personnel stationed abroad. Even all these persons stay abroad for more than a year, they are not considered to have changed their centre of interest and hence residents.

c) Pvt. Non-Profit bodies serving individuals :-

All Pvt. Non-Profit bodies serving individuals are resident economic entities of the economy on whose territory they are located and conduct their affairs. These bodies comprise those which are engaged in furnishing educational, health, cultural services almost free of charge.

d) Enterprises :-

Resident Enterprises include all enterprises engaged in the production of goods and services on a commercial basis within the territory of a given economy.

The conventions adopted for determining 'resident' status while compiling India's BOP are broadly consistent with the recommendations of IMF manual.

2.8 Presentation and Classification :-

The BOP statement is presented in the conventional two column credit/debit accounting format. The BOP items are divided into two broad sections - (i) Current Account (ii) Capital Account.
(i) **Current Account** :-

The current account covers all transactions involving flow of goods and services between the reporting country and rest of the world. Under the present IMF procedure, Exports and Imports of visible items of goods are to be valued at the customs frontier of the exporters country. Any difference that exists between the credits and debits of visible exports and imports is called a "Balance of Trade". If debits are greater than credits this is termed as "Unfavourable Balance of Trade". If the reverse holds it is "Favourable Balance of Trade". Though merchandise trade, accounts for the major part of the current account for most of the countries, the rest of the account known as 'Invisible Account' also constitutes an important element. The Invisible Account covers such service items like travel, transportation, insurance etc. and investment income and transfers (grants, gifts etc.). For many reasons, current account is regarded as most basic of all sub-accounts. Firstly because of its relative size compared with other sub-accounts. Secondly it contains all transactions that give rise to or use up a country's National Income. Thirdly because even, long term capital movements, can be effected ultimately via movement of real goods and services.

(ii) **Capital Account** :-

It covers debts and claims payable in money or constituting money. It contains all changes in claims on or of a country owed
by or owed to the rest of world. The capital account is concerned with changes in the claims of residents to overseas residents, and changes in the liabilities of residents to overseas residents. The changes in the bank balance held by residents in foreign banks and change in bank balance held by foreigners in domestic banks are held in capital account.

The capital account may be subdivided into 'Long Term' and 'Short Term'. Long term involves all movements of ownership instruments with a maturity of more than a year whereas Short term capital involves all movements of ownership instruments with less than one year's maturity. Long term capital consists mainly of transactions in equities, loans, bonds, real estate whereas Short term capital is mainly bank deposits, acceptances, drafts. Long term capital involves international transfer of purchasing power which provide the means of financing net flow of goods and services from the lending country to the rest of world. Short term capital movements can be regarded as induced (i.e. not autonomous) by other BOP transactions in the sense that they operate so as to temporary fill in any gap between total receipts payment of other transactions.

The capital account may also be divided into Official and Private accounts on the basis that private capital flows takes place in order to make a profit or to avoid loss whereas official capital flows may be induced responses to changes that takes place elsewhere in BOPs.
Monetary Gold Account :-

This includes all movements of gold between countries out of and into official monetary reserves. Gold exported from the monetary gold reserves are treated as Exports and therefore as a credit whereas gold imports are debits. For most of the countries, gold stocks along with a convertible currency constitute a 'reserve'. The gold and convertible currency reserves are drawn upon in order to cover a payments deficit in all other sub-accounts combined. It may be therefore regarded as an official compensating capital type movements used to settle residual international payments.

2.9 Concept of Surplus and Deficit in Balance of Payment :-

A surplus in the current account is said to arise when receipt from export of goods and services exceeded payments for similar items. Similarly, deficit means an excess of such payments over corresponding receipts. To make these concepts unambiguous when applied to BOP as a whole, it is necessary to know the distinction between - (a) transactions for their own sake, for the profit they entail or the satisfaction they give and (b) transactions result from these. Former are called "Autonomous Transactions" and later are called as "Induced Transactions". In case of current account, export and import of goods and services are undertaken for the sake of profit they entail and so they are "Autonomous Transactions". When they differ, there is an induced increase or decrease in foreign balances i.e. short term capital movement which is undertaken not for its own
sake but it results from the relative size of exports or imports. Of
the other BOP transactions, donations are voluntary and deliberate
and so too are long term capital movements. Those short term capital
movements motivated by desire to earn a higher return, to make a
speculative gain, are considered as 'Autonomous'. The gold movements
and official short term movements are the result of other transactions.
Due to pressure on BOP a country's Central Bank may reduce its foreign
balance or may export gold.

A deficit appears in a BOP when 'Autonomous Transactions'
requiring payments exceed 'Autonomous Transactions' involving receipts.
By the same token a surplus exists when 'Autonomous Transactions'
giving rise to receipts exceed 'Autonomous Transactions' requiring
payments.

The induced transactions are movements of reserves. International
reserves serve the purpose of filling in a gap in a BOP. The size
of surplus or deficit can be measured by the volume of reserve
movements.

The BOP is construed on a double entry based book keeping
system in which the sum of credit items must exactly equal the sum
of debit items. Thus the concept of surplus or deficit in the BOP
in toto, is mathematically impossible, as it must always balance. But
it does not mean that any single sub-account or group of sub-accounts
cannot show deficit or surplus. Infact it would be highly unlikely
that balance within a 'BOP' should prevail everywhere.
It can be said that equality of total debits and credits is same as zero algebraic sum of balances in the separate sub-accounts, so that large imbalances can be said to exist within individual sub-accounts so long as they are exactly offset by imbalances of opposite in the other accounts i.e. surplus in the current account may be completely offset by a deficit in capital account. If offset is partial, then the total balance will be achieved by having a deficit on a gold account of the required size. In this sense, the terms 'Surplus' and 'Deficit' are used to refer to any single sub-account or group of sub-accounts within a BOP accounts.

The measurement of surplus and deficit is based on a division of BOP into two sections - one above the line (substantive) and other below line (balancing). The deficit or surplus is thought of as arising in the accounts above the line and being financed (or balanced) by the accounts below the line. Since obviously either the surplus (deficit) above the line or the corresponding deficit (surplus) below the line could be used to describe the overall BOPs, it is entirely convention that the substantive accounts (i.e. above the line measurements) are used for this purpose. Thus if a country has a deficit on current and capital taken together, one would refer to BOP as in deficit and expect to see corresponding surplus on monetary gold account.

It is not that all countries measure surpluses and deficits by including exactly same items below line except changes in gold and foreign exchange assets of monetary institutions.
To achieve certain degree of uniformity more and more economists are using concept of 'Basic Balance' and 'Overall Balance'. According to this method BOP accounts are divided into two major groups, one measuring 'Basic Balance' and the other 'Overall Balance'. In the Basic Balance are put 'Current Account' and 'Long Term Capital Accounts' items, which are so called fundamental transactions. While the Overall Balance contains 'Short Term Capital' and 'Monetary Gold' and 'Errors and Omissions' which are so called Financial Transactions.

The origin of this method lies in the report of 1961 Kennedy Task Force on Balance of Payment, which argues that purpose of so dividing BOP accounts was to discover if US surplus on Current Account was big enough to cover American loans and grants to other countries.

2.10 Disequilibrium in the Balance of Payment:

As per accounting principle a BOP must always balance. The debits must always equal credits in any circumstances like exports rising or falling; capital moving out of country or into a country, or prices fluctuating or remaining steady. Therefore country need not concern itself whether its BOP balances, as it is unavoidable. However country must concern itself about the fact that how this balance should be achieved. If this balance is achieved easily and without effort then there is no cause of worry for a country. As long as country manages within its international means not only BOP is in balance but
it is in equilibrium also. Only when expenditure made abroad by residents exceeds expenditure of foreigners towards this country, the deficit arises. To meet resultant deficit the country would draw on its international reserves. In technical terms, we can say the country's reserves will not change if its autonomous receipts equal its autonomous payments. From this we can also state that one important criterion of equilibrium is absence of changes in international reserves. In short trade and capital transactions may not result in equal inflows and outflows. The difference is made up by increase or decrease in the nation's monetary reserves or foreigners monetary claims on the country. If the country looses monetary reserves or its monetary liabilities to foreigners are increased it has a deficit in BOP. If it acquired monetary reserves it has a surplus in BOP. If there is surplus or deficit the country's autonomous outflows are not equal to inflows and the BOP is in disequilibrium.

In other words equilibrium in BOP exists only when total of debits is equal to total of credits without accommodating or compensatory capital transfers. The change in international reserves are accommodating transactions in the sense that changes are made not for their own sake but specifically to restore the equality between receipts and payments.

A surplus induced disequilibrium is not advisable because surplus can accumulate indefinitely while deficit cannot increase beyond available international reserves of a country. A surplus represents capital assets
which remain idle at the cost of outflow of valuable goods and services. A surplus results into increase in foreign exchange assets of the banking system which is a source of increase in the stock of money and hence it can unleash inflationary pressure.

2.11 The Adjustment Mechanism of Balance of Payment:

In an open economy i.e. one which is linked to the rest of world by trade, the changes in 'Income' and 'Structure' lead to disequilibrium in BOP of that economy. Some mechanisms available are changes in income, changes in price and changes in interest rates. These three mechanisms would continue to change until a BOPs equilibrium is restored among nations. There are two basic systems that would allow these three adjustment mechanisms to work - (a) fixed exchange rate (b) flexible exchange rate system.

An International Gold Standard was one form of fixed exchange rate system. If a nation has an international payments deficits, under a gold standard, gold will flow out of that country and into those countries that are having international payment surpluses. As gold served as a monetary base, loss of gold contracted money supply. As consequence deficit nations experience reduction in price levels and increase in their interest rates. The lower price restore competitiveness of country's product. The rise in interest rate would attract capital. The surplus nation experience an increase in their price level, income level and fall in interest rate. These action create international payment equilibrium.
The rule of the game under the gold standard require that deficit and surplus nation do not offset gold flows by sterilizing movements of gold. Under gold standard, burden of adjustment is on the internal economy. Internal prices, income, interest rates must adjust to the BOP. This is what is meant by 'rigidity' of gold standard. It was countries unwillingness and inability to allow these type of adjustments that led to the downfall of gold standard.

In 1944, representatives of major trading nations met in Breetonwoods, New Hampshire to create a new international monetary system to replace gold standard which was abandoned. The conference had two main objectives:

(i) To create a monetary system that would provide for relief and reconstruction of the countries that were devastated by World War-II.

(ii) To devise a system of fixed exchange rates as a means of correcting international payments disequilibrium.

To fulfill the first objective IBRD was established and IMF was established for the second objective.

The Breetonwood system was another fixed exchange rate system. It established "International Monetary Fund" to help nations to adjust short-run disequilibrium in their international payments. The IMF lent reserves to countries that suffered from short term liquidity in order to induce that country to keep its exchange rate fixed in terms of
other countries. When a fundamental disequilibrium existed a nation was allowed to change its official exchange rate significantly. In other words, in the short run member countries can draw foreign currency from fund so that they are not forced to support the parity entirely from its own reserves. In the long run, if there is fundamental disequilibrium peg can be adjusted i.e. par values can be altered. The foreign exchange system established at Breotonwoods was based on the concept of the adjustable peg.

Thus under the pegged system, first signs of disequilibrium will appear in a limited exchange rate fluctuations that were allowed. Later deficit country will start loosing its reserves as it defends the exchange rate. If the disequilibrium is of cyclical nature or of a temporary nature the country would borrow reserves from IMFs pool of funds contributed by member countries. At the same time country would be taking internal measures to correct its BOP. The measures were like raising interest rates and curbing inflationary pressure to discourage imports, encourage capital inflows. If the disequilibrium is chronic, a country may decide to alter the par value of its currency. In case of chronic disequilibrium a government may as a last resort suggest devaluation.

One of the fundamentals of the system was the convertibility of US dollar into gold. When the system was formed the supply of US dollars with other member countries was very limited and in
comparison the stock of gold with US treasury was enormous. So nobody doubted ability of US Government to convert US dollar into gold. By late 60s situation reached where supply of dollars held by Non-Resident owners, mainly central banks was above availability of gold with US treasury. This resulted into run on US gold as more and more central banks started converting US dollar into gold. This had major effect on international monetary system and in the year 1971 US authorities unilaterally suspended the gold convertibility of US dollar. This effectively ended fixed exchange rate system. There were few half hearted attempts to restore fixed exchange rates like "Smithsonian Agreement", however, once gold backing was taken away, fixed exchange rate system could not survive. Since then an era of floating exchange rates began.

The floating Exchange Rate System :-

On 16th of March, 1972, the finance ministers of the European Economic Community, the common market, announced that they would let their currencies float against dollar. Therefore since 1973, the world has been on floating exchange rate system. Exchange rates fluctuate to reflect supply of and demand for the currencies of individual countries.

Exchange Control Mechanism :-

If governments do not wish to allow a free exchange market then they can resort to exchange control and rigidly fix foreign exchange values of their currency through complete government monopoly of
foreign exchange. In that case government requires that all foreign exchange earnings be handed over to it or to its "Authorised Dealers". The government allocates available exchange under terms and conditions of its own choosing in the form of rationing. Under these conditions it is possible to fix the rate of exchange.

The exchange control is alternative means of dealing with BOP difficulties. The arbitrary decisions of government officials play major role here. The very core of exchange control is set of restriction on international payments so convertibility of currency is also sacrificed. In a full fledged system of exchange control there is complete government domination over foreign exchange market. All receipts from exports must be surrendered to exchange control authorities which is then allocated to various buyers according to criterion of national importance. The capital exports are usually banned while import of goods essential to the functioning of economy e.g. basic food stuffs receive liberal quota of exchange. In India exchange control finds its expression in the form of FERA act, Exchange Control Manual and Import-Export Policy.

However even if trade controls are effective, they can have detrimental effects on trading partners e.g. if import controls are imposed to correct deficit, they will directly affect exports of other countries. Therefore on "Economic Welfare" grounds any form of direct controls are not advisable or frowned upon. The controls may easily lead to retaliation, reduction in level of world trade and consequent adverse effects on world welfare.
Despite these objections and recent trend towards free trade, many countries still insist upon retaining rights to impose control on trade. Thus countries in deficit may attempt to reduce the outflow of capital seeking investment by taxing heavily on overseas investments or by making it difficult to acquire necessary foreign exchange. The countries may also impose controls over the amount of money that can be taken abroad and so directly affect the BOP.

The famous Economist 'Machlup' points out that "Direct Controls" are no solution to the problem. In any case, they only treat symptoms and not the disease. If controls are removed the imbalance in Demand/Supply of foreign exchange is likely to reappear. It is in this sense that 'Exchange Controls' deals deficit and not causes. To choose best way out between depreciation, deflation, exchange control a country should weigh carefully desirable and undesirable effects of each method.

2.12 Euro Currency Market:

The euro-currency market refers to the foreign currency market prevailing outside the country concerned. It represents US dollar deposits with banks outside the United States.

In the evolution of international monetary system, growth of euro-currency market marks a significant landmark. Euro-currency has served to create a transfer mechanism for efficient financing of BOP deficits outside official international financial system (IMF,IBRD,etc.).
Over the last two decades the Euro-currency market witnessed a remarkable growth. It rose from US $ 390 billion in 1974 to US $ 3858 billion in 1986.

Since initial concentration of deposits took place among banks in the city of London and other European Financial Centres, the market was referred to by prefix, "EURO." However, today market has spread so much that the prefix "EURO" has lost its narrow connotation and Euro-dollar or Euro-currency market has become global in character.

As a step towards creating necessary background of Balance of Payment, the foregoing study presented conceptual framework of Balance of Payment in general. It is felt that the study of Balance of Payment with special reference to India is pertinent to have complete background of Balance of Payment. This has been done in the chapter to come.