Difference between Balance of Payments and Balance of Trade

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1. Balance of Payments (BOP)

1. Balance of Payments (BOP) – is simply put – the summary of *all* the '*economic*' *transactions* India has had with the rest of the world (ROW) in a financial year.

When I say India and economic transactions – I mean to say business entities (individuals/companies/firms), Government entities etc. of India – having international business transactions.

2. Balance of Trade (BOT)

2. Balance of Trade (BOT) – is just the summary or the balancing of the total exports and the total imports of India in a financial year.

Or, in formulaic form it is –

BOT = Total Exports of visible items – Total Import of visible items

(*what is visible item? – hang on – I'll answer that in a bit!*)

3. Difference between BOP and BOT

BOP summarizes all the inter-country transactions (ALL international transactions) and is a wider term – which includes BOT.

So, BOT forms a part of BOP.

Whereas BOT is a narrower term, and includes only the summary of export and import of *Visible Items*.

4. Items that make up the BOP and BOT

BOP is a wider term – and includes:

- ***Visible Items*** – are those items which are visible/ touchable/ tangible/physical – i.e., they can be seen and measured and touched!

  BOP includes the export and import of such physical goods.

- ***Invisible Items*** – are those which cannot be seen (*and hence invisible!*) or touched – but can be felt – I am talking about *services*!!

  The import and export of services in included in BOP – services like banking/consultancy services of IT/ Legal/ Architecture/ Management/ CA etc./ insurance and logistics services.

- ***Unilateral Transfers*** – as the name suggests are transactions which are one way.

  The transactions I gave as examples above are two way transactions – sell/ buy goods/ services – receive/ pay money = two way.

  One way or unilateral transactions also form part of BOP and includes transactions like – remittances to and from abroad/ gifting across borders etc.

- ***Capital Transfers*** – are transfer of title or ownership of capital assets across borders. It includes purchase/ sale of capital assets like land, building, plant and machinery etc. – but across borders.

Like and NRI/ PIO selling his property in India. Since the person is not an Indian Resident then such a transaction becomes an international transaction and forms part of BOP.

BOT includes only the *visible items* – so it is a narrower term and is included in the broader term BOP.

5. Understanding BOP and BOT

- ***Balanced BOP*** is when forex payment and receipts are equal – which never happens in reality!
- ***Surplus BOP*** is when the forex receipts are more than the payments.
- ***Deficit BOP*** is when the forex payments are more than the receipts.
- ***Surplus BOT*** is when the exports are more than imports – it is a ***'favourable BOT'.***
- ***Deficit BOT*** is when the imports are more than the exports – it is ***'unfavourable BOT'.***

6. Current Account and Capital Account

- ***Current account*** includes transactions of visible, invisible items and unilateral transactions.

  In other words – current account transactions are import and export transactions of physical goods and services and also includes one way transfers.

- ***Capital account*** includes those international transactions which causes ***change in the assets and liabilities of the residents of India or the Government***.

  Transactions like making investments abroad or foreign investors investing in India, borrowings and lending of funds across borders etc.

  Since capital account transactions are concerned with capital assets – it does not affect the revenue incomes, output/ production or employment scenario of the country; these are reflected by the current account transactions instead.

7. Autonomous and Accommodating Items

- ***Autonomous Items*** also known as 'above the line items' – are those international transactions which happen due to profit earning motive.

  All profit oriented international transactions – like export and import are autonomous transactions.

  Autonomous transactions are called 'autonomous' because they happen on their own accord and not because of a country's BOP scenario.

  Autonomous transactions will include imports and exports (current account transactions) and also lending or borrowing of loans (cross border) or payment or receipt of interests thereon.

  As you can see these transactions will happen as when the originator of the transaction – i.e., importer/ exporter/ borrower/ lender/ etc. – wants to transact.

- ***Accommodating Items*** or 'below the line items' are those which originate to 'accommodate' the BOP scenario.

  If there is BOP surplus or deficit then accommodating transactions are carried out in a deliberate manner to balance out the surplus/ deficit BOP.

  Accommodating transactions compensate the surplus or deficit brought about by autonomous transactions.

  Usually we have BOP deficit and that is *accommodated* by bringing in flow of foreign exchange in the form of FDI/ loan from IMF etc. to balance out the deficit or to lower the deficit.