Balance of Payment

Very Short Answer Type Questions (1 Mark)

1. **Define foreign exchange rate.**
   Ans. Foreign exchange rate is the price of a foreign currency in terms of domestic currency
2. **What is foreign exchange?**
   Ans. Any currency other than the domestic currency.
3. **What is balance of payment Accounts?**
   Ans. It is a systematic record of all economic transactions between the residents of a country and the rest of the world in a given period (one year) of time
4. **State two sources of supply of foreign exchange.**
   Ans. Exports and foreign tourism.
5. **State two sources of demand of foreign exchange.**
   Ans. Import of goods & services and to get education in abroad.
6. **What does a deficit in balance of trade indicate.**
   Ans. Deficit in balance of trade indicates that the imports of good are greater than the exports.
7. **What is meant by balance of trade?**
   Ans . It is the difference between monetary value of exports and imports of material goods or visible items.
8. **Define balance of payment.**
   Ans. A balance of payment is a statement of double entry system of all economic transactions between residents of a country and the residents of foreign countries during a given period of time.
9. **When is there a deficit in the balance of trade.**
   Ans. When the value of imports is more than value of exports.
10. **State the components of capital account of balance of payment.**
    Ans.
    1. Borrowing and lending to and from abroad.

2. Investment to and from abroad.
3. Change in foreign exchange reserves

11. **Which transactions determine the balance of trade? When is balance of trade in surplus?**
Ans. Exports of goods and imports of goods determines BOT. When the value of exports of goods is greater than the value of imports of goods.
12. **What are the components of current account of the BOP account?**
Ans.
    1. Exports and imports of goods
    2. Exports and imports of services
    3. Unilateral transfers
13. **Explain the meaning of deficit in BOP**
Ans. When autonomous foreign exchange payments exceeds autonomous foreign exchange receipts, the difference is called balance of payments deficit.
14. **The balance of trade shows a deficit of Rs. 300 crs. and the value of exports is Rs. 500 crs. What is the value of imports?**
Ans. 800 Crores.
15. **List two items included in the balance of trade account.**
Ans. Visible items Watch, Petrol, Electronic item.
16. **List two items of the capital accounts of balance of payment.**
Ans.(i) Direct Foreign Investment
(ii) Loans
17. **Give meaning of managed floating exchange rate.**
Ans. Exchange rate influenced by the intervention of the central bank in the foreign exchange market.
18. **Distinguish between devaluation and depreciation of domestic currency**
Ans. When Government or authorities reduce the price of domestic currency in terms of all foreign currencies is called devaluation. The fall in market price of domestic currency (due to demand supply in the market) in terms of a foreign currency is called depreciation.
19. **When price of a foreign currency rises its supply also rises. explain why?**
Ans. If exchange rate increases, this will make domestic country’s goods cheaper to foreigners. The demand for our exports will rise. It implies more supply of foreign

exchange.

20. **What is meant by invisible items?**

    Ans. Invisible items are all those type of services which are exported and imported.

21. **What is meant by unilateral transfer?**

    Ans. These refers to one sided transfers from one country to other. These are not trading transactions.

22. **What is meant by Autonomous transactions?**

    Ans. Autonomous transactions refer to international economic transactions in the current and capital account that are undertaken for profit.

23. **Write the name of those economic transactions which are made by the government to make equilibrium in balance of payment.**

    Ans. Accommodating items.

24. **What do you mean by Fixed Exchange Rate?**

    Ans. Fixed exchange rate is the rate which is officially fixed in terms of Gold or any other currency by the govt. or adjusted only frequently.

25. **Define Flexible Exchange rate?**

    Ans. Flexible exchange rate is determined by demand for and supply of a given currency in foreign exchange market.

26. **State two merits of Flexible Exchange Rate.**

    Ans. (i) No need to hold foreign exchange reserve.

    (ii) Optimum resource allocation.

27. **State two demerits of Flexible Exchange Rate.**

    Ans. (i) Fluctuations in foreign exchange rate.

    (ii) Encourages speculation.

28. **State two merits of fixed exchange rate.**

    Ans. (i) Stability in Exchange rate.

    (ii) No scope for speculation.

29. **State two demerits of fixed exchange rate.**

    Ans. (i) Need to hold foreign exchange reserves.

    (ii) No automatic adjustment in the 'Balance of Payments.'

30. **What is the slope of demand curve of foreign exchange?**

    Ans. Negative slope.

31. **What is the slope of supply curve of Foreign Exchange?**

Ans. Positive slope.

32. **What will be the effect on exports, if foreign exchange rate increases?**

    Ans. Exports will increase because Indian goods have become cheaper for foreigners.

33. **What will be the effect on imports if foreign exchange rate increases.**

    Ans. Import will decrease because foreign goods have become costlier for Indians.

34. **Define Devaluation of Domestic Currency.**

    Ans. Devaluations means to reduce parity rate of its currency with respect of gold or any other currency by the Government.

35. **What is meant by Depreciation of Domestic Currency?**

    Ans. When the value of domestic currency reduce with respect to other currency by the demand and supply forces of foreign exchange in a free exchange market.

36. **What is meant by Appreciation of Domestic Currency?**

    Ans. Appreciation of currency refer when the value of foreign currency reduce with respect to domestic currency. It occurs in a free exchange market by the forces of demand and supply of currency.

HOTS (1 MARK)

1. **In which circumstances, the devaluation of currency will be in favour of economy?**

   Ans. Appreciation of currency refer when the value of foreign currency reduce with respect to domestic currency. It occurs in a free exchange market by the forces of demand and supply of currency.

2. **In which circumstances the appreciation of currency will be non favourable for the economy?**

   Ans. When we adopt the policy of Import Substitution.

3. **Under which circumstances, the purchasing power of foreign currency increases in comparison to domestic currency?**

   Ans. Capital account records capital transfer such as loans and investment between one country and the rest of the world which causes a change in the asset or liability status of the residents of a country or its government.

4. **With the help of which item BOP gets balanced?**

   Ans. With the help of international loans.

5. **Does BOP always remain balanced?**

   Ans. Always in equilibrium in the sense of accounting.

Short Answer Type Questions (3-4 Marks)

1. **State which type of exchange rate has no official intervention in the foreign exchange market? How it is determined?**
   Ans. Flexible exchange rate has no official intervention. It is determined by the interaction of supply and demand in the foreign exchange market.
2. **State which of the following is a visible item and which is an invisible item in Balance of payments.**
   (a) Export of jute product
   (b) Software services exports.
   Ans. (a) Export of jute product - Visible Item
   (b) Software services exports - Invisible Item
3. **Name the items which are not included in the current account of India's Balance of payment,**
   Ans. The capital transactions in the form of direct and portfolio investment that take place the countries are not included in the current account of India's Balance of payments.
4. **In which account of balance of payment tourism services to tourist are included?**
   Ans. Tourism services to tourist are included in current account of Balance of payments.
5. **Which transactions- autonomous or accommodating bring balance in the balance of payments.**
   Ans. Accommodating transactions bring balance in the balance of payment.
6. **Why foreign currency/exchange is needed?**
   Ans. i) To purchase of goods and services from other countries.
   ii) To send a gift abroad.
   iii) To purchase financial assets in a particular country .
   iv) To speculate on the value of foreign currencies.
7. **What are the factors responsible for inflow of foreign currency?**
   Ans. i) foreigners purchasing home country goods and services through exports.

ii) Foreigners investment in home country through joint ventures and through financial market operation.

iii) Foreign currencies flow into the economy due to currency dealers and speculators

8. **When exchange rate of foreign currency falls it's supply also falls. Explain how?**
   Ans. When exchange rate falls, experts become less profitable hence supply of foreign currency through exports falls.
9. **When exchange rate of foreign currency falls, its demand rises. Explain how?**
   Ans. When exchange rate falls, imports become cheaper, demand for imports rises and so rises the demand of foreign exchange to purchase more imports.
10. **What will be the value of imports, if the net imports are Rs 160 crores and the value of exports are Rs 400 crores.**
    Ans. Balance of Trade = Exports- Imports
    Imports= Exports – Balance of trade= 400-(-160)=560
    OR Imports= Exports + net imports = 400+160=560 Ans Rs 560 crores
11. **If Balance of payment of a country is Rs (-) 100 crores and total payment are Rs 500 crores. Find out its total receipts.**
    Ans. Balance of Payment = Total receipts- Total payments
    Total receipts= Total Payment +BOP
    = 500 + (-100)
    = 500-100=400 Ans Rs 400 crores
12. **Balance of payments always balances. Discuss it.**
    Ans. Balance of payments is always balanced. A negative balance on the current account is equated with positive balance in the capital account. The monetary authorities may finance a deficit by depleting their reserves of foreign currencies or by borrowing from the IMF etc. Hence BOP is always in balance.