UNIT – V

BOP, forex and the open economy

BOP · Exchange rate · Disequilibrium · Policy mix

Explanatory Lecture Slides

Money, Banking & International Trade · Major-2 · Semester II

MONEY, BANKING & INTERNATIONAL TRADE

LEARNING OBJECTIVES

Topics covered in this unit

01 **Define BOP and its accounts**

02 **Explain causes of disequilibrium**

03 **Contrast fixed and floating rates**

04 **Place India’s managed float**

05 **Name IMF’s role in one paragraph**

06 **Revise the paper in five headings**

How this unit is organised

01	02	03	04	05	06
BOP structure	Disequilibrium	Fixed v floating	Managed float	IMF (short)	Revision

Balance of payments structure

Double-entry: every credit has a debit. A ‘deficit’ means the official-settlement gap, not that the books do not balance.

- Current account + capital/financial account + errors and omissions + change in reserves.
- Trade balance is only goods; current account adds invisibles.
- PYQ: define BOP and causes of disequilibrium (2023).

Balance of payments structure

CREDIT

- Exports.
- Inward FDI.
- Remittances.

DEBIT

- Imports.
- Outward capital.
- Tourism abroad.

Disequilibrium — causes

Cyclical, structural (oil, technology), monetary (inflation differential), disorder (war, pandemic), capital flight.

- Correction: deflation, devaluation, direct controls, supply-side, waiting for a cycle.
- India 1991 is the teaching example — one paragraph.
- A lawyer meets this in FEMA compounding and in WTO safeguard/dumping law.

Disequilibrium — causes

INTERNAL

- Inflation.
- Fiscal deficit.
- Productivity gap.

EXTERNAL

- Oil shock.
- US rates.
- Protection abroad.

Exchange rates

Price of one currency in another. Fixed (gold / Bretton Woods / peg), floating, managed float (India).

- PYQ short note: foreign exchange rate; fixed exchange-rate system (2023, 2025).
- RBI intervenes in the forex market — managed float, not a pure clean float.
- FEMA replaced FERA: from prohibition to management.

Exchange rates

FIXED

- Stability for trade.
- Needs reserves.
- Imports others’ monetary policy.

FLOATING

- Automatic adjustment.
- Volatility.
- Speculation.

IMF — only what this paper needs

Fund that watches BOP, lends conditionally, sets a language of surveillance.

- Do not write the entire Bretton Woods history.
- SDRs, quotas, conditionality — three words.
- WTO is trade rules; IMF is macro-BOP; they meet in a crisis.

IMF — only what this paper needs

IMF	NOT IMF
• BOP support. • Surveillance.	• WTO DSB. • World Bank projects — different sister.

Policy mix for an open economy

Mundell: you cannot have a fixed rate, free capital, and an independent monetary policy at once (trilemma).

- India chooses: managed rate + some capital controls + some monetary independence.
- FEMA is the legal form of ‘some capital controls’.
- A glittering 16-mark closer if the question is on BOP policy.

Policy mix for an open economy

TRILEMMA

- Fix.
- Free capital.
- Independent M-policy.

INDIA’S PICK

- Two and a half — not all three.

Five-unit recap of the paper

Money and inflation; banks and money market; RBI; trade theory and WTO; BOP and forex.

- Carry Fisher, credit multiplier, repo, Ricardo, WTO pillars, current account.
- Statutes: RBI Act, BR Act, FEMA, Customs, WTO-implementing Indian law.
- Cases: Foley v Hill, Peerless, IMA v RBI, Novartis (TRIPS).

Five-unit recap of the paper

DEFINITIONS TO DRILL

- Money.
- Inflation.
- Credit creation.
- TOT.
- BOP.

THEORIES TO CRITICISE

- Fisher.
- Ricardo.
- H–O.

IMF — only what this paper needs

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LANDMARK AUTHORITIES

Cases a KSLU answer should name

CASE

Internet and Mobile Assn v RBI

(2020) 10 SCC 438

Proportionality of a central-bank ban on a forex-like activity.

CASE

Renusagar Power v General Electric

1994 Supp (1) SCC 644

Foreign-exchange public policy in awards — open-economy private law.

CASE

GVK Industries v ITO

(2011) 4 SCC 36

Extra-territorial tax and the open economy — one line if you reach it.

STATUTE / SECTION MAP

Provisions & materials to quote

FEMA 1999	Management of forex; current account convertibility in principle.
RBI Act	Reserves and intervention.
Customs Act	The tariff half of BOP goods.
PMLA	Capital-account cleanliness.
UN Charter / IMF Artic	The public-international cousin of this paper.

WRITE IT IN THE HALL

10 / 16-mark frames from this unit

Q1 Define balance of payments. Examine the causes of disequilibrium.

Q2 Fixed v floating exchange-rate systems. What does India practise?

Q3 Write a note on the foreign exchange rate.

Q4 How are monetary policy and BOP connected in an open economy?

BEFORE YOU CLOSE THE FILE

Unit recap

1. BOP books always balance; ‘deficit’ is a residual of official settlement.
2. India: managed float + FEMA.
3. Trilemma: you cannot have all three.
4. WTO ≠ IMF.
5. Revise this paper as money → banks → RBI → trade → BOP.