

3. are ready to shift
their production
facilities



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3. These days, if there are opportunities for earning additional profit income, foreign suppliers are ready to shift their production facilities to other countries. Quotas, being quantitative restrictions on imports, provide an economic incentive to potential foreign investors by assuring them a sheltered domestic market.

4. The effect of quotas on balance of payments is sometimes analysed in terms of their impact on saving, imports, consumption, and investment of a country. This is termed the absorption approach. Confining ourselves to the balance of trade component of BOP, this approach states that a country can improve its BOT by reducing its absorption which means more savings (thus releasing domestic output for exports) and reduced imports. Quotas help in reducing absorption by directly reducing imports. They may also lead to reduced absorption through additional savings.

This would happen if, because of quotas, income inequalities increase and the profit earners, because of their higher propensity to save, save more. However, it is not certain that quotas will definitely reduce absorption. If, for example, the domestic consumers divert their expenditure to exportable items, net absorption may actually increase. Thus, we can conclude that the use of quotas has a high probability of improving balance of payments position of a country. However, this outcome is not certain, and additional measures like export promotion, export subsidies, devaluation of the home currency or even recession in the home economy may be needed for improving the balance of payments position.

It should be noted that all this is in the nature of partial static analysis and suffers from several limitations. For example, it leaves out some important components of balance of payments like capital transactions. Comment: It can be argued that when factors causing BOP deficit are temporary, quantitative restrictions are preferable to devaluation because the latter leads to deeper rooted changes in the economy. Impact of quantitative restrictions may be diluted by a reduction in inventories and current consumption.

In contrast, when deficit is due to long term fundamental causes, relative desirability of quantitative restrictions and devaluation is more controversial. We may, however, add that it is difficult for the business community to judge with certainty the durability of the causes of BOP difficulties and base their long term investment decisions on it. As regards devaluation, it can be far more damaging for other countries if the devalued currency (such as the US dollar) is being widely used as a reserve currency. In practice, therefore, measures for overcoming balance of payments difficulties should be chosen on an objective basis and without any prior commitment.