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* Policies to correct the imbalances in the current account of balance of payments *

* **Current account Deficit (Higher AD) - Fiscal Policy**

→ To correct a current account deficit we can use contractionary fiscal policy. Government spending decreases and taxes increases leading to lower disposable income which leads to fall in the imports and even the domestic consumption, which leads to fall in the aggregate demand. Lower AD creates a surplus of goods in the economy, which forces firms to sell the surplus ~~to~~ foreign countries leading to increasing in exports, and overall leads to fall in imports, increase in exports, and a positive (X-M), which helps to reduce the current account deficit and leads to increase in aggregate demand.

* **Current account surplus (Lower AD) - Fiscal Policy**

→ To correct a current account surplus we can use expansionary fiscal policy as the AD is low. Government spending increases and tax rates decreases leads to higher ~~income~~ disposable income which leads to increase in ~~AD~~ imports due to higher income and increase in domestic ~~deman~~ consumption leading to rise in AD. Higher AD will lead to a fall in surplus of domestic goods and hence domestic firms will have to supply more domestically, hence exports fall. Exports fall, imports rise, leads to a negative (X-M), helping to reduce the current account surplus and fall in AD.

currency appreciation)

→ Current Account Deficit- Expansionary monetary

• Use of expansionary monetary policy leads to decrease in rate of interest, leads to fall in investment and fall in hot money flows, causing a decrease in demand for country's currency, leading to currency depreciation making exports cheaper and imports expensive, causing a current account surplus. (However C and I increase causing inflation).

→ Current Account surplus- Contractionary policy

• Use of contractionary monetary policy leads to increase in rate of interest, leads to rise in investment and rise in hot money flows, causing a rise in demand for ~~currency's~~ country's currency, leading to currency appreciation making exports expensive and imports cheaper, causing a current account deficit. (However C and I decreases, may lead to recession).

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* supply side- policies

1) privatisation - leads to firms being more efficient, leading to increase in supply of products, a rise in exports helping to correct current account deficit.

2) Any kind of supply-side policy will help to correct current account deficit as it leads to increase in the supply, which leads to increase in exports and decrease in current account deficit.

* Trade protectionism!

→ These can be used to correct current account deficit by decreasing imports. For eg:- increase in tariffs, quotas, embargoes, leading to fall in imports and help to correct current account deficit.