ECOHOLICS

# Absorption Approach to BOP

## What is it?

**Proposed by Sydney Alexander and is based on the Keynesian national income relationships.**
**It focuses on the relationship between domestic saving and investment in a country and its impact on the current account balance**

## Explained:

- **If a country has a deficit in its balance of payments, it means that people are 'absorbing' more than they produce. Domestic expenditure on consumption and investment is greater than national income.**
- **If they have a surplus in the balance of payments, they are absorbing less. Expenditure on consumption and investment is less than national income.**

## Understand like this:

**Y = C + Id + G + X–M**

**Now,**

C+Id+G= Total Absorption '**A**'

X–M= BOP '**B**'

Equation= Y = A + B

or B = Y–A

Y=National Income
C=consumption Exp
G=Autonomous Govt Spending
Id= Total domestic investment
X=Exports
M=Imports

- BOP can be increased by either increasing domestic income or reducing the absorption.

Devaluation acts both ways:

- **Increases exports and reduces imports, thereby increasing the national income.**