

Two options to reduce a balance of payments deficit¹

Option 1

Expenditure switching policies

These are attempts to make imports relatively expensive compared to exports, e.g.

- a) import controls such as tariffs
- b) bringing about a reduction in the exchange rate such as a devaluation such as the Swiss Government did between 2011-2015 fixing the exchange rate with the Euro whereby 1 Euro = 1.2 CHF thereby boosting exports and reducing imports. The market rate of exchange > 1.2 CHF

Option 2

Expenditure reducing policies

The Government attempts to reduce spending throughout the economy, i.e. deflate the economy. This is likely to reduce the amount spent on imports (although at the same time the amount spent on UK goods and services will also fall). To reduce spending, the Government could increase taxation rates, cut its own spending or increase interest rates.

Policy packages

It may be necessary to use a combination of policies, e.g. a depreciation will result in consumers switching from imports to exports. However, if domestic industry is at or near full capacity, it cannot produce enough and the result is inflation. Therefore, the Government might deflate the economy (expenditure reducing) to provide capacity for a depreciation (expenditure switching). Expenditure reducing and expenditure switching policies are complementary, not substitutes in terms of policy action.

Note carefully that a depreciation and appreciation are used in describing flexible exchange rates and devaluation and revaluation are used in describing fixed exchange rates.

¹ Consider the opposite for balance of payments surplus