

Balance of Payments



Definitions

- **Balance of trade:** A country's exports minus its imports
 - the largest component of a country's balance of payments.
 - Includes GOODS AND SERVICES
- **Balance of Payments:** record of *all* transactions made between one particular country and all other countries during a specified period of time.
 - Includes the balance of trade

Definitions (cont'd)

- **Current Account:** The difference between a nation's total exports of goods, services and *transfers*, and its total imports of them
 - Transfers refer to investments (intangible goods) and unilateral payments in other countries

- **Capital/Financial Account:** The net result of public and private international investments flowing in and out of a country

Balance of Payments

- BoP is done with “double entry” accounting
 - Whenever there is a credit, there is a debit somewhere else
 - **Exports are CREDITS, Imports are DEBITS!!!!**

- Current account + Financial Account = 0

Example

- Suppose the US resident exchanges \$1000 for ¥112,000 on the foreign exchange market
The transaction can be recorded by noting the following:

Step 1	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	0	0
Financial Account	+ \$1,000 (\$ currency)	- \$1,000 (¥ currency)

Next, the US resident uses his ¥112,000 to purchase a camera from a store in Japan and then brings it back to the US. **This is recorded as a credit entry on the financial account** and labeled '¥ currency' in the Table below. The item being imported into the US, is a camera. Since a camera is a merchandise good and is valued at ¥112,000 = \$1000, **the import is recorded as a debit entry on the current account in the Table below.**

Step 2	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	0	- \$1000 (camera)
Financial Account	+ \$1,000 (¥ currency)	0

Next, the Japanese resident uses his \$1000 to purchase a computer from a store in the US and then brings it back to Japan. **The computer, valued at \$1000, is being exported out of the US and is a merchandise good. Therefore, a credit entry of \$1,000 is made in the following Table on the current account and labeled 'computer.'** The other side of the transaction is the \$1,000 of US currency being given to the US store owner by the Japanese resident. Since the currency, worth \$1,000, is being imported and is an asset, a \$1000 debit entry is made in the Table on the financial account and labeled '\$ currency.'

Step 3a	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	+ \$1,000 (computer)	0
Financial Account	0	- \$1,000 (\$ currency)

Summary of Transactions

Summary 1,2,3a	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	+ \$1,000 (computer)	- \$1000 (camera)
Financial Account	+ \$1,000 (\$ currency) + \$1,000 (¥ currency)	- \$1,000 (\$ currency) - \$1,000 (¥ currency)

Summary of Transactions (canceling balances)

Summary 1,2,3a	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	+ \$1,000 (computer)	- \$1000 (camera)
Financial Account	+ \$1,000 — (\$ currency) — + \$1,000 — (¥ currency) —	- \$1,000 — (\$ currency) — - \$1,000 — (¥ currency) —

What if the Japanese Person purchased a Savings Bond instead?

Step 3b	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	0	0
Financial Account	+ \$1,000 (US savings bond)	- \$1,000 (\$ currency)

What if the Japanese Person purchased a Savings Bond instead?

Summary 1,2,3b	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	0	- \$1000 (camera)
Financial Account	+ \$1,000 (\$ currency) + \$1,000 (¥ currency) + \$1,000 (US savings bond)	- \$1,000 (\$ currency) - \$1,000 (¥ currency)

What if the Japanese Person purchased a Savings Bond instead?

Summary 1,2,3b	US Balance of Payments (\$)	
	Credits (+)	Debits (-)
Current Account	0	- \$1000 (camera)
Financial Account	+ \$1,000 (US savings bond)	

Important points

- **Exports are CREDITS, Imports are DEBITS!**
- **Double entry accounting**
- **Goods and services are current, purely financial transactions are capital/financial**