

BALANCE OF PAYMENTS

3.3.1: Meaning of the balance of Payments

Balance of Payments (BoP): the statistical statement that summarises, for a specific time period, the economic transactions of an economy with the rest of the world

Includes

- Current Account trade+flow of income between nations
- Capital Account transfer of ownership of capital goods
- Financial Account flow of funds for Investments in real or financial assets

3.3.2: Components of the Balance of Payments

Understanding how the BoP is measured:

- *Credit*: transaction brings money in → someone in the country gets paid
- *Debit*: transaction makes money leave → foreign person is getting paid

The Current Account: the flow of goods, the flow of services, the flow of income and the flow of transfers

→ Deficits occur when a country spends more on imports than it earns from exports

- ➔ Balance of Trade - Goods → spending by consumers on goods
 - + Good Credits: payments made to the exporting nation increases current account of the exporting nation
 - Good Debits: spending of domestic currency on imports takes away money from current account
- ➔ Balance of Trade - Service → non tangible products such as tourism, banking or legal services
 - + Service credits: Foreigners (Abroad and in that nation such as tourists) buy services
 - Service debits: Service purchased by domestic households from foreigners
- ➔ Income Balance → citizens of one country earn income in another country
 - + Credits: wages sent home, interest on saving abroad (US is Sweden → credit for US)
 - Debits: wages paid by firms to workers abroad, or foreign shareholders of stocks
- ➔ Current Transfer Balance → payments made from one nation to another in the form of a gift
 - + Credits: money coming in requires domestic citizens to be paid
 - Debits: Money going out requires domestic citizens to pay in the form of taxes

The Capital Account: the transactions involving ownership of capital, forgiveness of debt or the acquisition of non-produced, non-financial assets between a nation and other nations

- ➔ Capital Transfers:
 - + Credits: Canada pays Tanzania for school development → Credits for Tanzania
 - Debits: Canada will have a debit
- ➔ Debt Forgiveness
 - + Credits: Greece is relieved of Debts → Credits for Greece
 - Debits: All other EU countries that payed experience a debit
- ➔ Exchange of non-produced, non-financial assets
 - ◆ Land, patents, copyrights, trademarks, franchises, and licenses

The Financial Account

- Exchanges between a nation and the rest of the world that involve ownership of financial or real assets, such as real estate, factories or office buildings
 - transfer of ownership without consumption
- Also includes buying of stocks and government bonds

Direct Investment: the buying and selling of at least 10% of a companies shares by a foreign investor in a domestic firm or vice versa