



Balance of Payments

Chapter Three

Chapter Outline

- Balance of Payments Accounting
- Balance of Payments Accounts
 - The Current Account
 - The Capital Account
 - Statistical Discrepancy
 - Official Reserves Account
- The Balance of Payments Identity
- Balance of Payments Trends in Major Countries

Balance of Payments Accounting

- The balance of payments is the statistical record of a country's international transactions over a certain period of time presented in the form of double-entry bookkeeping.

Note: When we say “a country's balance of payments” we are referring to the transactions of its citizens and government.

Balance of Payments Example

- Suppose that Maplewood Bicycle in Maplewood, Missouri, USA imports \$100,000 worth of bicycle frames from Mercian Bicycles in Darby, England.
- There will exist a \$100,000 credit recorded by Mercian that offsets a \$100,000 debit at Maplewood's bank account.
- This will lead to a rise in the supply of dollars and the demand for British pounds.

Balance of Payments Accounts

- The balance of payments accounts are those that record all transactions between the residents of a country and residents of all foreign nations.
- They are composed of the following:
 - The Current Account
 - The Capital Account
 - The Official Reserves Account
 - Statistical Discrepancy

The Current Account

- Includes all imports and exports of goods and services.
- Includes unilateral transfers of foreign aid.
- If the debits exceed the credits, then a country is running a *trade deficit*.
- If the credits exceed the debits, then a country is running a *trade surplus*.

The Capital Account

- The capital account measures the difference between U.S. sales of assets to foreigners and U.S. purchases of foreign assets.
- In 2009, the U.S. enjoyed a \$281.1 billion capital account surplus—absent of U.S. borrowing from foreigners, this “finances” our trade deficit.
- The capital account is composed of Foreign Direct Investment (FDI), portfolio investments, and other investments.

Statistical Discrepancy

- There are going to be some omissions and misrecorded transactions—so we use a “plug” figure to get things to balance.
- Exhibit 3.1 shows a discrepancy of \$79.40 billion in 2011.

		Credits	Debits
Current Account			
1	Exports	\$2,843.7	
2	Imports		(\$3,182.8)
3	Unilateral Transfers	\$19.5	(\$154.0)
	Balance on Current Account		(\$473.6)
Capital Account			
4	Direct Investment	\$227.9	(\$406.2)
5	Portfolio Investment	\$166.9	(\$14.7)
6	Other Investments	\$395.8	\$40.4
	Balance on Capital Account	\$410.1	
7	Statistical Discrepancies	\$79.4	
	Overall Balance	\$15.9	
Official Reserve Account			(\$15.9)

The Official Reserves Account

- Official reserves assets include gold, foreign currencies, SDRs, and reserve positions in the IMF.
- The Special Drawing Right (**SDR**) is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member **countries**.

The Balance of Payments Identity

$$BCA + BKA + BRA = 0$$

where

BCA = balance on current account

BKA = balance on capital account

BRA = balance on the reserves account

Under a pure flexible exchange rate regime,

$$BCA + BKA = 0$$

U.S. Balance of Payments Data 2011

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In 2011, the U.S. imported more than it exported, thus running a current account deficit of \$473.6 billion.

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During the same year, the U.S. attracted net investment of \$410.1 billion—clearly the rest of the world found the U.S. to be a good place to invest.

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Under a pure flexible exchange rate regime, these numbers would balance each other out.

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In the real world, there is a statistical discrepancy.

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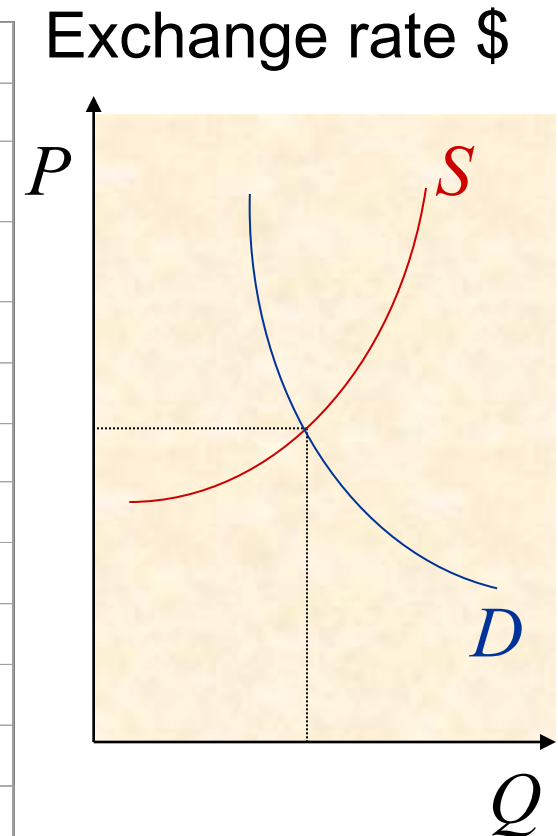
Including that, the balance of payments identity should hold:

$$\text{BCA} + \text{BKA} + \text{BRA} = 0$$

$(\$473.6) + \$410.1 - \$15.9 = (79.4)$ In other words that is how discrepancy is identified. Undeclarable differences.

Balance of Payments and the Exchange Rate

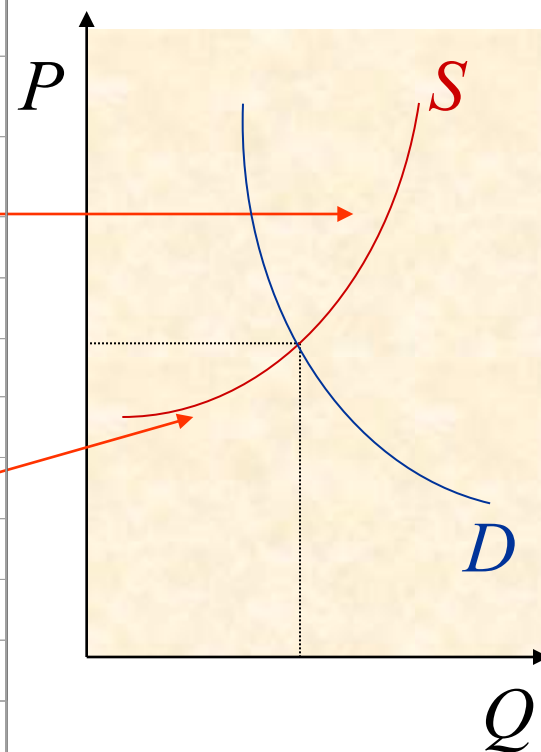
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Exchange rate \$

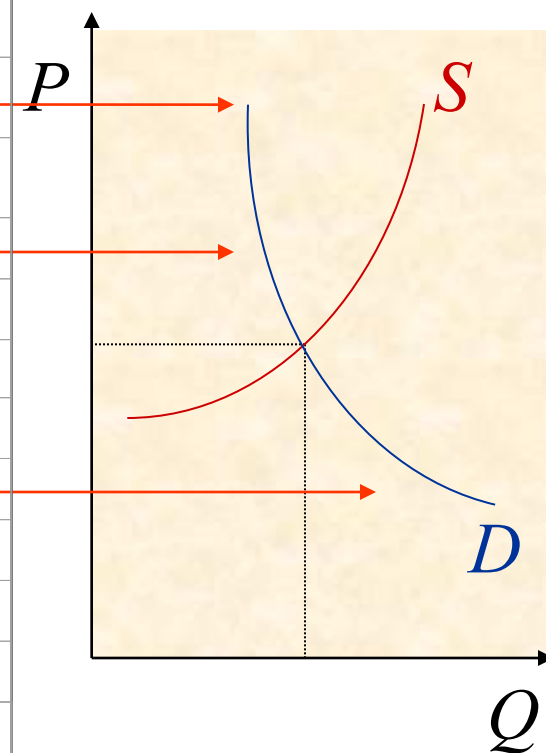


As U.S. citizens import, they supply dollars to the FOREX market.

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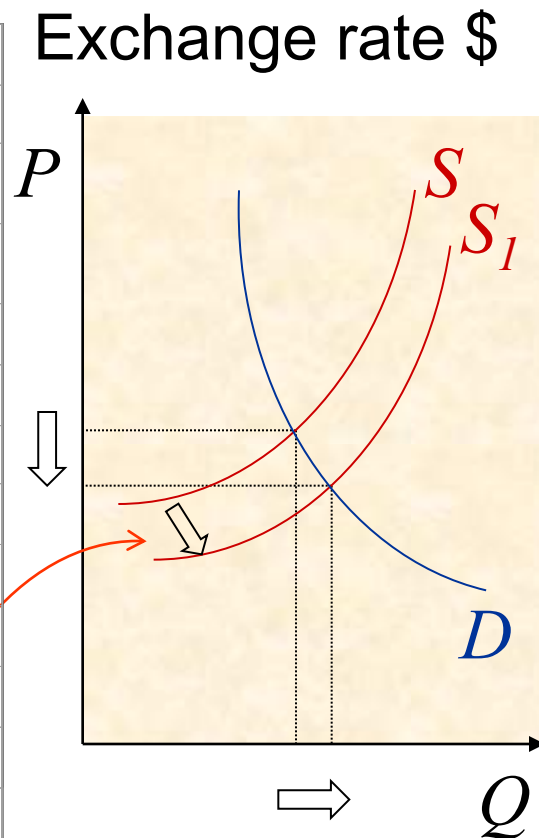
Exchange rate \$



As U.S. citizens export, others demand dollars at the FOREX market.

Balance of Payments and the Exchange Rate

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As the U.S. government sells dollars, the supply of dollars increases.