APPENDIX 9A: Balance of Payment Accounts

balance of payment accounts

Summary of all transactions between citizens of two countries.

Transactions between citizens of one country (e.g., the United States) with other countries are summarized in the **balance of payment accounts** of that country. The balance of payments of a country consists of payments made, over a stated period of time, between the residents of that country and the residents of foreign countries. It is an itemized account of transactions involving receipts from foreigners on one side and payments to foreigners on the other. Thus, the balance of payments shows, for some stated period of time, the flow of that nation's revenues from the rest of the world and its payments to the rest of the world. Since the revenues from foreigners relate to the international income of a country, they are termed credits, while payments to foreigners relate to international outflows and are termed debits. Balance of payment accounts use double-entry accounting methods such that debit entries must be matched with offsetting credit entries—the balance of payments must always balance. Table 9–6 shows the U.S. balance of payment accounts for the 12-month period from July 2006 through June 2007. Debits are designated as negative account balances; credits are designated as positive account balances. The balance of payments is divided into two accounts: (1) a current account and (2) a capital account. As will be explained below, the sum of these two accounts must always be zero—a current account surplus (deficit) must be exactly offset by a capital account deficit (surplus). We first describe these two accounts, and then we explain why the two account balances must just offset each other.

TABLE 9–6 U.S. Balance of Payment Accounts, 2007 *(in millions of dollars)*

Current Accounts		
1. Exports of goods, services, and income		$2,228,610
2. Goods, adjusted, excluding military	$1,076,226	
3. Services	445,110	
4. Income receipts on U.S. assets abroad	707,274	
5. Imports of goods, services, and income		−2,927,769
6. Goods, adjusted, excluding military	−1,900,544	
7. Services	−352,294	
8. Income payments on foreign assets in the United States	−674,931	
9. Unilateral transfers, net		−94,001
10. Total current accounts		−$793,160
11. Balance on goods (lines 2 and 6)		−824,318
12. Balance on services (lines 3 and 7)		92,816
13. Balance on investment income (lines 4 and 8)		32,343
Capital Accounts		
14. U.S. assets abroad, net (increase/capital outflow (−))		−$1,417,850
15. U.S. official reserve assets, net	$ 2,375	
16. U.S. government assets, other than official reserve assets, net	2,484	
17. U.S. private assets, net	−1,422,709	
18. Foreign assets in the United States, net (increase/capital inflow (+))		2,203,023
19. Foreign official assets in the United States, net	416,437	
20. Other foreign assets in the United States, net	1,786,586	
21. Financial derivatives, net		25,599
22. Statistical discrepancy (sum of above items with sign reversed)		−17,612
23. Total capital accounts		$793,160
24. Sum of current and capital accounts		$ 0

Source: U.S. Department of Commerce Bureau of Economic Analysis, October 2007. **www.bea.gov**

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Current Account

current account

The section of the balance of payment table that summarizes foreign trade in goods and services, net investment income, and gifts, grants, or aid given to other countries.

The **current account** in the balance of payments table summarizes a nation's foreign trade in goods and services, net investment income, and gifts, grants, or aid given to other countries. Lines 1–13 in Table 9–6 show the current account for the United States. Notice from lines 2 plus 6 that the United States has a substantial trade deficit in goods, resulting from the import of more foreign goods relative to the export of domestic goods, equal to $824.318 billion in 2007. This deficit has increased in the 1990s. For example, the deficit in the trade of foreign goods was just $19.350 billion in 1991. This is mainly due to the relatively high economic growth rate in the United States compared to the Japanese and European growth rates. As an economy grows relative to other countries, the demand for imports increases relative to the amount exported. In particular, goods that might have been exported get "consumed" at home.

In contrast, from lines 3 plus 7 in Table 9–6, the United States ran a surplus in the services component of the balance of payments current account, $92.816 billion in 2007 versus $13.830 billion in 1991. The U.S. service sector (e.g., financial services, transportation fares, defense expenditures) generally generates a substantial positive balance. Thus, these services have a positive impact on the overall U.S. balance of payment account.

Net investment income, lines 4 plus 8 in Table 9–6, of U.S. citizens contributed $32.343 billion in 2007, to the balance of payments. Prior to the 1990s, net investment income was generally positive.

Unilateral transfers are gifts and foreign aid that require no repayment and were –$94.001 billion in 2007. Because of its relatively large participation in overseas aid programs, the U.S. generally runs a negative balance for unilateral transfers. Thus, overall the U.S. current account had a deficit balance of –$793,160 billion.

CAPITAL ACCOUNTS

capital accounts

The section of the balance of payment table that summarizes capital flows into and out of a country.

Capital accounts measure investment capital (principal) flows into and out of a country. A positive balance in these accounts indicates that foreign investors purchased more U.S. assets than U.S. investors purchased foreign assets, creating a capital inflow into the United States. A negative balance in these accounts indicates that U.S. investors purchased more foreign assets than foreign investors purchased U.S. assets, creating a capital outflow on capital accounts. U.S. asset purchases abroad (e.g., a U.S. investor's purchase of foreign stock) include: (1) private asset purchases ($1,422.709 billion in 2007, line 17 in Table 9–6), and (2) government asset purchases, e.g., SDRs (Special Drawing Rights[14]) or foreign currencies (reserve currencies discussed in Chapter 4) ($4,859 billion in 2007, lines 15 plus 16 in Table 9–6). Foreign purchases of assets in the United States (e.g., Japanese investors buying U.S. Treasury securities) include foreign government assets in the United States, $416.437 billion in 2007 (line 19 in Table 9–6), and other foreign assets in the United States, $1,786.586 billion in 2007 (line 20 in Table 9–6). The high level of economic growth in the United States in the 1990s plus the role of the dollar as the principal "international currency" has resulted in the United States being an attractive place for foreigners to invest. Other foreign assets in the United States were only $41.910 billion in 1991. Finally, financial derivatives totaled $25.599 billion in 2007 (line 21).

As can be seen in Table 9–6, the capital account surplus is $793,160 billion, which exactly offsets the current account deficit (–$793,160 billion). Thus, overall the balance of payments balances (i.e., line 24 in Table 9–6) must equal $0. An intuitive reason or way to understand why this occurs is to think of the analogy between a country and a single consumer. When an individual spends more on goods and services than he or she earns (runs a current account deficit), he or she must either borrow to finance that deficit or sell some of his or her financial assets. What is true for an individual is also true for a country. In

[14]SDRs are used to transfer currencies to central banks through the International Monetary Fund in exchange for domestic currency.

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particular, excessive net consumption by a country on foreign goods and services (such that its imports exceed exports) has to be financed by borrowing from investors abroad or selling off that country's assets (e.g., sale of domestic equities and real estate to foreigners such as the Japanese). In other words, sufficient net capital inflows into a country are needed to finance the gap that a country is running due to excessive consumption of foreign goods and services.

Thus, a nation is considered to have a surplus on its current account during a stated period if its net revenues (from exports) on current account transactions are greater than its net payments (for imports). This will be reflected in an increase in its capital account balances. A nation is said to have a deficit on its current account when its net payments (for imports) on its current account are greater than its revenues (from exports). This will be reflected in a decrease in its capital account balances. In the United States, we have run persistent current account deficits in the 1990s and early 2000s (imported more than we have exported) financed by both borrowing from abroad and selling domestic assets to foreigners (i.e., running a capital account surplus reflected by net capital inflows).

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