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 9–7 shows the U.S. balance of payment accounts for 2012. 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 9–7 U.S. Balance of Payment Accounts, 2012 *(in millions of dollars)*

Current Accounts		
1. Exports of goods, services, and income		$2,986,949
2. Goods	$1,561,239	
3. Services	649,346	
4. Income receipts on U.S. assets abroad	776,364	
5. Imports of goods, services, and income		−3,297,677
6. Goods	−2,302,714	
7. Services	−442,526	
8. Income payments on foreign assets in the United States	−552,437	
9. Unilateral transfers, net		−129,688
10. Total current accounts		−440,416
11. Balance on goods (lines 2 and 6)		−741,475
12. Balance on services (lines 3 and 7)		206,820
13. Balance on investment income (lines 4 and 8)		223,927
Capital Accounts		
14. U.S. assets abroad, net (increase/capital outflow [−])		−$97,469
15. U.S. official reserve assets, net	−$4,460	
16. U.S. government assets, other than official reserve assets, net	85,331	
17. U.S. private assets, net	−178,340	
18. Foreign assets in the United States, net (increase/capital inflow [+])		543,884
19. Foreign official assets in the United States, net	393,922	
20. Other foreign assets in the United States, net	149,962	
21. Financial derivatives, net		−7,064
22. Statistical discrepancy (sum of above items with sign reversed)		1,065
23. Total capital accounts		$440,416
24. Sum of current and capital accounts		$ 0

Source: U.S. Department of Commerce Bureau of Economic Analysis, August 2013. **www.bea.gov**

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 9–7 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 $741.475 billion in 2012. This deficit increased in the 1990s and 2000s. 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, Chinese, 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 9–7, the United States ran a surplus in the services component of the balance of payments current account, $206.820, billion in 2012 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.

In terms of net investment income, lines 4 plus 8 in Table 9–7, U.S. citizens contributed $223.927 billion to the balance of payments in 2012. Prior to the 1990s, net investment income was generally positive.

Unilateral transfers are gifts and foreign aid that require no repayment and were −$129.688 billion in 2012. 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 −$440.416 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 ($178.340 billion in 2012, line 17 in Table 9–7), and (2) government asset purchases, e.g., SDRs (Special Drawing Rights[12]) or foreign currencies (reserve currencies are discussed in Chapter 4) ($80.871 billion in 2012, lines 15 plus 16 in Table 9–7). 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, $393.922 billion in 2012 (line 19 in Table 9–7), and other foreign assets in the United States, $149.962 billion in 2012 (line 20 in Table 9–7). The role of the dollar as the principal "international currency" and recognition of U.S. Treasury securities as "safe haven" securities during the recent financial crisis and the worldwide economic downturn have resulted in the United States being an attractive place for foreigners to invest. Finally, financial derivatives totaled –$7.064 billion in 2012 (line 21).

As can be seen in Table 9–7, the capital account surplus is $440.416 billion, which exactly offsets the current account deficit (−$440.416 billion). Thus, overall the balance of payments balances (i.e., line 24 in Table 9–7) 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 accounts 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.

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

In particular, excessive net consumption by a country of foreign goods and services (such that its imports exceed its 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 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).