2.1.4 Balance of Payments

- The balance of payments is a record of international payments over the course of a year
- The balance of payments is the difference between all money flowing into the country in a particular period of time and the outflow of money to the rest of the worlds
- The balance of payments is made up of the Current account and the Capital and Financial account

Current Account

- This is made up of the balance of trade, primary balance and secondary balance
- The current accuont measures the inflow and outflow of goods and services into a

country (this includes earnings on investments)

- The balance of trade is the value of goods and services exported minus the value of goods and services imported (X-M)
- The primary income (investment income) is the value of earnings of foreign investments (profit, interest, dividends) minus payments made to foreigners
- The secondary income (current transfers) is the payments recieved from foreign institutions minus payments paid abroad (e.g. taxes, social security, foreign aid). It is the provision of economic value without directly recieving a counterpart item of economic value, "something for nothing"

Capital and Financial Accounts

- These are covered in Theme 4 notes

Current Account Deficit/Surplus

- A current account surplus occurs when a current account is positive (more money is flowing into the country than is flowing out)
- A current account deficit is the opposite of a surplus

Causes of a Current Account Deficit

- Currency is too strong
    - UK exports become too expensive
    - Foreign goods become cheap
    - Decrease in X
    - Increase in M
- High rate of inflation relative to other countries

    - UK goods become expensive
    - (Repeat of above)
- High wage costs relative to other countries
    - Goods have higher costs
    - Leading to higher prices in order to retain profit
    - (Repeat of above)
- High rate of economic growth can lead to higher domestic incomes leading to people importing foreign goods
    - Increase in M relative to X

Causes of a current Account Surplus

- The opposite of the above points

Relationship between Current Account Imbalance and other Macro Objectives

- A persistent current account deficit may imply global uncompetitiveness, which could lead to unemployment
- The above points may lead to a fall in economic frowth or perhaps decline
    - This may not be true if deficit was caused by an economic boom and high incomes (leading to a SR increase in imports)
- It could lead to a fall in the exchange rate of UK currency
    - This leads to imports becoming more expensive, which could be inflationary

The Interconnectedness of Economies through international trade

- Global trade causes interdependency between countries as the result of reliance on global supply chains

(worldwide networks of suppliers, manufacturers, warehouses, distribution centres and retailers)

- Global supply chains cover the process of raw material to finished consumer goods and cross many countries
- There are benefits of lower prices and cooperation
- Global trade can lead to the formation of trade blocs that can be extremely powerful and reduce the ability for developing nations to trade fairly