Balance of Payments Accounts

A country's *balance of payments* accounts are a summary of all of the country's transactions with other countries. There are two important accounts within the balance of payments: the *current account* and the *financial account* (formerly known as the *capital account*). The current account records a nation's exports and imports of goods and services, and also includes net investment income and net transfers. The financial account records the difference between a country's sale of assets to foreigners and its purchase of assets from foreigners. The balance of payments is essential for making sense of a nation's position in the global economy.

The current account records a nation's exports and imports of goods and services. It also includes net investment income (U.S. earnings on investment abroad *minus* foreign earnings from capital invested in the United States) and net transfers (e.g., foreign aid sent to other countries and funds that immigrants send to family abroad).

The financial account records the flows of money from the purchase and sale of assets domestically and abroad. For example, U.S. investors might buy a hotel building in Tokyo or shares of stock in a Swedish company while foreign investors might buy a factory in the United States or stock in a U.S. company. Foreign assets are bought and sold using currencies purchased on foreign exchange markets. The financial flows recorded in the financial account are part of the loanable funds market. Foreign investors provide funds that are used to purchase assets, which means they supply loanable funds. Changes in the supply of loanable funds affect the equilibrium real interest rate in the loanable funds market, which then affects a country's investment, aggregate demand, output, employment, and price level.

When classifying a transaction, consider whether a country uses (loses) or earns (gains) foreign currency. If the international transaction *uses* foreign currency to complete the transaction, it is a *debit* (*negative*). If it *earns* foreign currency, it is a *credit* (*positive*).

1. Evaluate each of the transactions on the U.S. balance of payments and complete Table 7-2.1. Check either debit or credit, and current account or financial account.

Table 7-1.1
Transactions on the U.S. Balance of Payments

	Credit +	Debit −	Current account	Financial account
1. Harley-Davidson USA purchases $25 million in production machinery from a Japanese company.		✔	✔	
2. André Prenoor, U.S. entrepreneur, invests $50 million to develop a theme park in Malaysia.				
3. A Chinese company sells $1 million worth of berets to the U.S. Army.				
4. BMW pays $1 million to a U.S. shipper for transporting cars from Germany to the United States.				
5. Each month, Ima Grent, who recently arrived in the United States, sends half her paycheck to her sister in Poland.				
6. Bank of America pays $5 million in interest to French depositors.				
7. Senor Ramos from Spain buys a shopping center in Florida.				
8. A Brazilian investor buys five $10,000 U.S. Treasury bonds.				
9. German tourists spend $3 million in the United States; U.S. tourists spend $5 million in Germany.				
10. Brit-Discz, a London record store, spends $10,000 on CDs by the Generic Gurls, a U.S. kiddy-pop group.				
11. Sam Boney, U.S. ice-rink magnate, buys stock in a Chilean ice-rink chain.				

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It is important to understand that *the current account balance and the financial account balance must sum to zero.* Consider the example of a country that imports more than it exports and runs a current account deficit. A surplus in the financial account must offset the current account deficit because the net imports must either be paid for or purchased on credit. That is, the foreign currency used to buy the net imports had to come from somewhere. A financial account surplus must exist to supply the needed foreign currency if there is a current account deficit. In other words, *a current account deficit must come from a financial account surplus and vice versa.*

Assume there are only two countries, country A and country B.

2. If Country A is running a current account surplus, what must be true of Country A's financial account? Explain.

3. Draw a graph of the loanable funds market in Country B and show how an increase in Country A's current account surplus affects the supply of loanable funds and the equilibrium interest rate. Make sure you label all axes and curves.