Balance of Payments (Economics CIE A Level) Cheat Sheet

by tarsrko via cheatography.com/146114/cs/31564/

An introduction to BOP

Definition
It records all economic transactions which take place internally and externally; it shows the inflows and outflows of money.
Inflows = CR
Outflows = DR
Components (mainly)
- Current Account
- Capital Account
- Financial Account

BOP is used to analyse trade performance of a country and allow for comparison between countries.

Structure of BOP

	CR $M	DR $M	BALANCES $M
Current Account			
Trade In Goods	500	700	(200)
Trade In Services	800	600	200
Primary Income	75	50	25
Secondary Income	10	25	(15)
Current Account Balance			**10**
Capital Account	80	75	**5**
Financial Account	60	100	**(40)**
Total			*(25)*
Official Financing			**24**
Net Errors & Omissions			**1**
			25

BOP should be zero.
Current, Capital and Financial should balance each other out.
Current + Capital + Financial + Balancing item = 0

Current Account Surplus

Financial Account

It records investments made overseas by the residents of a country (**domestic ownership of foreign assets**) and those carried out by foreigners in the country (**foreign ownership of domestic assets**)

Official Financing

It refers to the borrowing and reserves of a country. Governments borrow from financial institutions and existing reserves. The surplus arising from these is used for payment of external debts.

Net Errors and Omissions

It is simply a balancing item. The recording of transactions in a BOP is a very complex exercise and therefore, authorities need to cater for errors and omission that occur under this heading.

Current Account

It records the flow of goods and services in and out of a country.
Export = inflow = CR entry
Import = outflow = DR entry
The Current Account Balance is obtained from summation of Trade in Goods, Trade in Services, Primary income and Secondary income.

Current Account Components

Defn -
Causes -
Consequences

Capital Account

It records transactions pertaining to the **transfer of ownership, acquisition and disposal of assets**.
For example, if a government obtains a capital for construction of a college, it is recorded as an inflow of capital (CR)

The difference between inflows and outflows of capital is termed as the net capital flow

1. Trade In Goods
It includes *the import and export of tangible items*. The difference between the two is the Balance of Trade - either Balance of Trade deficit or surplus. Eg an Indian firm paying a Canadian firm for supplying raw materials will be recorded as a DR entry in India and CR entry in Canada.
2. Trade In Services
It includes *the export and import of intangible items* such as education, accountancy, health services. The difference between the two is the Balance of Invisible Trade. Eg a Canadian firm paying an Indian firm for accountancy services will be recorded as a DR entry in Canada and a CR entry in India.
3. Primary Income
It covers income earned by individuals and firms.
4. Secondary Income
Previously called Current Transfers,

Unlike the BOP (which should be equal to be 0), the Current Account balance is expected to theoretically run at a surplus or deficit.

When **value of inflows (CR entries) > value of outflows (DR entries)**, a Current Account **Surplus** is recorded.
When **value of outflows (DR entries) > value of inflows (CR entries)**, a Current Account **Deficit** is recorded.

Surplus - positive balance
Deficit - negative balance