Edexcel (A) Economics A-level

Theme 2: The UK Economy, Performance and Policies

2.1 Measures of Economic Performance

2.1.4 Balance of payments

Notes

Components of the balance of payments

This is a record of all financial transactions made between consumers, firms and the government from one country with other countries.

It states how much is spent on imports, and what the value of exports is.

Exports are goods and services sold to foreign countries, and are positive in the balance of payments. This is because they are an **inflow** of money.

Imports are goods and services bought from foreign countries, and they are negative on the balance of payments. They are an **outflow** of money.

The balance of payments is made up of:
- The current account
- The capital account
- The official financing account.

For the AS course, only the current account is focussed on.

- The **current account on the balance of payments** is the balance of trade in goods and services.

Current account deficits and surpluses

- A current account surplus means there is a net inflow of money into the circular flow of income. The UK has a surplus with services, but a deficit with goods.

- The UK has a current account deficit. This means the UK spends more on imports from foreign countries, than they earn from exports to foreign countries. If the deficit is large and runs for a long time, there could be financial difficulties with financing the deficit.

The relationship between current account imbalances and other macroeconomic objectives

- The UK government's macroeconomic objectives are to have:

  - Full employment
  - Low, stable inflation
  - A sustainable current account on the balance of payments
  - Sustainable economic growth

- By selling more exports to foreign countries, the UK will have a greater inflow of money into the circular flow of income. This will increase AD and improve the rate of economic growth.
- In the UK, during periods of economic decline or recessions, the current account deficit falls. This is because consumer spending falls.
- During periods of economic growth, when consumers have higher incomes and they can afford to consume more, there is a larger deficit on the current account.
- If imported raw materials are expensive, there could be cost-push inflation in the UK, since firms face higher production costs.

The interconnectedness of economies through international trade

- In theory, the sum of all countries' trade balances should be zero, since what one country exports will be imported by another country.

- If the UK's main export market, such as the EU, faces an economic downturn then demand for UK goods and services will fall, since consumers in the EU are less able to afford imports.

- International trade has meant countries have become interdependent. Therefore, the economic conditions in one country affect another country, since the quantity they export or import will change.