Edexcel Economics AS-level

Unit 2: Macroeconomic Performance and Policy

Topic 1: Measures of Macroeconomic Performance

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.

- When a country has a current account deficit, they are spending 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 causes of an imbalance in the current account

- **Appreciation of the currency**: A stronger currency means imports are cheaper and exports are relatively more expensive, which means the current account deficit would worsen.

- **Economic growth:** During periods of economic growth, consumers have high levels of spending. Consumers with a high marginal propensity to import are likely to spend more on imports. This leads to a worsening of the current account deficit. However, export-led growth, such as that of China and Germany, means a country can run a current account surplus and have high levels of economic growth.

- **More competitive:** If a country becomes more internationally competitive, such as with lower inflation or if there is economic growth in export markets, exports should increase. This could cause the current account deficit to improve, or increase the current account surplus.

- **Deindustrialisation:** In the UK, the manufacturing sector has been declining since the 1970s. The goods that the UK previously made domestically now have to be imported, which worsens the deficit.

- **Membership of trade union:** The UK has traditionally had negative current transfers, since fees are paid for membership of the EU.