

The Balance of Payments

Well, I don't give a [expletive deleted] about the lira.

—RICHARD M. NIXON

This chapter concerns balance-of-payments accounting procedures. The purpose is to make the basic statistics in the rest of this book understandable.

1. THE NATIONAL BUDGET IDENTITY

The budget identity (or *Wairas's Law*) is a basic economic concept applying to any individual or group of individuals, whether a person, a family, or a nation: the act of buying something is by definition an act of selling something of equal value in return.

Well, then, what is it that we as a nation are buying? First of all are all the *goods and services* that we are importing from the rest of the world; call the total of these M , and measure it in terms of our currency. Next come the assets that we are buying from the rest of the world: stocks, bonds, foreign real estate, foreign money, and so on. Call the total of all these C_B (for Capital assets Bought), and measure it in terms of our currency.

The next two items are a little more subtle. First, if foreigners have invested in our country by buying our stocks, bonds, and so forth, we must pay them the interest, dividends, and so forth that their investments have earned—that is, we are buying the services of their investments, and we must pay for those services. Denote by E_p the total, in domestic currency, of investment Earnings that we must Pay the rest of the world. So far we have considered payments that we must make to the

rest of the world for things we have received from it. But there are also payments made for their own sake. For example, some of us might send money or gifts to relatives still in the “old country.” Or perhaps pensions are owed to people who are now foreign residents. Or perhaps the government is paying for foreign economic aid or for foreign military aid or for foreign bribes. Denote the total of such obligations by U_p , for Unilateral Payments transferred abroad, and measure it, too, in terms of domestic currency.

Thus the total, in terms of domestic currency, of all our purchases abroad and transfers there is $M + C_B + E_p + U_p$.

How are we paying for all this? First of all, by the *goods and services* that we are exporting to the rest of the world; call the total of these X , and measure it in terms of our currency. Next come the *assets* that we are selling to the rest of the world: stocks, bonds, foreign real estate, foreign money, and so on. Call the total of all these C_S (for Capital assets Sold), and measure it in terms of our currency. Next, if we have invested abroad by buying foreign stocks, bonds, and so forth, we will receive from them the interest, dividends, and so forth that our investments have earned—that is, we are selling the services of our investments, and we must be paid for those services. Denote by E_R the total, in domestic currency, of investment Earnings that we are Receiving from the rest of the world. Finally, there are also unrequited payments received from the rest of the world. Denote the total of such payments by U_R , for Unilateral Receipts transferred from abroad, and measure it, too, in terms of domestic currency.

Thus the total, in terms of domestic currency, of all our sales abroad and transfers received from there is $X + C_S + E_R + U_R$. Thus the national budget identity—that total sales to the rest of the world plus transfers received from there must equal total purchases from the rest of the world plus transfers made there—can be written

$$X + C_S + E_R + U_R = M + E_p + U_p + C_B. \quad (12.1)$$

Subtracting the right-hand side from the left-hand side gives the following equivalent formulation:

$$T + E + U + C \quad (12.2)$$

where

$T = (X - M)$ balance-of-trade surplus

$E = (E_R - E_P)$ net investment earnings

$U = (U_R - U_P)$ net transfers from abroad

$C = (C_R - C_P)$ net sale of assets

Equation (12.2) displays the major categories of a nation's international payments and shows that they are not independent of each other: they must always sum to zero.

The *balance-of-payments accounts* attempt to fill in the national budget identity with actual numbers. More specifically, they record transactions in a specific time interval between national residents and the rest of the world. The time interval is usually a year; some countries, such as the United States, also report quarterly.

A country's *balance-of-payments accounts* are a record of transactions in a specific time interval between residents of that country and the rest of the world.