Summary

4.6 Balance of payments

Subject	Year	Start date	Duration
Economics	IB2	Week 4, January	1 week 2 hours

Course Part

4. The global economy

Description

4.6 – The balance of payments, you should be able to:

- Outline the role of the balance of payments.
- Distinguish between debit items and credit items in the balance of payments.
- Distinguish between a surplus and a deficit on an account.
- Explain the four components of the current account:
  - Balance of trade in goods
  - Balance of trade in services
  - Income
  - Transfers
- Distinguish between a current account deficit and a current account surplus.
- Explain the two components of the capital account, which are:
  - Capital transfers
  - Transactions in non-produced, non-financial assets
- Explain the four main components of the financial account:
  - Foreign direct investment (FDI)
  - Portfolio investment
  - Reserve assets
  - Official borrowing
- Calculate elements of the balance of payments from a set of data.
- Explain how the current account balance is equal to the sum of the capital account and financial account balances.
- Examine how the current account and the financial account are interdependent, including how credits are matched by debits and deficits are matched by surpluses.

(HL)

- Define the following terms: balance of payments, current account, capital account, financial account, credits, debits, deficits, surpluses, direct investment, portfolio investment, reserve assets, official borrowing, expenditure-switching policies, expenditure-reducing policies, Marshall–Lerner condition, J-curve.
- Explain why a deficit in the current account of the balance of payments may result in downward pressure on the exchange rate of the currency.
- Explain why a surplus in the current account of the balance of payments may result in upward pressure on the exchange rate of the currency.
- Explain, using a diagram, the relationship between the current account balance and the exchange rate.
- Discuss the implications of a persistent current account deficit on:
  - Exchange rates
  - Interest rates
  - Foreign ownership of domestic assets
  - Debt
  - Credit ratings
  - Demand management
  - Economic growth

- Explain the methods that a government can use to correct a persistent current account deficit, including:
  - Expenditure-switching policies
  - Expenditure-reducing policies
  - Supply-side policies
- Evaluate the effectiveness of the measures used to correct a persistent current account deficit.
- State the Marshall–Lerner condition.
- Apply the Marshall–Lerner condition to the effect of devaluation/depreciation on the current account.
- Explain the J-curve effect, with reference to the Marshall–Lerner condition.
- Discuss the possible implications of a persistent current account surplus, including:
  - Domestic consumption and investment
  - Exchange rates
  - Inflation
  - Employment
  - Export competitiveness

Inquiry & Purpose

Inquiry / Higher Order Questions

Type	Inquiry Questions
Skills-based	The patterns of current account deficits/current account surpluses for different countries.

Curriculum

Objectives

Synthesis and evaluation (AO3)

HL only: demonstrate economic synthesis and evaluation of the extension topics

HL only: select and use economic data using economic theory to make policy recommendations.

Use and application of appropriate skills (AO4)

Use quantitative techniques to identify, explain and analyse economic relationships

Syllabus Content

Unit 4: The global economy

Real-world issue 1 - Who are the winners and losers of the integration of the world's economies?

4.6 Balance of payments

Balance of payments

Credit and debit items

Surplus or deficit on an account

Calculation: elements of the balance of payments from a set of data

Components of the balance of payments

- Current account
  - Balance of trade in goods
  - Balance of trade in services
  - Income
  - Current transfers
- Capital Account
  - Capital transfers
  - Transaction in non-produced, non-financial assets
- Financial account
  - Foreign direct investment (FDI)
  - Portfolio investment
  - Reserve assets
  - Official borrowing

Interdependence between the accounts

- Zero balance in the balance of payments
- Credits matched by debits
- Deficits matched by surpluses

Relationship between the current account and the exchange rate (HL only)

Diagram (HL only): on exchange rate showing the relationship between the current account balance and the exchange rate

Relationship between the financial account and the exchange rate (HL only)

Implications of a persistent current account deficit in terms of: (HL only)

- exchange rates
- interest rates
- foreign ownership of domestic assets
- debt
- credit ratings
- demand management
- economic growth

Methods to correct a persistent current account deficit (HL only)

Expenditure switching

Expenditure reducing

Supply-side policies

Effectiveness of measures to correct a persistent current account deficit (HL only).

The Marshall-Lerner condition and the J-curve effect (HL only)

Diagram (HL only): J- curve with reference to the Marshall Lerner condition

Implications of a persistent current account surplus in terms of (HL only):

domestic consumption and investment

exchange rates

inflation

employment

export competitiveness

Concepts

The increased **interdependence** of economies has benefits and costs.

• Increased economic integration may result in **efficiency**, welfare gains and improvements in **economic well-being** but the benefits may not result in **equity**.

ATL Skills

Approaches to Learning

Thinking

- In this unit, we will

ask students to formulate a reasoned argument to support their opinion or conclusion

Developing IB Learners

Learner Profile

Knowledgeable

Reflective