Mohamed Khaider University, Biskra

Faculty of Economics, Commerce and Management Sciences

Commerce Department

Module: International Finance

Branch: International Trade
Level: Third year Bachelor

Lecture 07: The Balance of Payments

Learning Outcomes

When you have completed your Study of this Lecture and its readings, you will be able to:

- Showing the meaning of the Balance of Payments

- Explaining the Accounting Principles of Balance of Payments

- Discussing the Importance of Balance of Payment

Financial managers of multi-national corporations monitor the balance of payments so that they can determine how the flow of international transactions is changing over time. The balance of payments can indicate the volume of transactions between specific countries and may even signal potential shifts in specific exchange rates. Thus it can have a major influence on the long-term planning and management by multi-national corporations.

1- Definition

The balance of payments is a summary of transactions between domestic and foreign residents for a specific country over a specified period of time. It represents an accounting of a country's international transactions for a period, usually a quarter or a year. It accounts for transactions by businesses, individuals, and the government. A balance-of-payments statement is composed of the current account, the capital account, and the financial account. According to Bo Sodersten, "The balance of payments is merely a way of listing receipts and payments in international transactions for a country".

2-Accounting Principles of Balance of Payments

The compilation of Balance of Payment is based on some principles as:

. Residence principle: In compiling the BoP account, it is necessary to distinguish residents of an economy from non-residents. The concept of residence in the system of the balance of payments is not based on the criteria of national identity or the legal criteria for the determination of residents of a particular state. The economic entity (individuals or organizations) is said to be the resident of that country if its center of economic interest falls in the economic territory of that country and has already engaged in economic activities and transactions on a significant scale in that country for one year or more or if that economic unit intends to do so.

. Double-entry bookkeeping Principle: The balance of payments account of a country is constructed on the principle of double-entry bookkeeping. Each transaction is entered on the credit and debit side of the balance sheet. Thus, the total debit and the total credit of the balance of payments are always equal. Hence it is for this reason that balances of payments for a country must always balance in accounting sense.

. Principle of the uniform system for valuation of transactions: The third principle of the balance of payments is the principle of the uniform system for valuation of transactions, recorded in the balance of payments. The essence is that market prices that are aligned with economic transactions are used for the evaluation of transactions in real recourses and financial assets and liabilities. The market price refers only to the price for one specific transaction. Compliance with the given principle ensures comparability of the balance of payments in different countries, as well as comparability of accounts of the balance of payments of the particular country.

. **Principle of timing:** The fourth principle of the balance of payments is the principle of timing. Each transaction should be reflected in the balance of payments on the credit side and on its corresponding debit side at the same time, and both parties of the transaction should record the operation under the same number, which corresponds to the date of its execution.

. Principle of unit of account: During the compilation of the balance of payments, the unit of account should be clearly defined. Accordingly, it should be used the same unit of account used during internal payments and accounting by the country will also be used in the preparation of the balance of payments. However, it is necessary to note that the balance of payments in most countries is kept in U.S. dollars.

3-Importance of Balance of Payment

A balance of payment is an essential document or transaction in the finance department as it gives the status of a country and its economy. The importance of the balance of payment can be calculated from the following points:

. It reveals the economic and financial details of a country.

. The BOP statement can be an indicator to determine whether the currency of a country is appreciating or depreciating.

. BOP helps the government on trade and fiscal policies.

. It provides important information to understand and analyze the economic dealings of one country with the other.

. The government can formulate appropriate policies to divert the funds and technology imported to the critical sectors of the economy that can drive future growth