

Current account of balance of payments

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What you need to know

This topic has four syllabus outcomes:

1. **The structure of the current account.** It has four parts: **trade in goods**, **trade in services**, **primary income** and **secondary income**. You must be able to place any transaction in the right part, and **calculate** a deficit or surplus on the whole current account and on each part.
2. **Causes of a current account deficit and of a surplus:** why money paid out to other countries can be more (or less) than money coming in.
3. **Consequences of a deficit and of a surplus** for a country's **GDP**, **employment**, **inflation** and **foreign exchange rate**.
4. **Policies to achieve balance of payments stability:** the range of policies a government can use to reduce a deficit (or a surplus), and how effective each might be.

Understand it

What the balance of payments records

The **balance of payments** records all the money flows between one country and the rest of the world over a year (or a quarter): payments for trade, income earned abroad and money sent abroad.

Each flow is either a **credit** or a **debit**:

- a **credit** is money flowing **into** the country, such as payment for an export;
- a **debit** is money flowing **out of** the country, such as payment for an import.

The **current account** is the part that records trade and income flows, and the only part in the 0455 syllabus.

The four parts of the current account

1. Trade in goods. Exports and imports of physical things you can touch: cars, rice, oil, phones, machinery. These are sometimes called **visible** trade.

- A country's **exports of goods** are a **credit**: foreigners pay the country for them.
- Its **imports of goods** are a **debit**: the country pays foreigners for them.
- **Balance of trade in goods = exports of goods – imports of goods.** This is also called the **balance of trade** or **visible balance**.

2. Trade in services. Exports and imports of things you cannot touch, sometimes called **invisible** trade: tourism, transport and shipping, banking, insurance, education, consultancy, software, telecoms.

The trick is to follow the money, not the person. When **foreign tourists** spend money in Kenya, money flows into Kenya, so it is a Kenyan **export** of services. When a Kenyan family takes a holiday in Spain, Kenyan money flows out, so it is a Kenyan **import** of services. A firm in Ghana buying insurance from a German company is likewise a Ghanaian services **import** (a debit).

3. Primary income. Income earned by **factors of production** working or invested in another country, so wages, interest, profit and dividends:

- **wages** (compensation) earned by people who work abroad for a short time, such as seasonal or cross-border workers;
- **interest** on loans to, or savings held in, other countries;
- **profits** and **dividends** on investments abroad, such as shares in a foreign firm or a factory owned abroad.

Income coming **in** from abroad is a credit; income going **out** is a debit. If a Japanese car maker owns a factory in Mexico and sends the profit home to Japan, that profit is a **debit** in Mexico's primary income and a **credit** in Japan's. If Mexico pays interest on a loan from a foreign bank, that is a Mexican primary income debit too.

4. Secondary income. Transfers: money sent from one country to another **with nothing given in return**. Examples:

- **workers' remittances:** money that migrants working abroad send home to their families;
- **foreign aid** given by one government to another (current spending, such as food aid);
- **contributions** to international organisations such as the United Nations or a regional body;
- state pensions paid to people who have retired to another country;
- gifts.

A transfer coming in is a credit; going out is a debit. So when workers from Nepal working in Qatar send part of their wages home, it is a **credit** in Nepal's secondary income and a **debit** in Qatar's.

Wages or remittances? The wages a worker earns abroad count as primary income (they are a payment for labour). The part they later **send home as a gift** to relatives is secondary income (a transfer). Exam questions about "money sent home to families" want **secondary income**.

Item (from the point of view of country X)	Part	Credit or debit
X sells wheat to another country	Trade in goods	Credit
X buys machinery from abroad	Trade in goods	Debit
Foreign tourists stay in X's hotels	Trade in services	Credit
X's residents receive dividends on foreign shares	Primary income	Credit
A foreign-owned firm in X sends its profits home	Primary income	Debit
Migrants from X working abroad send money to families in X	Secondary income	Credit
X's government gives aid to another country	Secondary income	Debit

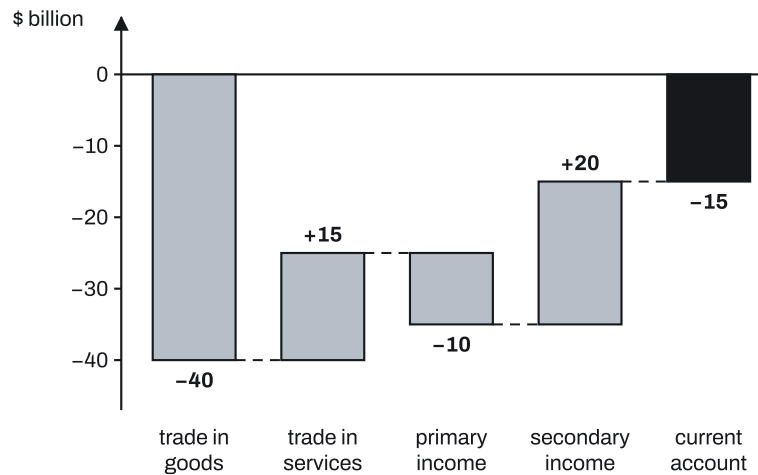
Calculating the balances

For each part, the balance is **credits – debits**. The current account balance is the total of the four balances:

current account balance = goods balance + services balance + primary income balance + secondary income balance

- If the total is **positive**, more money flows in than out: a **current account surplus**.
- If it is **negative**, more flows out than in: a **current account deficit**.
- If it is **zero**, the current account is **in balance**.

Each part can be in surplus or deficit on its own. A country can have a big deficit on trade in goods and still have an overall surplus if its services and income balances are in surplus by more. Even when the total stays in deficit, a services surplus (from tourism or financial services, say) can offset part of a large goods deficit.



Here is the calculation behind the chart, for a country in one year (\$ billion):

Item	Credits	Debits	Balance
Trade in goods	210	250	-40
Trade in services	65	50	+15
Primary income	18	28	-10
Secondary income	26	6	+20
Current account			-15

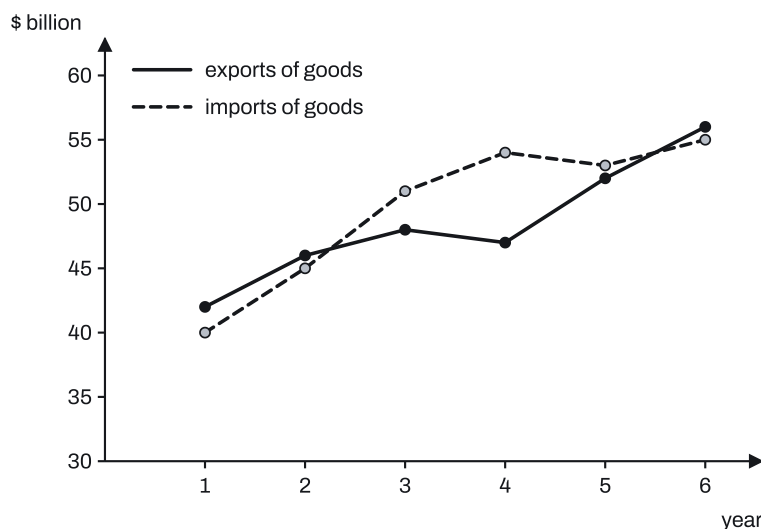
The current account balance is $-40 + 15 - 10 + 20 = -15$, a **deficit of \$15 billion**. The country's **balance of trade in goods and services** (goods and services together) is $-40 + 15 = -25$, a deficit of \$25 billion.

Three more ideas you need for the calculations:

- **An improvement** in a balance means it moves towards surplus: a surplus gets bigger, or a deficit gets smaller. A balance that goes from -8 to -3 has **improved** by 5, even though it is still a deficit. A balance that goes from $+6$ to $+2$ has **worsened** by 4.
- **The change in a balance** is new value minus old value. From -8 to -3 : $-3 - (-8) = +5$.
- **As a percentage of GDP**. Big economies have big numbers, so countries are compared using the balance as a percentage of GDP: a \$15 billion deficit in a country with GDP of \$600 billion is $\frac{15}{600} \times 100 = 2.5\%$ of GDP.

Reading a chart of exports and imports

Data questions often give exports and imports as a line or bar chart rather than a table. The balance in any year is the **gap** between the two: exports above imports means a surplus; imports above exports means a deficit.



Year	1	2	3	4	5	6
Exports of goods (\$bn)	42	46	48	47	52	56
Imports of goods (\$bn)	40	45	51	54	53	55
Balance (\$bn)	+2	+1	-3	-7	-1	+1

Where the lines cross, the balance changes sign: between years 2 and 3 it moves from surplus into deficit, and between years 5 and 6 it moves back into surplus. Notice that exports **and** imports both rose between years 5 and 6, but exports rose by more (4 against 2), so the balance improved. A rise in imports does not on its own mean a worse balance: compare the size of the two changes.

Causes of a current account deficit

A deficit happens when export revenue plus income and transfers coming in are less than import spending plus income and transfers going out. Most causes work through **trade in goods and services**, by making exports fall or imports rise.

Why exports may fall

- **Higher inflation than in other countries.** If prices in the country rise faster than abroad, its exports become dearer compared with rivals' goods, so foreign buyers switch away. Its own consumers also switch to imports, which now look cheaper.
- **A rise in the exchange rate (appreciation).** Each unit of the currency costs more foreign money, so exports cost more in foreign currency and imports cost less in home currency (see [Foreign exchange rates](#)).
- **Low productivity and high costs of production.** If workers produce less per hour, or wages and raw materials cost more, firms must charge more, so their goods are less **price competitive**.
- **Poor quality or out-of-date products**, so they are less **quality competitive** than foreign goods.
- **Recession in trading partners.** When incomes fall in the countries that buy its exports, they buy less of everything, including its exports.
- **Better technology or new competitors abroad**, so foreign firms produce cheaper or better versions and win the market.
- **Trade barriers abroad:** other countries put tariffs or quotas on its exports.
- **Supply problems at home:** a drought, flood, strike or war cuts the output available to export.

Why imports may rise. A country may buy more imports because:

- **incomes at home rise** (for example in an economic boom), so households and firms spend more, and part of the extra spending goes on imports;
- **imports become cheaper**: foreign firms' costs fall, or the country's exchange rate rises;
- **the quality of imports improves**, or foreign products become more fashionable;
- **trade barriers are reduced or removed**, such as lower tariffs, bigger quotas or an embargo lifted, which makes it easier and cheaper to import;
- the country **lacks the raw materials, machinery or technology** its own firms need to grow, so it must buy them abroad;
- a **harvest failure or natural disaster** means it must import food or materials it normally produces itself.

Causes in the income parts

- **Foreign-owned firms** (multinational companies, MNCs) in the country send their profits home: a primary income debit.
- **Interest on foreign borrowing**: a country with large foreign debts pays out a lot of interest.
- **Fewer remittances** arriving, for example if fewer citizens work abroad, or more foreign workers in the country sending money out.
- **Government spending abroad**, such as aid, contributions to international bodies or the cost of troops and embassies overseas, adds to the money going out.

Causes of a current account surplus

A surplus has the opposite causes. A country tends to have a surplus when its goods are **competitive** and foreign demand for them is strong:

- **Low inflation** compared with other countries keeps its goods relatively cheap, so exports rise and households buy home-produced goods instead of imports.
- **High-quality products** with a strong reputation keep foreign demand high even when the price is high.
- **High productivity and modern technology** keep costs low.
- **A low exchange rate** keeps exports cheap abroad and imports dear at home.
- **Strong economic growth in trading partners** raises demand for its exports.
- **Valuable natural resources** whose world price rises. Because demand for a necessity such as oil is **price-inelastic**, a higher price raises export revenue.
- **Large investments abroad**, so profits, dividends and interest flow in (primary income credits), or many citizens working abroad who send money home (secondary income credits).
- **Low incomes or a recession at home**, so people buy fewer imports.

A **strong currency** usually works against a surplus, but it can help in one way: it makes **imported raw materials and components cheaper**, which cuts firms' **costs of production** and lets them keep export prices low. A country that imports most of its inputs and sells high-quality goods can keep a surplus even with a strong currency.

Consequences of a current account deficit

The syllabus asks for the effects on four things.

- **GDP**. Spending on imports is money that leaves the circular flow; export revenue is money coming in. In a deficit, net exports (exports minus imports) are negative, so **total (aggregate) demand is lower** than it would otherwise be. Firms sell less, produce less, and **GDP and economic growth are lower**.
- **Employment**. With less demand for home-produced goods, firms in **export industries** and in industries that **compete with imports** cut output and need fewer workers, so **unemployment rises**. When these workers spend less, other firms lose sales too.

- **Inflation.** A deficit can **reduce** inflation: lower total demand means less demand-pull pressure, and cheap imports keep prices down and push home firms to keep their own prices low. But if the deficit causes the currency to fall, imports become dearer and **cost-push inflation** may follow.
- **Exchange rate.** To pay for imports, people sell the home currency to buy foreign currency, so its **supply rises**; weak exports mean less **demand** for it. In a floating system the exchange rate **falls (depreciates)**. Under a fixed rate the government must use its foreign currency reserves to hold the rate up.

Is a deficit always bad? It depends.

- **How long and how big?** A small or short-lived deficit is not a problem. A **large, persistent** deficit means the country is running down its reserves or borrowing from abroad, and the interest on that borrowing adds to future primary income debits.
- **What is being imported?** If the deficit comes from importing **capital goods** (machinery, technology), these can raise productivity and future exports. If it comes from consumers buying imported luxuries, the long-run benefit is smaller.
- **Living standards now.** Imports let people consume more goods and services, and a wider choice, than the country produces.
- **Self-correction.** Under a floating rate, the depreciation a deficit causes tends to shrink it over time.

Consequences of a current account surplus

- **GDP.** Positive net exports **add to total demand**, so output and **GDP rise**, and economic growth is higher.
- **Employment.** Firms in export industries take on more workers, so **unemployment falls**.
- **Inflation.** If the economy is already close to full capacity, the extra demand can cause **demand-pull inflation**. Firms also compete for scarce workers and materials, raising costs. Fewer goods are left for the home market.
- **Exchange rate.** Foreign buyers need the currency to pay for its exports, so **demand for the currency rises** and it **appreciates** (rises in value) under a floating rate. Its exports then become more expensive abroad, which may later reduce the surplus.

Is a surplus always good? Not necessarily. Trading partners have the matching deficits and may **retaliate**; the country depends on **foreign demand**, so a world recession hits it hard; the appreciation can make exports **less competitive** later; and a surplus built on one resource is exposed to swings in its world price.

Policies to achieve balance of payments stability

Balance of payments stability is one of the government's macroeconomic aims: the current account should not have a large deficit or surplus for a long time. To **reduce a deficit**, a policy must **raise export revenue**, **cut import spending**, or both. To **reduce a surplus**, it must do the opposite.

Some policies **switch spending** to home-produced goods by making them cheaper or better than foreign ones; others **reduce spending** in the whole country, so it buys fewer imports.

1. A lower exchange rate. A **depreciation** (floating rate) or **devaluation** (fixed rate) makes exports cheaper in foreign currency and imports dearer in home currency. Export revenue rises and import spending falls, **as long as demand for exports and imports is price-elastic**.

- *Might not work:* if demand is price-inelastic, people buy almost the same quantity, so the country earns less per export and pays more per import, and the deficit can get worse. Dearer imported raw materials and fuel raise firms' costs and can cause **cost-push inflation**, which slowly wipes out the price advantage. Trading partners may retaliate.

2. Protection: tariffs, quotas and embargoes. A **tariff** (import duty) is a tax on imports; a **quota** is a limit on the quantity of imports; an **embargo** is a ban. Each makes imports dearer or scarcer, so households and firms switch to home-produced goods.

- *Might not work:* other countries may **retaliate**, so exports fall too. With no good home-produced substitute, people keep buying the import at a higher price. Protected firms may become inefficient, and tariffs on imported raw materials raise exporters' costs. A quota set above what people want to buy changes nothing, and smuggling may grow.
- Read quota wording carefully: a quota is a **limit**, so **lowering** (tightening) a quota lets **fewer** imports in, and **raising** or removing it lets **more** in.

3. Contractionary fiscal policy. Raising income tax or cutting government spending reduces households' disposable income and total demand, so people **buy fewer imports**. Lower demand also reduces inflation, making exports more price competitive.

- *Might not work:* lower demand also means less output and **more unemployment**, and people may cut spending on home-produced goods rather than imports.

4. Fiscal policy aimed at firms: subsidies and tax cuts. Some fiscal measures help the current account by improving competitiveness rather than cutting demand.

- **Subsidies to export industries** lower their costs, so they can cut prices or spend on quality. More exports are sold and home goods replace imports.
- **Tax cuts** can help too:
 - a cut in **corporation tax** (tax on firms' profits) leaves firms more money and more reason to **invest**, raising quality and cutting costs, so exports rise and imports fall; it can also **attract MNCs** that export from the country and make goods that were imported before;
 - a cut in **income tax** can raise workers' **motivation** and productivity, cutting costs;
 - a cut in **indirect taxes** (such as sales tax) on home-produced goods lowers their prices, so people switch to them from imported substitutes;
 - lower tariffs on imported **raw materials** let exporters buy cheaper inputs and cut their prices.
- *Might not work:* a cut in income tax gives households **more to spend, and some of it goes on imports**. More spending can cause **inflation**, making exports less competitive, and firms may **divert exports to the busier home market**. Tax cuts and subsidies cost the government money (opportunity cost), so it may have to **cut spending on education, healthcare or transport**, which lowers productivity in the long run. Firms may keep a subsidy as profit instead of cutting prices. Lower tariffs on finished imports raise imports. If inflation abroad is lower, or incomes abroad are falling, exports may not rise. Other governments may complain or retaliate against subsidised exports.

5. Higher interest rates (contractionary monetary policy). Dearer borrowing and better rewards for saving reduce spending, including spending on imports, and lower inflation helps competitiveness.

- *Might not work:* higher interest rates attract savings from abroad (**hot money**), raising demand for the currency, so the exchange rate **rises** and exports become dearer. Firms invest less, which harms productivity and future exports. Growth and employment fall.

6. Supply-side policies. Education and training, investment in infrastructure (ports, roads, power), research grants, privatisation and deregulation all aim to raise **productivity**, cut costs and improve quality. Home goods become more competitive on **price and quality**, so exports rise and imports fall.

- *Might not work:* they are **slow** and costly, and trained workers may emigrate.

Reducing a surplus. A government wanting to cut a surplus reverses these: it can let the exchange rate rise (revaluation or appreciation), **raise import quotas or remove them**, cut tariffs, remove export subsidies, or use **expansionary** fiscal and monetary policy so that people buy more, including more imports. A devaluation, higher import duties or tighter quotas would make a surplus **bigger**.

How effective will a policy be? Judge using:

- **the cause of the imbalance:** a deficit caused by high inflation needs a different cure from one caused by low productivity or a recession abroad;
- **price elasticity of demand** for exports and imports;
- **time:** exchange rate and protection work quickly; supply-side policies are slow but last;
- **side effects** on other aims: unemployment, growth and inflation;
- **reactions abroad:** retaliation, and what is happening to incomes in trading partners.

Key facts and formulas

There is no formula list in the 0455 exam, so learn these.

Formula	Status
Balance on trade in goods = exports of goods – imports of goods	Learn it
Balance on trade in services = exports of services – imports of services	Learn it
Balance on any part of the current account = credits (money in) – debits (money out)	Learn it
Current account balance = trade in goods balance + trade in services balance + primary income balance + secondary income balance	Learn it
Current account: positive = surplus; negative = deficit; zero = in balance	Learn it
Missing balance = current account balance – the sum of the other three balances	Learn it
Change in a balance = new balance – old balance; a positive change is an improvement	Learn it
Current account balance as a percentage of GDP = $\frac{\text{current account balance}}{\text{GDP}} \times 100$	Learn it

Key facts: goods are physical products; services are tourism, transport, insurance, banking and education; **primary income** is wages, interest, profits and dividends from factors of production abroad; **secondary income** is transfers with nothing in return (remittances, aid, contributions, pensions paid abroad). Money **in** is a credit, money **out** a debit. A current account deficit is **not** a government budget deficit.

How to do it

In the questions we have tagged for this topic (61 questions (54 different), 2021–2026: 39 Paper 1 multiple choice, 7 of them repeats, and 22 Paper 2 question parts), the types came up this often. 4 of the questions mix two types, so the counts add up to 65.

Question type	Questions
Place an item in its current-account component / define a component	14
Choose, explain or discuss a policy to reduce a deficit (or surplus)	13
Explain or analyse causes of a deficit or surplus	13
Calculate a current-account balance or a missing component	10
Read balances off a table or bar/line chart	6
Consequences of a deficit or surplus	6
Analyse a data relationship involving the current-account balance	3

Paper 2 parts are marked point by point: **(1)** for identifying a point and **(1)** for each step that develops it. An 8-mark "Discuss" in Section B is marked by **levels** (Level 3, 6–8 marks, needs both sides developed); a 6-mark "Discuss" in Section A gives up to 4 marks for each side.

1. Place an item in its current-account component / define a component (14 questions)

Multiple choice (12):

1. **Decide which country's account** you are recording, and whether money flows **in** (credit) or **out** (debit) of it.
2. **Ask what the payment is for:**
 - for a physical product → **trade in goods**;
 - for a service (travel, transport, insurance, finance, teaching) → **trade in services**;
 - a reward for labour or capital working abroad (wages, interest, profit, dividend) → **primary income**;
 - money given with nothing in return (remittances to family, aid, contributions to international bodies, pensions sent abroad) → **secondary income**.
3. Check the option has both the right part **and** the right direction.

For example, a Thai resident receiving interest from a savings account in Singapore is a primary income **credit** for Thailand. A Peruvian firm paying a Canadian company to design its website is a services **debit** for Peru. Neither involves a physical product, however the money is spent.

Variations you will meet:

- **"Which formula gives the current account balance?"** Pick the one that adds the **four** balances. A formula that leaves a part out, or works with totals instead of balances, is wrong.
- **"What is measured in secondary income?"** Look for a transfer: aid, contributions, remittances. Income from factors of production is primary, not secondary.
- **Government spending abroad**, such as keeping troops or embassies in other countries, is money flowing out, so it **increases a deficit** (or reduces a surplus).
- **Signs of the parts and the total.** The total is the sum of the four parts, so if you know the sign of the total and of three parts, you can work out the fourth. For example, if services, primary income and secondary income are all in surplus but the whole account is in deficit, trade in goods **must be in deficit**, by more than the three surpluses together. Only conclude what the arithmetic proves.

Written parts (2):

- **"Define primary income" [2]:** one mark for saying it is **part (a component) of the current account of the balance of payments**, and one mark for an example of what it contains, such as **profits, interest or dividends earned on investments abroad, or wages earned abroad**. The mark scheme notes that few candidates know this term, so it is

easy marks to learn.

- **"Explain how a country can have a trade in goods deficit but a current account surplus" [4]:** the current account adds four balances (1); a deficit on goods can be outweighed (1) by surpluses on services, primary income or secondary income (1), for example large earnings from tourism or financial services, or profits on investments abroad (1).

2. Choose, explain or discuss a policy to reduce a deficit (or surplus) (13 questions)

Multiple choice (7):

1. **Is the problem a deficit or a surplus?** Underline it. To reduce a **deficit** you need **more exports or fewer imports**; to reduce a **surplus**, the opposite.
2. For each option, follow the chain one step at a time: does it make home goods **cheaper or better** compared with foreign ones, or make imports **dearer or harder** to get? Or does it **cut total spending** at home?
3. Watch the **direction of the change** in each option: cutting back or scrapping a measure that shields home firms or helps sellers abroad does the **opposite** of bringing it in.
4. Ignore options about the government's **budget**: the current account is about trade with other countries.

For example, a government with a deficit that offers cheap loans to firms selling abroad is helping exports; one that raises state pensions is adding to spending at home, some of it on imports, so it is unlikely to help.

"Analyse how a fall in the exchange rate could reduce a deficit" [6]:

1. The fall makes exports **cheaper in foreign currency** (1), so foreign demand for them rises (1) and export revenue rises (1).
2. Imports become **dearer in home currency** (1), so people buy fewer imports and switch to home-produced substitutes (1), and import spending falls (1).
3. The gap between import spending and export revenue narrows (1), **if demand is price-elastic** (1).

"Discuss whether or not [policy] will reduce a deficit" [6] or [8]:

1. **Why it might:** take the policy's chain from "Policies to achieve balance of payments stability" in Understand it, step by step, ending with "more exports / fewer imports → smaller deficit".
2. **Why it might not:** use the "might not work" points for that policy. Make each point **different**, not just the reverse of the first side.
3. **Judgement:** say what it **depends on** (the "How effective" list in Understand it).

For **MNCs** setting up in the country: *might reduce* — they export from the country and make goods that used to be imported; *might not* — they import many of their components and **send profits home**, which is a primary income **debit**.

3. Explain or analyse causes of a deficit or surplus (13 questions)

"Explain two reasons why [country] had a surplus (or deficit)" [4]:

1. For each reason: **identify** it (1), then **explain** how it affects exports or imports (1). Two reasons, two marks each.
2. Take the reasons from the source if there is one, using the causes lists in Understand it, and say which way each pushes **exports and imports**.

Example 2 below shows the layout.

"Analyse why a country may demand more imports" [6]: give **at least three** causes from the "Why imports may rise" list in Understand it, each with a reason. Listing alone earns at most 3 marks, so develop each: for example, "Incomes have risen (1), so households can afford more goods (1), including foreign goods that the country does not produce itself because it

specialises in other products (1)."

"Analyse how higher productivity (better technology, more capital equipment, a more skilled workforce) could reduce a deficit" [4]–[6]: write the full chain without jumping stages:

productivity rises (1) → more output per worker, so average costs fall (1) → firms can cut prices, so their goods become more price competitive (1) → and / or quality improves (1) → more exports are sold abroad, raising export revenue (1) → people at home buy home goods instead of imports, cutting import spending (1) → the deficit shrinks (1).

Examiners often see answers that stop at "costs fall"; the marks come from linking it to **exports, imports and the current account**.

Variations you will meet:

- **"Why might exports decrease?"** Use the "Why exports may fall" list in Understand it, each linked to price or quality competitiveness or foreign incomes.
- **"Discuss whether economic growth causes a deficit" [8]:** *it might* — higher incomes buy more imports, and firms sell more at home instead of exporting; *it might not* — growth led by exports or productivity raises exports too.
- **Multiple choice on causes:** follow each option to exports or imports. Anything that makes the country's goods cheaper or better, or foreign incomes higher, increases a surplus; anything that makes foreign goods cheaper or better, or puts money out of the country, increases a deficit.

4. Calculate a current-account balance or a missing component (10 questions)

1. **Work out each part's balance:** credits minus debits. If the table gives gross exports and imports, subtract them; if it gives "net" figures, use them as they are, with their signs.
2. **Add the four balances**, keeping the signs. A negative total is a deficit; a positive total is a surplus.
3. If a part is said to be zero, or "the country has no secondary income", leave it out.
4. Check your answer is **not** the sum of all the gross figures: that is a common wrong option.

For example (\$ million): exports of goods 300, imports of goods 340, exports of services 90, imports of services 55, net primary income −15, net secondary income +8. Goods = −40, services = +35, so the current account = −40 + 35 − 15 + 8 = −12: a deficit of \$12 million.

Variations you will meet:

- **A missing part.** Missing balance = current account balance − (sum of the other three). If the account is "in balance", the total is 0, so the missing balance is minus the sum of the others. For example, goods +30, services −10, primary income −5, and the current account is in balance: secondary income = $0 - (30 - 10 - 5) = -15$.
- **A missing pair.** If two parts are unknown and the account balances, those two must add to **minus** the sum of the known parts. Test each option by adding its pair: the right one cancels the known total exactly. A surplus counts as +, a deficit as −.
- **Change between two years.** Find the missing part in each year separately, then subtract: change = year 2 value − year 1 value. An increase from −5 to +12 is +17.
- **A list of transactions.** Turn each into a credit (+) or debit (−) **for the country named**, then add. For example, for country Z: exports goods worth 120 (+120), its people pay 40 for holidays abroad (−40), foreign workers in Z send 15 home (−15), Z receives 10 of aid (+10). Total = $120 - 40 - 15 + 10 = +75$.

5. Read balances off a table or bar/line chart (6 questions)

1. For each year, find the **balance = exports – imports** (read both values carefully from the scale).
2. Exports above imports is a **surplus**; imports above exports is a **deficit**. Where the lines (or bars) swap order, the balance changes from one to the other.
3. For "which year" or "between which years" questions, work out the balance for **every** year in a small table first, then answer.

Variations you will meet:

- **"Which balance improved?"** from a table of the four parts in two years: an improvement means the number went **up** (towards a bigger surplus). From -0.8 to -0.3 is an improvement; from -2.5 to -3.1 is a worsening; from $+20$ to $+18$ is a worsening. Don't pick the part with the largest number; pick the one whose number rose.
- **Imports rising but the balance improving:** possible whenever exports rise **by more** than imports. Compare the two changes, not just their directions.
- **Trade with one partner** (a chart of a country's exports to, and imports from, one other country): the same rule applies, comparing the two bars in each year.

6. Consequences of a deficit or surplus (6 questions)

Multiple choice (3): use the chains in Understand it.

- A **surplus** adds to total demand → **higher GDP, lower unemployment**, possibly **higher inflation**, and a **stronger currency**, so the country's goods then cost foreign buyers more.
- A **deficit** reduces total demand → **lower GDP, higher unemployment**, less inflationary pressure, and a **weaker currency**, so its goods cost foreign buyers less.
- Don't confuse a **cause** with a **consequence**: a lower exchange rate can **cause** a surplus, but a surplus **leads to** a higher exchange rate.

"Discuss whether or not a surplus (or more exports) will benefit an economy" [6] or [8]:

Use "Consequences of a current account surplus" in Understand it: for = more demand, output, jobs and tax revenue, cheaper imported inputs; against = demand-pull inflation, a stronger currency hurting later exports, fewer goods at home, dependence on foreign demand, retaliation. Judge by the surplus's size and length, how close the economy is to full employment, and whether it rests on one product or many.

Variation: "Discuss whether a fall in the price of a main export harms the economy": a fall in export revenue (worse current account, lower demand, jobs lost in that industry) against lower costs for any firms using the product at home, and against the chance that demand is price-elastic, so a larger quantity is sold.

7. Analyse a data relationship involving the current-account balance (3 questions)

These are Section A data questions, [4] or [5]. Follow four steps:

1. **State the relationship:** positive (direct: they move the same way) or negative (inverse: they move opposite ways). (1)
2. **Give evidence** from the data, quoting years or countries and figures. (1)–(2)
3. **Explain why**, using economics: the chain that links the two variables. (1)
4. **Name any exception** (a year or country that doesn't fit) and suggest a reason for it. (1)–(2)

For example, take five countries' economic growth rates and current account balances (as % of GDP):

Country	P	Q	R	S	T
Economic growth rate (%)	1.0	2.5	4.0	5.5	7.0
Current account balance (% of GDP)	+3.2	+1.5	−0.8	−2.4	+1.0

- **Relationship:** generally inverse: the faster the growth, the weaker the current account balance (1).
- **Evidence:** P has the slowest growth and the largest surplus (3.2% of GDP), while S grows at 5.5% with the largest deficit (2.4% of GDP) (1).
- **Explanation:** faster growth means rising incomes, and people spend part of the extra income on imports (1).
- **Exception:** T has the fastest growth but a surplus (1). Its growth may come from rising exports, for example of a resource whose world price rose (1).

Balances are often given **as a percentage of GDP** so that countries of different sizes can be compared fairly; say so if asked why. Describing each country's figures in turn without stating a relationship earns little.

Worked examples

Example 1

The table shows items in a country's current account for one year.

Item	\$ billion
exports of goods	450
imports of goods	520
exports of services	180
imports of services	95
primary income credits	40
primary income debits	75
net secondary income	−12

(a) Define **secondary income**. [2]

(b) Calculate the country's current account balance, and state whether it is a surplus or a deficit. [2]

(c) Identify the component of the current account that is in surplus. [1]

(a) A component of the current account of the balance of payments (1) that records transfers of money between countries with nothing given in return, such as workers' remittances or foreign aid (1).

(b) Goods = $450 - 520 = -70$; services = $180 - 95 = +85$; primary income = $40 - 75 = -35$; secondary income = -12 (1 for finding the balances).

Current account = $-70 + 85 - 35 - 12 = -32$: a **deficit of \$32 billion** (1).

(c) Trade in services (1).

Example 2

Explain **two** reasons why a country may have a deficit on the current account of its balance of payments. [4]

Reason 1. The country's inflation rate is higher than its trading partners' (1). Its exports become relatively dearer, so foreign demand for them falls, while its own consumers switch to imports that now look cheaper, so import spending rises above export revenue (1).

Reason 2. Many foreign-owned firms operate in the country (1). They send their profits back to their home countries, which is money flowing out on primary income, adding to the deficit (1).

Example 3

Analyse how a persistent current account deficit could affect a country's economy. [6]

A persistent deficit means import spending is greater than export revenue (1), so net exports are negative and total (aggregate) demand is lower (1). Firms in export industries and those competing with imports sell less (1), so they cut output, and GDP and economic growth are lower (1). These firms need fewer workers, so unemployment rises (1). To pay for imports, people sell the country's currency, so its supply rises and, under a floating system, the exchange rate depreciates (1). Imports then cost more, which may cause cost-push inflation (1). The country must borrow from abroad or run down its reserves to pay for the deficit (1), and interest on the borrowing adds to future debits on primary income (1). (Any 6.)

Example 4

A country has a large current account deficit. Its central bank is considering raising its interest rate.

Discuss whether or not a rise in the interest rate will reduce a deficit on the current account of a country's balance of payments. [8]

Why it might. A higher interest rate makes borrowing dearer and saving more rewarding, so households cut spending on things they buy with loans, such as cars and electrical goods, many of which are imported. Spending on imports falls. Firms facing dearer loans also invest less in imported machinery. Lower total demand reduces demand-pull inflation; if the country's prices then rise more slowly than its trading partners', its exports become more price competitive and export revenue rises. With import spending down and export revenue up, the deficit narrows.

Why it might not. A higher interest rate attracts savings from abroad (hot money), so demand for the currency rises and the exchange rate appreciates. Exports become dearer in foreign currency and imports cheaper, which can make the deficit worse. Firms that invest less will not improve productivity and quality, so in the long run exports become less competitive. If households cut spending mostly on home-produced goods and services rather than imports, the effect on the deficit is small, while unemployment rises. And if the deficit was caused by a recession in trading partners, lower spending at home does nothing to raise exports.

Judgement. A rise in the interest rate is more likely to reduce the deficit quickly if much of the spending it cuts is on imports and the exchange rate does not rise much. But it costs growth and jobs, and it does not tackle a deficit caused by low productivity. Supply-side policies would deal with that cause, though more slowly.

(Level 3, 6–8 marks: both sides are developed with clear chains of reasoning and the judgement is justified by what the outcome depends on.)

Common mistakes

- **Confusing a current account deficit with a government budget deficit.** Examiners report this in almost every session. The current account is about money flowing between the **country and the rest of the world**; a budget deficit means the **government** spends more than it collects in tax. Cutting government spending is not a way to "save money for the current account".

- **Putting remittances and income in the wrong part.** Money sent home to families is **secondary** income; wages, interest, profits and dividends from abroad are **primary** income. Learn one example of each.
- **Following the person, not the money.** Foreign tourists visiting a country are an **export** of services for that country, because money comes in.
- **Adding gross figures, or losing signs.** Find exports minus imports for each part, write its sign, then add the four balances.
- **Calling a smaller negative number "worse".** A balance moving from -6 to -2 has **improved**.
- **Vague answers.** "The current account will increase" earns little. Say which part changes and how: "the services surplus increases" or "the current account deficit shrinks".
- **Stopping the chain early.** Analysing how productivity cuts costs and prices, but never saying that exports rise, imports fall and the deficit shrinks, loses the final marks.
- **Getting a policy's direction wrong for a surplus.** A devaluation or higher import duties make a surplus **bigger**. To reduce a surplus you need **more imports** (larger quotas, lower tariffs, a higher exchange rate) or fewer exports.
- **One-sided "discuss" answers.** Examiners note that many candidates only explain why a policy would reduce a deficit and never why it might not. Without the other side, an 8-mark answer cannot reach Level 3.
- **Describing the data without a relationship.** In a data question, state the relationship first, then use figures as evidence.

How to get the marks

- **Identify, then develop.** Most Paper 2 parts give **(1)** for naming a point and **(1)** for each logical step that follows. "Explain two" [4] needs two points, each with one clear step. "Analyse" [6] needs a chain of several linked steps, or three developed causes; **listing** causes caps you at about half marks.
- **End every chain at the current account.** The last step should mention export revenue, import spending, or the size of the deficit or surplus.
- **"Define" [2]:** one mark for the core idea (what it is part of, or what it measures) and one for precision or an example.
- **"Discuss" [6] (Section A):** up to 4 marks for why it might, up to 4 for why it might not. Each point counts once, on one side only; a mere reversal of a point already made earns nothing on the other side.
- **"Discuss" [8] (Section B):** marked by levels. Level 3 (6–8) needs **both sides developed** and **evaluation**: what the outcome depends on and a justified conclusion. A one-sided answer stays in Level 2 (3–5).
- **Refer to the source** in Section A: use its facts (its inflation, products, exchange rate).
- **Data questions [4]–[5]:** relationship, evidence with figures, explanation, exception with a reason.
- **Calculations:** show the balances, give units and say "surplus" or "deficit". If a question asks for **two** reasons, give two.

Quick check

1. For country K, state the part of the current account and whether it is a credit or debit: (a) K's citizens pay for courses at a university abroad; (b) a foreign bank pays interest to a firm in K; (c) K gives emergency food aid to a neighbour; (d) K sells copper to China.
2. A country's current account is in balance. Its trade in goods balance is -12 , trade in services $+4$ and secondary income $+3$ (\$ billion). Calculate its primary income balance.
3. Use the graph of exports and imports of goods in Understand it. (a) In which year was the trade in goods deficit largest, and how large was it? (b) Between which two years did the balance move from surplus to deficit?
4. Explain **two** reasons why a rise in incomes in a country may increase its current account deficit. **[4]**
5. A country has a large current account surplus. State whether each of these would tend to reduce it: (a) raising its import quotas; (b) devaluing its currency; (c) cutting taxes so households spend more.

Answers

1. (a) Trade in services, debit. (b) Primary income, credit. (c) Secondary income, debit. (d) Trade in goods, credit.
2. The four parts add to 0, so primary income = $0 - (-12 + 4 + 3) = +5$: a surplus of \$5 billion.
3. (a) Year 4: imports 54, exports 47, a deficit of \$7 billion. (b) Between years 2 and 3: from +1 to -3.
4. Higher incomes let households buy more goods and services (1), and some of the extra spending goes on imported goods, so import expenditure rises (1). Firms may sell more of their output in the busy home market (1) instead of exporting it, so export revenue falls (1).
5. (a) Yes: more imports are allowed in, so import spending rises. (b) No: exports get cheaper and imports dearer, so the surplus grows. (c) Yes: more spending at home means more imports.

Past questions to try

- [0455/13/M/J/25 Q30](#): calculating a current account balance from exports, imports and income.
- [0455/12/M/J/24 Q30](#): which of four component balances improved between two years.
- [0455/12/F/M/25 Q30](#): choosing a policy to reduce a surplus.
- [0455/22/F/M/26 Q1](#): part (d), how more capital equipment could reduce a current account deficit.