

Current account of the balance of payments

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Read first: [Introduction to the circular flow of income](#), [The reasons for international trade](#), [Price elasticity, income elasticity and cross elasticity of demand](#)

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What you need to know

By the end of this topic you should be able to:

1. **Name the four parts of the current account** of the balance of payments: trade in goods, trade in services, primary income and secondary income. Say which part any transaction belongs to, and whether it is money coming into the country or going out.
2. **Explain what a balance, a surplus and a deficit mean** on the current account. A deficit or a surplus is an **imbalance**.
3. **Calculate** the balance of trade in goods, the balance of trade in services, the balance of trade in goods and services, and the current account balance (CAB).
4. **Explain the causes** of a current account deficit or surplus.
5. **Explain the consequences** of a deficit or a surplus, both for the **domestic** economy (output, jobs, inflation, living standards) and for the **external** economy (the exchange rate, foreign investment, other countries).

How a government can **correct** an imbalance (expenditure-switching, expenditure-reducing and supply-side policies) is the next topic, and exchange rates have a topic of their own; this note uses them only where they explain causes and consequences.

Understand it

What the balance of payments records

The **balance of payments** is a record of every transaction between the residents of one country and the rest of the world over a period, usually a year. It has three accounts:

- the **current account**: trade and income flows, the subject of this topic;
- the **capital account**: small capital transfers, such as debt forgiveness;

- the **financial account**: buying and selling assets across borders, such as foreign direct investment (FDI, a foreign firm building or buying a factory), shares, bonds, property, loans and short-term "hot money".

Money **coming into** the country is a **credit** (+). Money **going out** is a **debit** (–). Ask "which way does the money move?", not "which way do the goods move?": an export of goods brings money in, so it is a credit.

The four parts of the current account

Part	What it records	Examples (credit for country A)
Trade in goods ("visibles")	Exports and imports of physical goods	A sells cars, coffee, coal or oil abroad
Trade in services ("invisibles")	Exports and imports of services	Foreign tourists spend in A; A's banks or insurers sell to foreign firms; A's universities teach foreign students; A's ships carry foreign cargo
Primary income	Income paid for the use of labour and capital across borders	Interest, profits, dividends and rent earned by A's residents on assets they own abroad; wages earned by A's residents employed abroad for a short time
Secondary income	Current transfers: money given with nothing provided in return	Aid received from foreign governments; money sent home by A's citizens who have settled abroad; gifts; pensions paid from abroad

Three tests help with the hard cases:

- Is it a payment for something bought?** Goods or services. A holiday abroad is an **import of services** for the tourist's country, even though the tourist travels out. Fees paid to educate foreign students are an **export of services**, even when a foreign government pays them ([9708/12/O/N/23 Q28](#)).
- Is it a reward for lending, owning or working?** Primary income. Interest, profits, dividends and rent are **investment income**. A worker who goes abroad on a short contract and is still a resident of their home country earns **compensation of employees**, also primary income: a debit for the country that employs them and a credit for their home country ([9708/13/M/J/23 Q17](#)).
- Is it a one-way gift?** Secondary income. A migrant who has settled in a new country and sends part of their wage home makes a **personal transfer** ("workers' remittance"): a debit on the new country's secondary income and a credit for the home country ([9708/11/O/N/23 Q26](#)). Foreign aid and contributions to international organisations are also secondary income.

Read the wording for workers. "Is employed in" or "works in" another country, with family back home, describes a migrant worker who is still a resident of the home country, so the wages (even the part sent home) are **primary** income. The 2023 examiner report calls the money in [9708/13/M/J/23 Q17](#) "remittances" and still classes it as primary income. "Lives and works in" another country describes someone who has settled there, so the money they send home is **secondary** income. When an option just says "workers' remittances" with no other detail, treat it as secondary income ([9708/12/F/M/25 Q28](#)).

Not in the current account: buying shares, bonds, property, land or a factory abroad, and FDI (all **financial account**); capital transfers (capital account); the **balancing item** (net errors and omissions); and goods made and used inside the country, which never cross a border. Watch the pairs: buying a foreign share is in the financial account, but the **dividend** it later pays is primary income (9708/11/O/N/21 Q25). FDI is in the financial account, but the **profits** the foreign firm later sends home are a primary income debit.

Balances, surpluses and deficits

A **balance** is credits minus debits:

$$\text{balance of trade in goods} = \text{exports of goods} - \text{imports of goods}$$

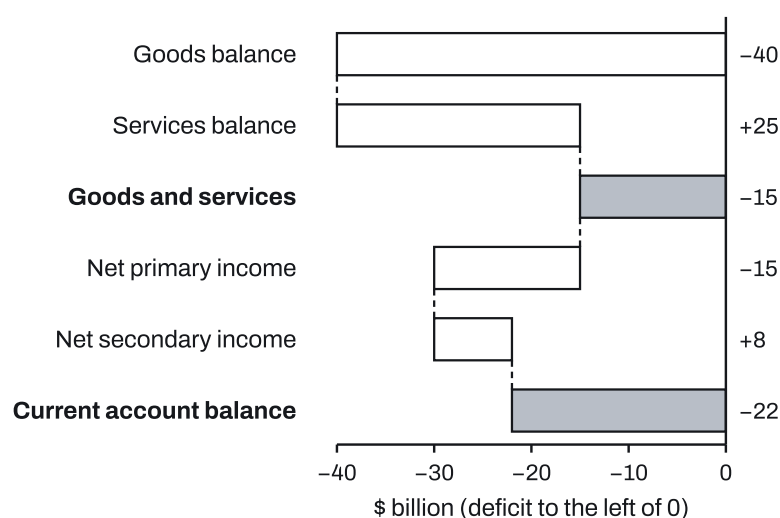
and the same for services. The **current account balance (CAB)** adds all four parts:

$$\text{CAB} = (X_g - M_g) + (X_s - M_s) + \text{net primary income} + \text{net secondary income}$$

- A **surplus** means the money received (export revenue plus income and transfers received) is **greater** than the money paid out. The balance is positive.
- A **deficit** means the money paid out is **greater** than the money received. The balance is negative.
- These are **values** (price × quantity), not volumes. Selling more units at a much lower price can lower export revenue.

Take country Z (\$ billion):

	Credits	Debits	Balance
Trade in goods	180	220	−40
Trade in services	75	50	+25
Balance of trade in goods and services			−15
Primary income	20	35	−15
Secondary income	12	4	+8
Current account balance			−22



Z has a deficit on goods but a surplus on services, a deficit on primary income (foreign owners of Z's firms take more profit out than Z's residents earn abroad) and a surplus on secondary income. Overall the current account is in deficit by \$22 billion.

The parts can point different ways. A country can have a **trade deficit and a current account surplus** at the same time if its income and transfers received are large enough, for example big remittances from citizens working abroad ([9708/12/F/M/25 Q28](#)). And a trade surplus can sit beside a current account deficit when primary income or services are in deficit.

Comparing countries. A deficit is often shown as a **percentage of national income** (GDP), because a \$30 billion deficit means much less to a large economy than to a small one. If country A has a deficit of \$30 billion and a GDP of \$1500 billion, its deficit is 2% of GDP; country B's deficit of \$12 billion with a GDP of \$200 billion is 6% of GDP. B's deficit is smaller in dollars but larger compared with the size of its economy.

Why the whole balance of payments balances

Every transaction is recorded twice. If a country spends more abroad than it earns (a current account deficit), the extra foreign currency must come from somewhere: foreign firms investing (FDI), foreigners buying its shares or bonds, borrowing from abroad, or the central bank using its reserves. Those appear as inflows on the **financial account**. So

$$\text{current account} + \text{capital account} + \text{financial account} + \text{net errors and omissions} = 0.$$

That is why a deficit on the current account is matched by a surplus on the capital and financial accounts ([9708/12/O/N/21 Q21](#)), and why attracting **FDI** is a way of **financing** a deficit ([9708/11/O/N/21 Q24](#)). The balancing item (net errors and omissions) is the number that makes the totals add to zero when the records are incomplete. "The balance of payments always balances" does **not** mean the current account must balance: the current account can be in deficit or surplus for years.

Causes of a current account deficit

A deficit means spending on imports (and income paid abroad) is high compared with export revenue (and income received). The causes fall into groups.

Cyclical: strong domestic demand. When incomes at home grow fast, households and firms buy more of everything, including imports. Firms may also sell more at home and less abroad. So rapid **economic growth** or a consumer boom tends to worsen the current account. A **recession** in the country's trading partners has the same effect from the other side: they buy fewer of its exports.

Loss of price competitiveness. A country's goods become dearer than foreign goods if:

- its **inflation rate is higher** than its trading partners' ([9708/12/O/N/23 Q25](#), [9708/13/O/N/24 Q27](#));
- its **exchange rate appreciates** or is **overvalued**, so its exports cost more in foreign currency and imports cost less at home ([9708/13/M/J/25 Q27](#));
- its **wage costs rise faster than productivity**, so unit costs rise, or national **productivity falls** ([9708/13/O/N/23 Q25](#)).

Whether a loss of price competitiveness actually worsens the balance depends on **price elasticity of demand**. If foreign demand for its exports is **price elastic**, a rise in their price cuts the quantity sold by a bigger percentage, so **export revenue falls**. If home demand for imports is elastic, cheaper imports raise **import spending**. With very inelastic demand the effect is small, or even the other way round.

Non-price competitiveness. Poor quality, design, reliability or after-sales service make foreign buyers choose other countries' goods even at the same price.

Structural causes (why some deficits persist).

- A **narrow export base**: a country that exports a few primary products (crops, minerals) earns less when their world prices fall or harvests fail, while it must keep importing fuel, machinery and manufactures.
- **Dependence on imported capital goods and fuel** that cannot be made at home.
- **Deindustrialisation**: manufacturing that has shrunk can no longer supply the home market.
- **Protection by trading partners** blocks its exports.

Income and transfer flows. A large **primary income deficit** comes from heavy foreign ownership of the country's firms (profits and dividends paid abroad, [9708/12/M/J/24 Q26](#)) or large foreign debt (interest paid abroad). The secondary income account worsens if the government **gives more aid** abroad ([9708/11/O/N/22 Q26](#)), if migrant workers living in the country send more money home, or if fewer citizens abroad send money back.

Causes of a current account surplus

The same list, the other way round:

- an **undervalued** or depreciating exchange rate, which keeps exports cheap ([9708/12/M/J/25 Q27](#));
- **productivity gains** in the export sector, lowering costs ([9708/11/O/N/21 Q29](#)), or high non-price competitiveness;
- **weak domestic demand**: a recession, or households that save a large share of income, so spending on imports is low ([9708/12/M/J/21 Q26](#));
- strong world demand or rising world prices for the country's main exports (if demand for them is inelastic, a higher price raises export revenue);
- large **income from assets owned abroad**, or large remittances from citizens working abroad.

Terms of trade. A rise in the terms of trade (export prices rising relative to import prices) raises the revenue from each unit exported and lowers the cost of each unit imported. It **improves** the current account if demand for the exports is price **inelastic**, so that sales hardly fall. If export demand is **elastic**, buyers switch to other suppliers, export revenue falls and the current account **worsens**. A **depreciation** works the other way: exports get cheaper and imports dearer, and it improves the balance only if demand for exports and imports is elastic enough. (At A Level this condition has a name, the Marshall–Lerner condition; at AS, explain it with price elasticity of demand.)

Consequences of a deficit

For the domestic economy

- **Aggregate demand falls:** net exports ($X - M$) are a component of AD, so a widening deficit reduces AD, output and **economic growth**, and raises **unemployment**, especially in export and import-competing industries.
- **Lower demand-pull inflation**, because AD is lower and cheap imports keep prices down. But if the deficit pushes the currency down, imports get dearer and **cost-push inflation** can follow.
- **Living standards** can be higher for now: the country consumes more than it produces, including cheap imported food and consumer goods.
- **Future costs:** if the deficit is financed by borrowing, the country must pay **interest** later (a primary income debit), and the government may have to raise interest rates or cut spending to correct the deficit, slowing growth.

For the external economy

- **Pressure on the exchange rate:** buying more imports means supplying more of the currency, and selling fewer exports means less demand for it, so a floating currency tends to **depreciate**. A government that fixes its exchange rate must use its **foreign currency reserves** to buy its own currency, and reserves run out.
- **Dependence on capital inflows:** the deficit must be financed through the financial account, so foreign firms and investors own more of the country's assets, and more profits flow out later. **Short-term "hot money"** can leave quickly.
- **Loss of confidence:** a large, persistent deficit can worry foreign lenders and investors, raise borrowing costs and, at worst, leave a country unable to pay for essential imports or its debts, so it needs a loan from the IMF.
- **Other countries** gain: one country's deficit is its trading partners' surplus, so they sell more and enjoy more jobs.

When a deficit is not a worry. A deficit that is **small** (a few per cent of GDP), **temporary** (one boom year), caused by importing **capital goods** that will raise productive capacity and future exports ([9708/14/M/J/25 Q28](#)), or financed by long-term **FDI** rather than short-term borrowing is much less of a concern than a large, persistent deficit caused by consumer imports and uncompetitive industries.

Consequences of a surplus

Benefits

- **Higher aggregate demand:** more net exports raise output, **growth** and **employment** in export industries ([9708/13/O/N/21 Q27](#)), and spending on domestic rather than imported goods creates jobs at home.
- **Foreign currency earned** can be saved as reserves or invested abroad; the assets bought earn **primary income** in the future.
- **Confidence:** a surplus reassures investors and makes it easier to borrow.

Drawbacks

- **Inflation:** if the economy is near full employment, extra AD from net exports raises the price level rather than output and jobs.
- **A sign of weakness:** a surplus can come from a **recession** or **weak domestic demand** (households not spending), so it does not always mean a strong economy.
- **Lower living standards:** output is sent abroad rather than consumed at home.
- **Exchange rate:** high demand for the currency pushes it up, making future exports dearer and less competitive.
- **Other countries:** one country's surplus is someone else's deficit, with lower output and jobs there; trading partners may **retaliate** with protection.

Size, length, cause and financing

Every judgement on an imbalance comes back to four questions. **How big** is it (as a % of GDP)? **How long** has it lasted (temporary or persistent)? **What caused** it (capital goods or consumer goods, a boom or lost competitiveness)? **How is it financed** (long-term FDI or short-term borrowing)? Use them in every "consider", "assess" and "discuss" answer.

Key facts and formulas

There is no formula list in the 9708 exam, so everything here is "Learn it".

Formula	Status
Balance of trade in goods = exports of goods – imports of goods	Learn it
Balance of trade in services = exports of services – imports of services	Learn it
Balance of trade in goods and services = goods balance + services balance	Learn it
Net primary income = primary income credits – primary income debits (same for secondary income)	Learn it
CAB = goods balance + services balance + net primary income + net secondary income	Learn it
Current + capital + financial account + net errors and omissions = 0	Learn it
$\text{CAB as \% of GDP} = \frac{\text{CAB}}{\text{GDP}} \times 100$	Learn it

Formula	Status
% change in a deficit (or surplus) = $\frac{\text{new size} - \text{old size}}{\text{old size}} \times 100$, using sizes without the minus sign; then say whether it rose or fell	Learn it
Export revenue = export price × quantity exported; import spending = import price × quantity imported	Learn it

How to do it

We tagged 60 questions for this topic (2021–2025): 45 Paper 1 multiple choice and 15 Paper 2 data-response and essay questions. For Paper 2 we count only the parts about this topic. 5 questions have parts of more than one type, so the counts add up to 66.

Question type	Questions
Multiple choice and short parts: put a transaction in the right part of the current account	19
Causes of a deficit, a surplus or a change in the balance	18
Consequences of an imbalance: is a deficit or surplus good or bad?	10
Calculate a balance from figures	9
Describe or interpret current account data	7
Why the balance of payments balances; financing a deficit	3

1. Put a transaction in the right part of the current account (19 questions)

- Is it in the current account at all?** Buying shares, bonds, property, land or factories abroad, FDI and loans are **financial account**; the balancing item is neither; goods made and used at home are not recorded.
- Which part?** Payment for a good → trade in goods. Payment for a service (tourism, transport, insurance, banking, education, consultancy) → trade in services. Interest, profits, dividends, rent, or wages of a short-term worker abroad → primary income. Aid, gifts, remittances from settled migrants → secondary income.
- Credit or debit, and for which country?** Follow the money. The question often names one country and asks about the other.

Variations you will meet:

- "Not included in the current account":** FDI ([9708/12/M/J/24 Q30](#), [9708/11/O/N/24 Q28](#)), the purchase of foreign assets ([9708/11/O/N/23 Q22](#)), the balancing item ([9708/12/F/M/22 Q24](#)), or food produced and eaten at home ([9708/11/O/N/25 Q29](#)). "Which change will not affect the current account?" → a rise in FDI ([9708/14/M/J/22 Q19](#)).
- Primary or secondary?** Rent from a property abroad is primary income ([9708/13/O/N/25 Q27](#)); profits earned abroad are primary, government transfers are secondary ([9708/11/M/J/25 Q29](#)). Dividends received from a **domestic** firm are not an international flow at all.

- **Two transactions, two parts:** a family's holiday abroad is a service import; coal sold abroad is a goods export ([9708/14/M/J/25 Q27](#)). A share purchase is financial account, its dividend primary income ([9708/11/O/N/21 Q25](#)).
- **Workers and their money:** "is employed in / works in" another country (still a resident at home) → the wages are primary income, a debit for the host country ([9708/13/M/J/23 Q17](#): only 6% of candidates got this right, even though the report itself calls the money "remittances"). "Lives and works in" another country (settled) → the money sent home is secondary income, a fall in secondary income for the host country ([9708/11/O/N/23 Q26](#)).
- **What changed a component?** A bigger primary income deficit comes from more dividends or interest paid **to foreigners** ([9708/12/M/J/24 Q26](#)), not from goods or tourism.
- **Essay version:** "Explain three components of the current account" ([9708/22/O/N/25 Q4 \(a\)](#)): name each part **and** explain it with an example, one mark each.

2. Causes of a deficit, a surplus or a change (18 questions)

Multiple choice:

1. Decide whether the event makes **exports** more or less valuable, and **imports** more or less valuable.
2. Pick the option that moves the balance the way the question says.

Worsens the current account	Improves it
Relatively high inflation	Relatively low inflation
Appreciation, overvalued currency	Depreciation, undervalued currency
Rapid growth of domestic incomes, consumer boom	Recession at home, high saving, higher taxes
Falling productivity, rising unit labour costs	Productivity gains in exporting firms
More aid given abroad, more profits paid to foreign owners	More income and remittances received
Recession or protection in trading partners	Strong world demand for its exports

Watch for "**not** valid" and "**not** likely" versions: low consumer spending does **not** cause a deficit ([9708/12/F/M/24 Q30](#)); growth making home goods cheaper is **not** why growth worsens the current account ([9708/12/F/M/25 Q20](#)).

Written (8-mark (a) parts): "Explain two reasons why an economy may have a deficit and consider whether the government is likely to be concerned" ([9708/23/O/N/25 Q5](#)), "Explain why some countries consistently have a deficit" ([9708/23/M/J/22 Q4](#)).

1. **Define (AO1):** the current account records trade in goods, trade in services, primary income and secondary income; a deficit means the value of money paid out is greater than the value received.
2. **Two causes (AO1),** each named and explained in a sentence: for example low price competitiveness (high inflation, an overvalued currency) and strong domestic growth pulling in imports. Explain each cause briefly as a chain (higher inflation → exports dearer abroad → export revenue falls → deficit). For

"persistent", give **structural** causes (narrow export base, dependence on imported capital goods, foreign ownership).

3. **Analyse the second half of the question (AO2, up to 3):** the analysis marks are for **why the government is or is not concerned**, not for more causes. Concerned: the currency comes under downward pressure, so imports cost more and inflation may rise; foreign investors may lose confidence, cutting the capital inflows that pay for the deficit. Not concerned: the deficit is temporary, or it comes from imports of capital goods that will raise future capacity. Give both views; the 2025 mark scheme allowed at most 2 marks for either one.
4. **Evaluate (AO3, 2):** how concerned depends on size, duration, cause and financing; then a conclusion (the second mark).

Depreciation, terms of trade and elasticity: "Consider whether a depreciation will always lead to a surplus" (9708/22/O/N/25 Q4 (a)), "explain two reasons for a rise in the terms of trade and consider whether it will benefit the current account" (9708/23/M/J/25 Q5 (a)), "explain using PED how inflation changed the current account" (9708/22/F/M/22 Q1 (c)).

- Say what happens to **export prices** and **import prices**, then use **PED** to say what happens to export **revenue** and import **spending**. Both sides are needed for full marks.
- Mention the **other components** (services, primary and secondary income): a better trade balance may not turn the whole current account into surplus. The 2025 mark scheme capped analysis at 2 out of 3 without this.
- Evaluate with elasticity, time (demand is more elastic in the long run) and the other components.

3. Consequences of an imbalance (10 questions)

Mostly 12-mark (b) essays: "Assess whether an economy will always benefit from a surplus" (9708/21/O/N/24 Q5), "Assess the likely consequences of a persistent deficit for the domestic and external economy" (9708/23/O/N/23 Q5), "whether an improvement in the terms of trade or a current account surplus is of more benefit" (9708/22/M/J/25 Q5).

1. **Define** the current account and the imbalance (deficit or surplus, persistent or temporary).
2. **Domestic consequences**, as chains: net exports → AD → output, growth, jobs, inflation; living standards; interest on borrowing.
3. **External consequences**, as chains: exchange rate, reserves, capital inflows and foreign ownership, investor confidence, trading partners. Writing only about one of domestic or external caps the answer at Level 2.
4. **Both sides:** benefits **and** costs (for a surplus: jobs and growth against inflation, weak home demand, appreciation, harm to others).
5. **Evaluate** using size, duration, cause, financing and how close the economy is to full employment; **conclude** on the word in the question ("always", "more benefit").

Variations you will meet:

- **Deficit to surplus, effect on jobs and prices (9708/22/M/J/22 Q4 (a)):** with **spare capacity**, more net exports raise output and employment with little inflation; at **full employment** they only raise prices.
- **Multiple choice:** lower exports and higher imports mean **AD falls** and the balance **worsens** (9708/11/M/J/23 Q29); an improving current account means **fewer unemployed** (9708/13/O/N/21 Q27); a deficit can be good in the long run if the country **imports capital goods** (9708/14/M/J/25 Q28).
- **Terms of trade against the balance of trade (9708/22/O/N/23 Q4 (a)):** the terms of trade compare export and import **prices** (an index); the balance of trade compares export **revenue** and import **spending**. Keep them apart.
- **Data response with AD/AS (9708/21/M/J/21 Q1 (e)):** a sustained rise in net exports shifts AD right; benefits (output, jobs, the current account) against costs (inflation, less for the home market).

4. Calculate a balance from figures (9 questions)

1. **Find each balance:** credits minus debits. Some tables give credits and debits, some give net figures; some mix both.
2. **Add only the current account items:** goods, services, primary income, secondary income. **Leave out** capital account, financial account and the balancing item.
3. **Check the sign:** negative is a deficit, positive a surplus.

For example, exports of goods and services \$12 million, imports \$220 million and net income −\$15 million give $CAB = 12 - 220 - 15 = -223$, a deficit of \$223 million (9708/12/O/N/24 Q29).

Variations you will meet:

- **Credits and debits listed (9708/11/M/J/24 Q29):** goods $15\,000 - 17\,000 = -2000$; services $2500 - 2000 = +500$; primary $100 - 1000 = -900$; secondary $+60$; $CAB = -2340$.
- **Exports and imports for every part (9708/12/F/M/24 Q27):** $(150 - 200) + (70 - 50) + (120 - 100) + (15 - 20) = -15$.
- **Trade balance only (9708/13/M/J/22 Q22):** goods $+134\,000$ plus services $+8000$ gives $142\,000$; the capital and financial account and the balancing item are distractors.
- **Change between years (9708/12/F/M/24 Q28):** add goods and services for each year first (90, 80, 40, 70, 90), then compare the changes: the largest is -40 , from the second year to the third.
- **The balancing item (9708/12/M/J/21 Q23):** current + capital + financial + errors = 0, so $-7000 + 1300 + 7600 + x = 0$ and $x = -1900$.
- **What can and cannot be concluded (9708/12/M/J/23 Q17):** from the goods and services figures alone you can work out the missing exports or imports, but **not** the current account balance, because income flows are missing. Comparing two countries (9708/11/O/N/22 Q23): work out each country's balances before reading the options.
- **Percentage change in a deficit (9708/21/M/J/24 Q1 (a)(ii)):** work with the **size** of the deficit, without the minus sign. A trade deficit falling from \$858 million to \$410 million changes by $\frac{410-858}{858} \times 100 = -52\%$, so write "the deficit **fell by 52%**". The mark scheme wants the word "deficit" and "fallen" (not just "improved"), and accepted 51–53%.

5. Describe or interpret current account data (7 questions)

Short data-response parts (1–2 marks).

1. **Overall trend** (1 mark): one statement about the whole period, such as "the trade deficit fell" or "the balance moved from deficit to surplus". Don't describe each month.
2. **Describe a change** (2 marks): "from a **surplus** (1) to a **deficit** (1)". Use the words surplus and deficit, not "positive", "negative" or "worse" ([9708/22/F/M/22 Q1](#) (a)).
3. **Compare two countries** (2 marks): what they share ("both in deficit", 1) and the difference, using the units of the data ("the deficit was a larger **percentage of national income** in Cambodia", 1) ([9708/22/M/J/21 Q1](#) (b)).
4. **Explain an apparent puzzle**: "why is the current account in deficit despite a surplus on goods and on secondary income?" Only the **other** parts can cause it: a deficit on **primary income** (1) and/or on **services** (1) ([9708/22/O/N/24 Q1](#) (a)). Naming secondary income items earns nothing here.

Variations: label the export, import and trade balance lines on a graph (the trade balance line is the gap between the other two, and is below zero whenever imports are above exports, [9708/11/M/J/22 Q25](#)); explain a rising trade deficit with a current account surplus (more remittances or other income received, [9708/12/F/M/25 Q28](#)).

6. Why the balance of payments balances; financing a deficit (3 questions)

All multiple choice.

- The whole balance of payments balances because the **current account is matched by the capital and financial accounts** ([9708/12/O/N/21 Q21](#)); not because of exchange rates or government action.
- A deficit is **financed** by inflows on the financial account, such as attracting more **FDI** ([9708/11/O/N/21 Q24](#)) or borrowing, or by running down reserves.
- "The balance of payments must always balance" is **not** a reason for a government to let a current account deficit continue; good reasons are FDI financing it, surpluses elsewhere in the accounts, or cheaper imports raising living standards ([9708/13/O/N/24 Q25](#)).

Worked examples

Example 1

Which transaction is a **debit** in the **secondary income** account of country K's balance of payments?

A A resident of K receives dividends from shares in a foreign firm.

B K's government gives a grant to a country hit by a drought.

C A foreign tourist pays for a stay in a hotel in K.

D A firm based in K buys a factory in another country.

[1]

A is a primary income **credit** (investment income coming in). C is an export of services, a credit. D is foreign direct investment, in the financial account. A grant is a one-way transfer, and money leaves K. The answer is **B** (1).

Example 2

The table shows part of country W's balance of payments for one year.

	\$ million
Exports of goods	340
Imports of goods	395
Exports of services	120
Imports of services	85
Primary income credits	30
Primary income debits	64
Net secondary income	−9
Net financial account	+60

What is W's current account balance?

A −\$20 million **B** −\$54 million **C** −\$63 million **D** −\$3 million

[1]

Goods $340 - 395 = -55$; services $120 - 85 = +35$; so the balance of trade in goods and services is -20 . Primary income $30 - 64 = -34$. CAB = $-55 + 35 - 34 - 9 = -63$. The answer is **C** (1). A is only goods and services; B leaves out secondary income; D wrongly adds the financial account.

Example 3

Explain two reasons why an economy may have a surplus on the current account of its balance of payments and consider whether the surplus is likely to last. [8]

A current account surplus means the money a country receives from exports of goods and services, income from assets and work abroad, and transfers is greater than the money it pays out for imports, income and transfers to other countries (**1, AO1**). One reason is high productivity in its exporting firms: lower costs per unit let them sell at lower prices than foreign rivals, so foreign buyers choose its goods and export revenue rises (**1, AO1**). A second reason is weak spending at home, for example because households save a large share of their income, so the country buys few imports (**1, AO1**).

The surplus may last if it rests on productivity, because a cost advantage built on better technology and skills is not quickly copied by other countries, and quality and reputation keep foreign demand strong even when prices rise a little (**1, AO2**). It may also grow over time, since the foreign assets bought with the surplus earn interest and profits that come back as primary income credits (**1, AO2**). On the other hand, a surplus creates high demand for the currency, so a floating exchange rate appreciates: exports become dearer abroad and imports cheaper at home, and if demand is price elastic the surplus shrinks; a surplus caused by weak spending also fades once incomes and spending recover (**1, AO2**).

Whether it lasts depends on its cause: a surplus based on productivity and non-price quality is far more likely to persist than one based on a slump at home or a temporarily cheap currency, and a government that holds its exchange rate down can keep a surplus going for longer (**1, AO3**). So a surplus from competitive exporters is likely to persist, while one caused by low domestic demand is likely to be temporary (**1, AO3, justified conclusion**).

(Knowledge 3, analysis 3, evaluation 2: **8/8**.)

Example 4

Assess whether a country with a large and persistent current account surplus should take action to reduce it. [12]

Model answer (outline of each paragraph):

1. **Terms.** The current account and its four parts; a surplus means credits (export revenue, income and transfers received) are greater than debits; "large and persistent" means several per cent of GDP for many years. (*Accurate knowledge, part of Table A.*)
2. **Why it may need to act.** Net exports add to AD; near full employment the extra demand raises the price level (demand-pull inflation) rather than output. A large surplus means output is sent abroad instead of being consumed at home, so living standards are lower than they could be. Trading partners carry the matching deficits, with lower output and jobs there, and may retaliate with tariffs on the country's exports, which would hurt its export industries anyway. (*Developed chains on the domestic and external effects: Table A Level 3.*)
3. **Why it may not.** The surplus supports jobs and growth in export industries, especially if there is spare capacity. The foreign currency earned builds reserves and buys assets abroad that will pay primary income for years, useful for a country with an ageing population that needs income later. Acting to cut it, for example by pushing up the currency, could make exporters uncompetitive and cost jobs quickly. (*The other side, balanced and explained: Table A Level 3 (6–8 marks), here 8/8.*)
4. **Evaluation.** It depends on the **cause** (a surplus from competitive industries is less of a problem than one from very weak home spending), the **size** relative to GDP, whether the economy is at **full employment** (then inflation is the main risk), and how trading partners respond (the threat of protection makes action more urgent). A floating exchange rate may reduce the surplus without any government action. (*Weights the conditions: Table B top level (3–4 marks).*)

5. **Conclusion.** A government should act when the surplus comes from weak home demand and is causing inflation or trade disputes, because then it lowers living standards at home and abroad; when it reflects competitive industries and the economy has spare capacity, the benefits are greater than the costs and action is not needed. (*Justified conclusion: Table B top level, here 4/4.*)

(Table A Level 3: 8; Table B: 4; **12/12.**)

Common mistakes

- **"The current account is exports minus imports."** It also includes **primary and secondary income**. Examiners reported that accurate definitions with all four parts were rare.
- **Volume instead of value.** A deficit is about the **value** of payments (price × quantity), not the number of goods. Selling more units at a lower price can earn less.
- **Confusing the terms of trade with the balance of trade.** The terms of trade is a ratio of **prices**; the balance of trade is revenue minus spending. Examiners have reported this confusion in almost every year from 2022 to 2025; it can cost every mark in a part.
- **Remittances and wages.** Read the wording: a worker who "is employed in" another country (still a resident at home) earns **primary** income, even when the money is sent home; someone who "lives and works in" another country (settled) sends **secondary** income. In one paper only 6% of candidates placed a migrant worker's wages correctly.
- **Putting FDI or share purchases in the current account.** They are in the financial account; only the income they later pay is primary income.
- **Using PED vaguely.** Say what happens to export **revenue** and import **spending**, using the elasticity of each. Talking only about export volumes, or only about exports, limits the marks.
- **Asserting instead of explaining.** "A depreciation will lead to a surplus" earns little without the chain: export prices fall, and if demand is price elastic, export revenue rises.
- **Describing every month.** "Overall trend" and "describe the change" questions want one clear statement, using **surplus** and **deficit**, not "positive", "negative" or "worsened".
- **Only domestic, or only external, consequences.** When a question asks for both, an answer about one side is capped at Level 2. Many candidates also mix them up: jobs and inflation are domestic; the exchange rate and foreign investors are external.
- **Ignoring spare capacity.** A rise in net exports raises jobs only if there are unemployed resources; at full employment it raises prices.
- **Explaining one cause when the question says "persistent" or "consistently".** Persistent deficits usually have **structural** causes; a one-year boom does not explain them.
- **Summaries instead of evaluation.** Repeating the analysis is not a judgement; use size, duration, cause and financing, then conclude.

How to get the marks

- **Multiple choice:** for every transaction, ask "goods, services, income or transfer?", then "money in or out, for which country?" Write each balance next to a table before reading the options.
- **"Identify" or "state"** (1 mark each): one precise answer. **"Describe"** data (2 marks): direction and the turning point, using the words surplus and deficit and the units in the data.
- **"Calculate":** show the balances you added, give the sign and say "deficit" or "surplus". For a percentage change, say whether the deficit **rose** or **fell** by that percentage.
- **"Explain":** a chain of reasoning with at least two links: cause → effect on export revenue or import spending → effect on the balance.
- **8-mark (a) parts** are point-marked: up to 3 knowledge (define the current account, the imbalance, name the causes or components), 3 analysis (developed chains), 2 evaluation (one for a reasoned judgement, one kept for a justified conclusion). If the question says "two", give exactly two well-explained points.
- **12-mark (b) parts** are level-marked: 8 for knowledge and analysis, 4 for evaluation. Level 3 needs both sides, accurate and explained, tied to the current account. A one-sided answer gets **no** evaluation marks.
- **"Always", "more benefit", "concerned":** find the case where the claim fails (a surplus from a recession; a deficit from investment imports) and weigh the cases with size, duration, cause and financing.
- **"Domestic and external economy":** write a paragraph on each, then compare which consequences are most likely and most serious.

Quick check

1. Say where each transaction is recorded in country P's balance of payments, and whether it is a credit or a debit for P: (a) a resident of P earns wages on a three-month contract with a firm in country Q; (b) P's government pays its yearly contribution to an international organisation; (c) an insurance firm in P sells a policy to a shipping company abroad; (d) a foreign firm buys shares in a company in P.
2. Country R's figures (\$ billion): exports of goods 62, imports of goods 48, exports of services 15, imports of services 21, primary income credits 4 and debits 13, secondary income credits 5 and debits 2. Calculate the balance of trade in goods, the balance of trade in services, the balance of trade in goods and services, and the current account balance.
3. A country's balance of trade in goods and services moves from a deficit of \$650 million to a deficit of \$260 million. Calculate the percentage change and describe what happened. **[2]**
4. Explain how a country can have a deficit on its trade in goods and services but a surplus on its current account. **[2]**
5. Explain why a government may not be worried about a current account deficit caused by imports of machinery. **[2]**

Answers

1. (a) Primary income (compensation of employees), credit. (b) Secondary income, debit. (c) Trade in services (an export), credit. (d) Financial account, not the current account (the dividends paid later will be a primary income debit for P).
2. Goods $62 - 48 = +14$; services $15 - 21 = -6$; goods and services $+8$; primary income $4 - 13 = -9$; secondary income $5 - 2 = +3$. CAB $= 14 - 6 - 9 + 3 = +2$, a surplus of \$2 billion.
3. Using the size of the deficit: $\frac{260-650}{650} \times 100 = -60\%$ (1): the deficit fell by 60%, so the balance improved though it is still in deficit (1).
4. The current account also includes primary and secondary income (1). If net income and transfers received, such as profits from investments abroad or remittances from citizens working abroad, are larger than the trade deficit, the current account is in surplus (1).
5. Machinery is a capital good that raises the country's productive capacity and productivity (1), so it should lead to more output and exports in the future, which will reduce the deficit later (1).

Past questions to try

- **9708/11/M/J/24 Q29**: the current account balance from credits and debits.
- **9708/13/M/J/23 Q17**: where a migrant worker's wages are recorded.
- **9708/22/O/N/24 Q1**: (a) why there is a current account deficit despite a goods surplus.
- **9708/23/O/N/23 Q5**: (b) the domestic and external consequences of a persistent deficit.