Similar to book keeping and accounting in business firms, international transactions - international trade activity and the accompanied international financial settlement, must be recorded in a nation’s accounts over every certain time period. These are referred to as balance of payments accounts. While the balance of payments records transactions during a certain period, the statement of international investment positions presents a country’s financial claims on, and financial liabilities to, the rest of the world at the end of a given period. So they mirror corporate income statements and balance sheets in a sense. Unlike the accounts of individual corporations, the entries to balance of payments accounts are an aggregate of all relevant international transactions carried out by a country’s residents - corporations, individuals and government agencies. Therefore, the balance of payments is the statistical record of a country’s international transactions over a certain period of time. So is the international investment position statement in recording a country’s financial assets and liabilities.

The balance of payments and its accounts and the international investment position statement do not only record such international transactions and accumulated stock of assets/liabilities, but also indicate international flows of goods, services and capital, identify a country’s international positions in various areas, and demonstrate international economic linkages between nations. Making good use of balance of payments and international investment position information helps government policy formation and formulation, corporate financial management decision-making, as well as inter-governmental cooperation and coordination in international trade and monetary arrangements.

This chapter introduces the balance of payments and the international investment position statement, examining balance of payments accounts and categories, the ways in which entries to balance of payments accounts are recorded, and the relationships between these entries, between balance of payments accounts, and between the balance of payments and the international investment position statement. International economic linkages between nations and, in particular, a country’s international linkage with the rest of the world, are examined through analysing flows of goods, services and capital into and out of that country. International positions of individual countries revealed by the balance of payments and the international investment position statement are considered, together with the measures for altering the positions in specific areas.
4.1 Balance of Payments

The balance of payments is a statistical statement or record of a country’s international economic transactions with the rest of the world over a certain period of time, showing flows of goods, services and capital out and into the country. Transactions represented by flows of goods, services and capital are presented in the form of double-entry bookkeeping, i.e. every transaction is recorded as both a credit and a debit with equal values and opposite signs. A debit entry shows a purchase of foreign goods, services, and assets, which results in a decline in liabilities to foreigners and has a negative sign on a balance of payments account. A credit entry shows a sale of domestic goods, services, and assets, which incurs an increase in liabilities to foreigners and has a positive sign on a balance of payments account. While most entries in the balance of payments refer to transactions in which economic values are provided or received in exchange for other economic values, at times items are given away rather than exchanged. When these happen, recording is one-sided, special types of entries referred to as transfers are made as the required offsets.

Since the publication of the IMF Balance of Payments Manual 5th edition in 1993 (International Monetary Fund 1993) and its subsequent implementation, the structure and classification of balance of payments accounts have experienced significant changes. The development of the 5th edition of the Manual took place in conjunction with the development of the System of National Accounts 1993 and the two frameworks are now very closely aligned. According to the Manual, a balance of payments statement is constructed to include a current account and a capital and financial account. There involved major revisions and changes to the 4th edition of the Manual, not only in the names of the accounts, but also in the components of the accounts. Currently, the 5th edition of the Manual is the prevailing guideline for nations to follow in presenting their balance of payments, while proposals to revise and update it towards the 6th edition have been under way since 1999. In October 2000, the 13th meeting of the IMF Committee on Balance of Payments Statistics held in Washington, D.C. identified areas of the 5th edition of the Manual that require updating. This is prompted by the changes that have taken place in the international economy since the publication of the 5th edition of the Manual, the developments that are taking place in international trade negotiations, particularly in the services area, and the increased focus on both transaction and position statistics during and since the financial crises of 1994, 1997, and 1998. The focus of analysis, learned from the financial crises of 1994, 1997 and 1998, will be more on the financial account of the balance of payments and on the financial positions shown in the international investment position statement to be discussed in the following. External debt, reserves, and financial derivatives and other leveraged and complex transactions will be scrutinised in greater details.

The balance of payments provides flow measures for a certain time period, usually in one year. The IMF also compiles international investment position statistics that are stock at a specified time, usually at the year end. There are some relations between flows and stocks. The stock of a country’s financial assets at the latest