# International economics and finance

Finance

PART ONEINTRODUCTION

The most basic needs in an economic functioning is the starting of the expanding deficit and natural resources which are the essentials of making manufactured goods and are the most important foundation of consumption of economy. As the impact on the financial and economic development is a very entensive debate on its desirability in United Kingdom. Globalisation in both developed and developing countries have changed prior to the relatively unnoticed capital flows in the 1990's. The UK is one of the richest countries in the world, especially with the current decline in the global economy. They are one of very few that is managing to keep their heads above water.

As broadly defined, a Balance of Payment Account records all of the financial transactions of the government with the rest of the world (international economy) over a period of one year. (Begg D, 1987). Essentially, each transaction is always recorded relating with the double-entry bookekeeping. Any amount involved must be entered on each of the two sides of the balance of payment accounts to complete the balances. If the two sides of the balalcen of payment account are not the same, then the case if imbalance occurs. Therefore, these balances are referred to as surpluses or deficits in the balance of payment account.

This assignment attempts to discuss how can there be deficits or surpluses of the balance of payment account if the balance of payment account must always balance. With the introduction in the first part, it states the definition and principles of balance of payment. Part two consists of Structure of a balance of payment account, how does balance of payment account balance, causes of balance of payment surplus or deficit, reasons for financing a short term deficit and the steps in rectifying or correcting the deficit. Part three is the last part where there is a conclusion of any suggestions pertaining why the balance of payment account must always balance. Part four states the referencing and bibliography and details of the sources of information used in this essay.

PART TWO Structure of Balance of Payment Account

The Balance of Payment Account is divided into two sections where the current account measures both the trade in goods and trade in services whilst the capital account tracks associatedmoneyflows with investment, services and the currency stabilisation of the UK. Any credit transaction must have a corresponding debit entry so therefore; the sums must always be equal or balance at the end of each transaction made. In 1998 the UK's Balance of Payments transactions were brought into consideration with other members of the International Monetary Fund (IMF). The Balance of Payment's statistics was classified into groups as follows: the current account, the capital account, the financial account and the international investment position.

## How does a Balance of Payment Account balances?

As it has always been at the back of my mind when I was taught about the accounting principle of double entry, in every balance sheet there is a credit and debit entry. Every credit entry must have a sorresponding debit entry ans should always have an agreed sum of equal balance. Wherevet there is a surplus, there must be a deficit because they come to terms in a financial transaction and offset each other. Whenever the current account is a surplus, then there should be a deficit in the capital account. If there is a deficit in the capital account then it means that there is abruptly a rise in investment for the UK in the outside world but it cannot last because the other countries wolud also not want to be selling their assets to make another country benifiting from them. If the UK faces a current account surplus, then it is said to be that there is a flow of trade in goods and services funds. A current account surplus leads to an increase of external assets outside the UK.

On the other hand, if the current acount is on deficit there is a decrease of assets which are sold tofinancethe country. Each external transaction is entered in both the current and capital accounts to show the original transaction and how it has been financed.

## Causes of Balance of Payment Surplus or Deficits

There can be so many ways of causes of the balance of payment reaching the level of surplus or deficits. There might be a time when other outside countries are facing current account deficits whilst the UK is facing current account surplus. Therefore this is the most essential time to point out what causes the current account deficit before trying to find ways of correcting them. The causes are explained below as follows:

An over valued exchange rate can be a factor of current account deficit as it is believed that it is a branch of the exchange rate being too high which can lead to high export rate and high foreign markets when the import rate is going cheaper. The rising and falling of the imports and exports will affect the current account.

The rising of the level of the economic growth can also be a good reason for current account deficit because when consumption and investment tends to rise, there is an increase in spending for consumers which will encourage the deteriorating of the current account. The greater the marginal propensity of import, there will be an increase in imports too.

Lack of capacity productivity, poor pricing and non-pricing competition can cause current account deficit because if there in insufficient capacity to meet the needs from their consumers from the producers, then the imported goods and services comes into terms with the satisfaction of excessive demand. Quality, design, offers and reliability can also be considered as they are very important factors. Whereas inflation is seen as a key role for international competitiveness. It the inflation rate of the UK is higher to the rest of the world, and then it will be less competitive to the rest of the world. the UK's manufacturing sector has suffered over the last 25years because of low cost of production in some new industralised countries which is a declining comparative advantage.

## Reasons for Deficits and Financing a Short Term Deficit

## Ways of rectifying / correcting a Deficit

There can be ways in rectifying a deficit in the UK with government policies such as Expenditure Reducing Policies and Expenditure Switching Policies. In expenditure reducing policies, there can be higher direct taxes which can lead to a lower disposable income, increased interest rates to soften consumer confidence and consumption, and even the excess in the economy. By reducing the growth of domestic demand, it may encourage UK businesses to switch their production towards export markets. In other words, expenditure switching policies raises sterling price of imports, higher profitability of exporting but there can be an impact of lower exchange rate which depends on elasticity of overseas demand for UK exports. There can also be an instance of achieving a period of low relative inflation which helps the British economy with macroeconomic stability and important for their competitiveness.

PART THREE CONCLUSION

Currently, the UK is experiencing a current accouant deficit which is getting worst. On the other hand, it ignores the fact that trade deficits are linked to a weak pound currency. The government policy which is aimed at bringing an improvement of trade perrformance does not necessarily turn a deficit into a surplus but hence, the trade deficit is increasing around the world economy as the outside world is accpting the pounds in return for their import payments. The best thing the UK should dois to ignore the trade deficits and concentrate on the how to have a strong economy to attract foreign investment. Investors around the world are seeing the UK as a safe and profitable place for their savings so therefore, the trade deficit will still persisit and the British are better off because of it.

PART FOUR REFERENCING AND BIBLIOGRAPHY

Richard G L AND Chrystal K. A (2004) (10th Ed) Economics, Oxford: Oxford

University