**KEY CONCEPTS AND SKILLS: Unit 3.4 – Balance of Payments**

**Definitions:**

* **Balance of Payments**: A record (usually for a year) of all transactions between residents of a country and residents of other countries, showing all payments received (credits) and made (debits)
  + **Credit Items**: payments received from other countries
  + **Debit Items**: payments made to other countries
  + **Deficit**: in a balance of payments account, when the credits (inflows from abroad) are less than the debits (outflows to abroad)
  + **Surplus**: in a balance of payments account, when the credits (inflows from abroad) are greater than the debits (outflows to abroad)
* **Trade deficit**: when a country’s imports are greater than its exports (M>M); also called an “**unfavorable balance of trade**”)

**Concepts and Applications:**

1. ***Balance of Payments***
2. Outline the function of the balance of payments.
3. Distinguish between debit items and credit items in the balance of payments.
4. Explain the three accounts in the balance of payments
   * Explain the components of the *current account*, the *capital account*, and the *financial account*.
5. Distinguish between a current account *surplus* and *deficit*.
6. Explain why the current account balance must be equal to the sum of the capital account and financial account balances.
7. Examine how the current account and financial account are interdependent.
8. ***The Balance of Payments and Exchange Rates***
9. Explain why a deficit in the current account may result in downward pressure on the currency exchange rate.
   * Explain why a surplus in the current account may result in upward pressure on the currency exchange rate.
10. Compare and contrast fixed, floating and managed exchange rate systems.
    * Why might a country choose one system over another?
11. Explain the concept of “dirty float”.
12. ***HL Topics***
13. Calculate elements of the balance of payments from a set of data.
14. Discuss the implications of a persistent current account deficit.
15. Discuss the implications of a persistent current account surplus.
16. Explain the methods a government can use to correct a persistent current accounts deficit, and evaluate their effectiveness.
17. State the Marshall-Lerner condition and apply it to explain the effects of depreciation/devaluation.
18. Explain the J-curve effect, with reference to the Marshall-Lerner condition.