Methodological Guidelines on how to compile the Balance of Payments

The Balance of Payments (BOP) is defined as a statistic reporting system, reflecting total economic operations conducted between residents and non-residents over a certain period of time. The residential status of an institutional unit is identified through selection of any country's economic territory as the centre of its economic interests and close connection to the territory in question.

The BOP is compiled based upon a *double entry accounting* on ***current*** and ***capital accounts***. In this case any transaction is recorded through two opposite entries of equal value. Of these entries one being reflected on the credit side through **'positive',** the other one on the debit side through **'negative'** sign indicates inflows and outflows per exchange. According to the IMF's Balance of Payments Manual (6th Edition), the ***financial account*** in the BOP structure is classified under the **Net Assets/Net Liabilities** principle.

Export of goods and services, primary and secondary income generated are recorded in a balance sheet through the credit entry.

Import of goods and services, paid primary income and transferred secondary income are recorded in a balance sheet through the debit entry.

Majority of entries in BOP accounts reflect transactions with exchange of economic valuables between Parties: these economic valuables include ***real resources*** (goods, services, income, monetary aids) and ***financial resources*** (assets and liabilities). Under this principle the BOP is disaggregated into 4 parts:

- ***Current account balance*** - includes country's foreign trade (import-export), received and rendered services, received and paid primary income (salary, dividend, interest rate, rent and other payments of the kind) and secondary income (remittances, humanitarian aid, grants etc).

- ***Capital flow account*** – primarily reflects operations of a country with the rest of the world on non-produced non-financial assets (e.g. transfers of sportsmen) as well as other capital oriented transfers (e.g. equipment form humanitarian aid).

- ***Financial account*** – reflects country's *net external financial assets and net external financial liabilities.* Theese include various type investment flows, generated financial liabilities and claims (direct and portfolio investments, credits and loans, cash currency, deposits and other).

- ***Reserve assets*** – this item exhibits increase/decrease in country's foreign exchange reserves resulting from operations in current, capital and financial flow accounts. For instance, if unable to attract foreign borrowing to finance shortage of Current operations balance, the shortage is covered through intervening the forex market against Central Bank's forex reserves. Under the above accounting entries, the credit side shows assets decrease through a 'positive' sign, and the debit side shows assets increase through a 'negative' sign.

- ***Errors and omissions*** – conceptually all transactions with non-residents need to be recorded in the BOP. This item results from transactions, not recorded in the BOP components as statistic data. In practice, this item never drops to '0' in any country's BOP. Particularly, amid rapid expansion of country's economic ties, a number of transactions are hard to be exactly recorded (incomplete information, time interval between information sources, deviations in assessments etc). In most cases diverse information sources are utilized to record credit and debit sides of a single transaction. If one or some of these sources are incomplete, credit and debit sides fail to be equal, resulting in a certain gap. These gaps act as an errors and omissions item in the end total.

EXAMPLES on how to record operations in the BOP:

EXAMPLE 1. *'A'* country purchases USD 100 worth equipment from abroad. This transaction has two sides:

- Equipment brought in from abroad, which is a physical resource;
- USD 100 is paid abroad in return.

Dollar is a currency liability of the US Federal Reserve and is logically considered to be an asset of *'A'* country against the US Federal Bank.

Thus, as a result of this transaction in order to record an ***import transaction on the debit side of the current operations account,*** USD 100 is recorded as increase, the payment abroad amounting to USD 100 (in other words, decrease of financial asset of *'A'* country by USD 100) is recorded on the ***capital account's net financial assets*** column as decrease.

<u>EXAMPLE 2.</u> *'A'* country invites an expert from abroad to install the purchased equipment:

The invited specialist is a non-resident for the *'A'* country. Thus, permanent residential address, the centre of his/her economic interests are still in a foreign country, he/she has no intention to stay and reside in *'A'* country for a longer period. For this reason, the service rendered by the non-resident to residents of *'A'* country and income earned in return, as well as other operations with residents of *'A'* country are the BOP items.

According to the principle in *EXAMPLE 1,* decrease of the financial asset of *'A'* country as a result of the payment made to the non-resident expert is recorded in the ***capital account's net financial assets*** column as decrease, while as service import of *'A'* country it is recorded under ***Current account balance on debit* side.**

<u>EXAMPLE 3.</u> The foreign expert, when staying in 'A' country, spends money on accommodation, food, clothes etc.

Total of these expenditures is recorded as ***Export of tourism services in current account*** of the BOP of the *'A'* country. On the other hand, the volume of financial assets of *'A'* country increases through the funds spent by the foreign expert which is recorded in the same amount on the ***capital account's net financial assets*** column.

<u>EXAMPLE 4</u>. In some months the foreign expert (non-resident) finalizes his/her work and returns home. When leaving he/she purchases some products to sell in his/her country and shares of any domestic entity with no voting right.

Again, two economic cases occurred as an element of BOP. *'A'* country exported goods (***Current accounts balance***) and attracted foreign investment as portfolio investment (***Financial flow account***). This transaction is recorded as increase in ***Financial account's net financial liabilities***.

<u>EXAMPLE 5.</u> With the foreign expert's return home, a series of entries to the BOP does not end. Since an entity of *'A'* country has sold a portion of its shares to the non-resident, *'A'* country has a liability against the rest of the world and starts paying investment income in return. In the *'A'* country's BOP this transaction is recorded in the ***Debit*** *side of the* ***income section of Current account*** and the result of payments is recorded as decrease in ***Financial account's net financial assets***.