SOME BALANCE OF PAYMENTS CONFUSION*

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It is an inescapable fact that, while countries of the world may be engaged to varying degrees in foreign trade, their welfare is considerably affected by it. Large and economically advanced countries like the United States may derive a relatively small proportion of their income from foreign trade, but they cannot afford to neglect the impact of such international economic transactions on themselves and on the rest of the world, their share in world trade being relatively great. On the other hand, while the share in international trade of small and underdeveloped countries like Thailand may be comparatively small, it affects a significant proportion of their income(1) and they are compelled to keep an eye on what goes on in the rest of the world which may have repercussions on their economies via foreign trade.

In view of the importance of external trade to individual countries it is not surprising that increasing attention has been paid to the balance of payments representing a summary record of trade and other economic transactions between *residents* of a country and *residents* of the rest of the world during a given period of time(2). For its part, each Government, either through the Central Bank or through one of its Departments, undertakes the publication of the country's balance of payments annually or more frequently. This set of statistics constitutes not only a powerful tool of economic analysis(3) but also a helpful instrument of national economic policy. For one thing, it gives a broad, over-all view of a country's position vis-à-vis the rest of the world, assisting its authorities to reach decisions on such

* Thinking on this note has been stimulated by discussion with the writer's undergraduate students in international economics at the Faculty of Political Science, Chulalongkorn University.

(1) Export earnings account for 17% of the Gross National Product of Thailand (1950–1959).

(2) In what follows a "country", "foreign countries" and the "rest of the world" mean, where appropriate, "residents of a country", "residents of foreign countries" and "residents of the rest of the world" respectively.

(3) D.G. Badger: Balance of Payments –A Tool for Economic Analysis, IMF Staff Papers, September 1951.

questions as trade, payments and foreign exchanges(1). For another, it relates a country's international economic transactions to its national income, again enabling the authorities to develop not only suitable monetary and fiscal policy(1) but also proper plans for economic development or growth. In brief, apart from its theoretical value, the balance of payments is of great practical importance not only for external economic policy but also for domestic one.

Despite all this, some confusion arises over the balance of payments. To the writer's mind, much has resulted not only from the terminology but also from concepts in terms of which items in it are discussed and understood. It is unfortunate that adoption of improper terminology and concepts can lead further to an imperfect understanding of the true nature of the balance of payments itself. It is true that this was pointed out several years ago by Stephen Enke whose provocative paper(2) received comments from Robert L. Sammons later in the same year(3). As it seems to have been taken for granted by each party to the controversy that it has emerged victorious an outline of what the controversy was about may be helpful here.

Enke began by rejecting the receipt-and-payment terminology for describing and discussing items in the balance of payments and adopted instead the credit-and-debit terminology. Thus far Sammons could be in substantial agreement. Controversy arose, however, over the concepts in terms of which the credit and debit entries were to be explained. Enke was happy with the concepts of claim and counter-claim and Sammons's comments on this did not change his mind. Thus Enke and his colleague stated some years later that the balance of payments was essentially a balance of claims between residents of a country and those of the rest of the world(4). Sammons, on the other hand, found the concepts of claim and counter-claim unsatisfactory for the explanation of the balance of payments items and proposed instead concepts of asset and liability. These have been adopted by such economists as Charles P. Kindleberger(5). Both sides may therefore be said to have insisted on their own way of looking at things.

(1) Charles P. Kindleberger: International Economics, Revised Edition, 1958, pp. 16-17.

(2) Stephen Enke: Some Balance of Payments Pitfalls, American Economic Review, March 1951.

(3) Robert L. Sammons: Some Balance of Payments Pitfalls-Comment, American Economic Review, December 1951.

(4) Stephen Enke and Virgil Salera: International Economics, 3rd Edition, 1957, pp. 121, 125.

(5) Op. cit., pp. 19-20. Ironically, in Kindleberger's version the concept of claim replaces that of asset originally proposed by Sammons.

While much confusion has been cleared up by the efforts of the distinguished economists, it is the writer's humble submission, with all due respect to them, that something of it still remains which has not so far been noticed. It is the chief purpose of this note to make a modest attempt at clarifying what obscurity there is in the use of terms and concepts to explain items in the balance of payments. In this it will be well to begin by assessing arguments for and against using a given terminology, if only because such arguments are not found conveniently assembled in one place in the literature on the subject.

The very term "balance of payments" suggests that plus and minus entries in the balance of payments may conveniently be called "receipts" and "payments" respectively. To a certain extent and within certain limits, such terminology is useful and clear. For example, an export sale (a plus entry) may without the risk of being misunderstood be said to constitute *receipt* of funds from residents of foreign countries if settlement is made immediately so that there is no time lag due either to the time involved in shipping or to credit terms. Again, an import purchase (a minus entry) may safely be said to entail *payment* of funds to residents of foreign countries if there is no delay in settlement due generally to either of the two causes already mentioned[1]. In both cases the act of sale or purchase and that of settlement, being contemporaneous, fall within the same accounting period, no matter how short it may be, and it makes no difference whether the entries are made at the time of sale or purchase or at the time of settlement. Moreover. it is quite meaningful to speak of bank balances or foreign currencies acquired (both minus entries) as *payment* for exports[2].

On closer inspection the receipt–and–payment terminology does, however, lead to difficulties. In reality, settlement often lags behind an export sale or import purchase due to the time involved in shipping or credit terms so that *receipt* and *payment* are not contemporaneous with an export sale and import purchase respectively. All the same, entries are made in the balance of payments if the sale or purchase falls within the accounting period. The balance of payments does not therefore concern itself essentially with the corresponding *receipt* and *payment*. Moreover, by analogy with an import purchase (a minus entry), a minus entry representing currencies acquired

(1) This is merely enlarging Enke's point (Op. cit., pp. 161, 162) which needs stressing so as to give credit where it is due.

(2) This is touched upon by Enke (Op. cit., p. 163) and stressed by Sammons (Op. cit., p. 938).

through export may well be mistaken for *payment* out to residents of foreign countries(1). Finally, the receipt–and–payment terminology is totally unsuited to the true nature of a number of entries in the balance of payments in connection with which no *receipt* or *payment* ever takes place. These are the so–called "non-cash" items(2) including a direct barter of goods, transactions between branch plants of the same company in various countries and gifts(3). In these days, when bilateral agreements are made to assure each party of a secure market at any rate for a brief period, when companies expand their activities through investment in foreign branch plants and when inter–governmental grants are made to accelerate economic development, these "non–cash" items cannot be made light of.

The receipt–and–payment terminology being misleading in most cases, the language of double–entry book–keeping, whereby plus and minus entries are termed credits and debits respectively, has generally been adopted if only because it does not imply immediate or actual receipt and payment. The question then arises as to the adoption of criteria by which to judge whether an item is a credit or a debit. It is here that discussion in the literature is still confusing.

Enke (4) regards as credits items which give rise to a country's claims to payment on the rest of the world and as debits items which diminish such claims. On the strength of this an export sale is a credit entry, since a country's claims to payment are thereby increased by the corresponding amount. Again, judged by Enke's criteria, bank balances received in payment for exports constitute a debit entry, since the country's claims to payment are thereby diminished to the corresponding extent. Enke thus takes as his criteria changes in the country's claims to payment brought about by items under consideration.

But Enke also speaks of counter–claims (5) which, by analogy with claims just discussed, can be applied without complication. Imports are by this yardstick debit items since they increase counter-claims of foreign countries on a country while, by the same yardstick, bank balances transferred to foreign countries in payment for imports are credit items since they reduce such counter–claims by a corresponding amount.

(1) Stephen Enke, op. cit., pp. 161–162.

(2) P.T. Ellsworth: The International Economy, 1950, pp. 261–263.

(3) Charles P. Kindleberger, op. cit., p. 19; P.T. Ellsworth, ibid.

(4) Op. cit., pp. 162, 163; Stephen Enke and Virgil Salera, op. cit., pp. 125, 126.

(5) Op. cit., p. 162.

Thus to Enke's way of thinking credit items are those which either increase a country's claims to payment or reduce counter-claims on it and debit items are those which either reduce its claims to payment or increase counter-claims on it. It is in this sense that Enke speaks of the balance of payments as a balance of claims and counter–claims[1].

Sammons, on the other hand, finds it simpler to discuss credits and debits in terms of assets and liabilities in accordance with accounting practice. To him credit entries are those which either diminish a country's assets or increase its liabilities vis–à–vis the rest of the world and debit entries are those which either increase its assets or diminish its liabilities vis–à–vis other countries [2]. Thus exports are credit entries, since they diminish the country's assets by the amount of the goods transferred. Again, currencies or bank balances received in payment for exports are debit items, since these increase the country's assets to the same extent.

Up to this point all is clear. Unfortunately, Sammons also speaks of claims as instruments for settling transactions[3]. For instance, exports are paid for by foreign countries in such claims as balances in foreign banks or the exporting country's currency provided out of bank balances held in the country. In other words, payment for exports takes the form either of an increase in the country's claims on foreign countries or of a reduction in foreign claims on the country. Payment for exports being a debit item, this amounts to saying that a debit entry is one that causes either an increase in the country's claims on foreign countries or a reduction in foreign claims on the country–a statement which flatly contradicts that of Enke. In a similar manner, it can be argued that to Sammons's way of thinking a credit entry is one which causes either a reduction in the country's claims on foreign countries or an increase in foreign claims on the country [1] –a conclusion which is again sharply contradictory to that of Enke.

It is of the greatest importance to try to resolve such contradiction, if confusion is to be cleared up. Since Enke's and Sammons's arguments are both formally valid, the fact that they reach contradictory conclusions must be due their different premisses. In fact, both are seeing things in quite different light. Enke, on the one hand, concentrates on consequences brought about by entries, which consequences are quite distinct from acts giving rise to entries themselves. Since exports entail payment, they increase claims for payment. Similarly, since payment for exports eliminates a claim for payment

(1) Op. cit., p. 162.

(2) Op. cit., p. 938.

(3) Op. cit. pp. 939. Actually, such widespread use constitutes Sammons's objection to using concepts of claim and counter–claim for explaining balance of payments entries.

(1) See, for instance, Charles P. Kindleberger, op. cit., p. 16 et seqq.

of the corresponding sum, it reduces the country's total claims for payment. On the other hand, Sammons is not interested in such consequences but confines himself to analysing each act of transfer of goods or funds itself, regardless of its consequence. To him payment for exports increases a country's claims on foreign countries because the instruments of payment (e.g. balances in foreign banks) make it such. In fact, such tran-fer of funds from foreign countries to exporters and such increase in claims are merely aspects of the same act when looked at more closely. Similarly, from Sammons's restricted point of view, payment for imports reduces the country's claims on foreign countries because instruments of payment (e.g. balances in foreign banks) make it such. It need hardly be emphasized again that in the last analysis such transfer of funds to foreign exporters and such reduction in claims on foreign countries are but aspects of one and the same act.

Be this as it may, such distinction between the two approaches is subtle and not easily grasped by students of international economics. It seems to the writer much simpler to look at credit and debit items from a common-sense point of view. In general, as P.T. Ellsworth lucidly points out (1) for a thing received something must be given in exchange, while for everything given up, something can be expected in return. From this general principle it may be deduced that things given up in exchange for other things constitute credit items and that things obtained in exchange for what is given up constitute debit ones. Thus, an export sale is a credit entry, since payment for it can be expected. Similarly, payment for exports is a debit entry because it obliges the country to give exports in return. It must be made clear that what must be given in exchange for an entry may be bank balances, currencies, goods or whatever is accepted in international economic transactions. While this common-sense approach may not give students as much information on the actual details of international settlement as those of Enke and Sammons, it does have the distinctive merit of being clear and simple.

(1) Op. cit., p. 264.