The balance of payments accounting framework

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1 Overview

The balance of payments statement is a record of New Zealand residents' transactions with residents of other countries. The accounting framework covers the external transactions of all sectors of the economy – that is the household, government, and business, including financial, sectors. Transactions are recorded in New Zealand dollars and at the time ownership changes, or, in the case of services, when the service is performed.

The balance of payments statement consists of two accounts, the current account and the capital account. Double entry bookkeeping is used, so that in the accounting sense the accounts always balance: that is, the balance of the capital account is always equal to the balance of the current account, but with the opposite sign.

- The current account records income and expenditure flows, and, conceptually, is similar to a firm's profit and loss account.

- The capital account of the balance of payments reflects the financing/investment transactions which are the counterpart to the current account balance. If there is a surplus on the current account, then the capital account shows how that surplus has been invested, and if there is a deficit, the capital account shows how it has been financed. In other words, the capital account records transaction flows that help explain the evolution of a country's stock of international financial assets and liabilities, that is, changes to the balance sheet.

The main components of each of the current account and the capital account, how they 'add up', and the sections of this article where details on each are provided, are shown in table 1.

2 The current account

The credit side of the current account shows exports of goods and services, investment income from capital invested abroad by New Zealand, and transfers received. Transfers are monetary resources received by residents that

Table 1: Components of the balance of payments

Balance on merchandise trade	Section 2.1.1
Balance on services trade	Section 2.1.2
Goods and services trade balance[1]	
Investment income balance	Section 2.2
Net transfers	Section 2.3
Current account balance	**Section 2**
Net foreign direct investment	Section 3.1
Net portfolio investment	Section 3.2
Other net capital investment	Section 3.3
Change in official reserves	Section 3.4
Capital account balance	**Section 3**

[1] Note that in the official statistics published by Statistics New Zealand, the balances on merchandise trade and on services trade are not combined into an overall 'trade balance'. The 'invisibles' balance is also sometimes referred to in official data releases. This is the credit sum of services, investment income and transfers, less the debit sum. However, drawing a distinction on the basis of whether or not current account transactions involve physical goods is nowadays considered less relevant, given the increasing importance of service, investment income and transfer transactions.

do not involve exchange, eg bequests, aid and migrant transfers.

The debit side of the account shows imports of goods and services, investment income paid to overseas providers of capital to New Zealand, and outward transfers.

An indication of the overall pattern of New Zealand's current account transactions, averaged over the last three March years (1995, 1996 and 1997) is given in table 2.

The current account debits and credits shown in table 2 can be organised into three sub-categories:

- trade transactions (exports of goods and services less imports of goods and services);
- investment income transactions (investment income received from capital invested abroad less investment income paid to overseas providers of capital);
- transfers balance (transfers received less transfers paid).

The current account balance is the sum of the balances of these three categories. Each is elaborated on in the sections that follow.

2.1 Trade balance

2.1.1 Merchandise trade

Data on exports and imports of goods in the balance of payments is sourced from Customs data, which provide a comprehensive record of merchandise that crosses the border. However, some adjustment is required to the Customs trade data to ensure that it is consistent with balance of payments concepts.

Common conceptual adjustments include:

- when the physical movement of merchandise across the Customs border and ownership change do not occur at the same time, eg when goods are shipped to be warehoused overseas before being sold to an overseas buyer (ie goods sold on consignment). In addition, imported goods may pass into New Zealand ownership before they physically arrive. The frigate HMNZS *Te Kaha* is a case in point. *Te Kaha* passed into New Zealand ownership in the June 1997 quarter, but did not arrive until the September 1997 quarter. The ship was therefore recognised in the June quarter 1997 balance of payments imports, not September quarter imports;

Table 2
The broad pattern of New Zealand's current account transactions

Component	**Expenditure debits** (percentage of total)	**Income credits** (percentage of total)
Exports of goods		65
Exports of services		21
Investment income earned		3
Transfers received		11
Imports of goods	55	
Imports of services	20	
Investment income paid	21	
Transfers paid	4	
	100	100

- where equipment is exported or imported on an operating lease, or in other words, rental, basis. In this case, even though the equipment has crossed the Customs border, no merchandise import or export is recorded because there has been no change of ownership. An example is where Air New Zealand imports an aircraft under an operating lease.

2.1.2 Services trade

For New Zealand, the main categories of service exports and imports are transport and travel. The remaining smaller components of the services balance include insurance (all types other than cargo insurance, which is classified as a transport service), government current transactions (such as the operating expenses of New Zealand's embassies abroad), and a miscellaneous 'other services' category. Data on trade in services are mostly obtained from surveys conducted by Statistics New Zealand.

Transport:

This item covers services provided through carriers, such as carriage of freight, cargo insurance, passengers, and airport and harbour fees. Transportation services provided by New Zealand resident firms to non-residents (eg carriage of foreign passengers by Air New Zealand) are an export, and by non-resident firms to New Zealand residents (eg carriage of New Zealand passengers by Japan Airlines) an import.[2] Data are obtained from quarterly and annual surveys of New Zealand resident airlines and shipping companies. Non-resident airlines and ship operators are surveyed through their New Zealand offices or agents.

Travel:

Exports and imports of travel services comprise the goods and services acquired by individuals during their stay in a country. A 'traveller' is defined as a person who intends to stay in a country for less than a year. Expenditure by New Zealanders while travelling overseas is a debit entry, while expenditure by overseas visitors in New Zealand is a credit.

Data on overseas tourists' expenditures in New Zealand are derived from the *International Visitors Survey*, conducted by the New Zealand Tourism Board. Information contained in migration data on numbers of short-term visitors to New Zealand is also utilised.

Information on the expenditure of New Zealanders while travelling overseas has been obtained from a sample survey of returned New Zealand travellers. However, this monthly survey of returned travellers only operated over 1991-94. Therefore, quarterly estimates of travel imports are derived from the last survey results supplemented with immigration data on the numbers of New Zealanders returning from overseas travel.

2.2 Investment income balance

The investment income account records the income accruing to New Zealand investors from their investments and loans to overseas (credits), and the income accruing to overseas investors from their investments and loans to New Zealand (debits).

There are three classifications by functional type for investment income: official, direct, and other (portfolio).

2.2.1 Official investment income:

This captures the government's interest payments to non-residents and interest receipts from its overseas assets. Data on official investment income transactions are obtained quarterly from the Treasury and the Reserve Bank.

2.2.2 Direct investment income:

A direct investment relationship is defined as where an investor owns 25 percent or more of the equity of an enterprise.

2 The purchase of an airline ticket for an overseas trip by a New Zealand resident from Air New Zealand, however, is not a balance of payments item, since the transaction is between residents.

In these cases, the share of the post-tax earnings[3] of the enterprise corresponding to the ownership share is recorded as investment income. In the case of an at least 25 percent foreign owned company operating in New Zealand, the share of post-tax profit attributable to the foreign shareholder is recorded as an investment income debit. Conversely, the overseas earnings of off-shore firms that are at least 25 percent New Zealand owned are recorded as direct investment income credits.

Interest arising from lending and borrowing activities between resident and non-resident 'direct investment enterprises' is also recorded under this classification. These amounts are recorded gross of tax, with the tax on these transactions being recorded in government transfers.

Two points bear noting:

- first, it is the share of earnings, not just the dividends distributed, that are included as direct investment income. A direct investor's share of profits that are not distributed are accounted for as if the profits had been distributed and reinvested. For example, the undistributed profits of a New Zealand enterprise attributable to a foreign direct investor are treated as a direct investment income debit, and as a capital account direct investment inflow (credit). This reflects that non-residents, by retaining earnings in New Zealand, build up their stake in the New Zealand economy;

- second, in the balance of payments accounting framework, enterprises are considered to be a resident of the economy where they operate. Therefore, the earnings of a New Zealand branch of an overseas company are recorded as a direct investment income debit in New Zealand's current account, and the earnings of an overseas branch of a New Zealand company are recorded as a direct investment income credit.

[3] This comprises both dividends and earnings not distributed (but reinvested as retained earnings).

2.2.3 Other (portfolio) investment income:

This arises from investment relationships where an investor owns less than 25 percent of the equity of an enterprise. The principal types of income recorded are dividends, and interest arising from lending and borrowing. Where there is no direct ownership relationship earnings not distributed as dividends, but reinvested as retained earnings are not a balance of payments item. These undistributed earnings are not included where the shareholding is less than 25 percent, because the shareholder is not considered to have control or influence over their ultimate distribution.

Private sector international investment income flow data are obtained from Statistics New Zealand's *Quarterly Survey of International Investment Income*. In addition, information on investment income flows is sourced from the annual March *Capital Investment Survey*. This is a survey of all New Zealand enterprises identified in the Statistics New Zealand *Business Directory* as undertaking capital transactions with non-residents (approximately 5,500 enterprises). These surveys, however, do not cover investment income transactions of individuals, which are therefore not captured in the balance of payments data. Ideally these transactions would be included in the balance of payments; the only reason why they are not is the lack of a suitable data source.

2.3 Transfer balance

There are three types of transfer recorded in the balance of payments: government, personal, and migrant. The most significant are government and migrant transfers.

2.3.1 Government transfers:

Government transfers record non-resident withholding tax transactions, benefit and pension payments to foreign governments for New Zealand citizens living abroad, as well as foreign aid. Under the double entry bookkeeping system, offsetting 'contra' entries for transfers (such as pension and foreign aid payments) are recorded in the capital account under 'other investment capital'. Government transfer data are obtained directly from various government departments.

Non-resident withholding tax credits are the amount of tax that non-residents pay to the New Zealand government on dividend and interest income earned in New Zealand. The debit entries are the amount of tax New Zealand resident individuals and enterprises pay to foreign governments on their income earned in those countries.

2.3.2 Migrant transfers:

Funds which immigrants bring with them to New Zealand (credit entries) and emigrants take to other countries (debit entries) are recorded here. The value of household and personal effects of migrants that are actually transferred are recorded as migrant transfers, with offsetting entries in the merchandise imports/exports categories.

Migrant transfers are estimated by Statistics New Zealand, using migration data and information on fund transfers from the New Zealand Immigration Service.

It should be noted that in relation to migrants' transfers New Zealand's balance of payments statistics are compiled in accordance with the 4th edition of the IMF's *Balance of Payments Manual*. When Statistics New Zealand fully adopts the conventions laid out in the 5th edition, migrants' cash transfers presently classified as current transfers will be removed from the current account and entered in the capital account.[4]

If this revised classification of migrants' cash transfers had been in effect in recent years, the overall current account deficit would have been larger. For example, when inward migration to New Zealand was around its peak in the March 1996 year, the current account deficit as a percentage of GDP was around 4 percent. This rises to almost 6 percent of GDP when migrants' cash transfers are reclassified from the current account to the capital account. However, since then the impact of tighter immigration policy has seen migrant transfers fall sharply. Hence, the impact of the change in the new IMF accounting rules for migrants' transfers in the period ahead should be smaller.

3 The capital account

The capital account of the balance of payments shows how the current account deficit has been financed, or surplus invested.

To be included in the capital account:

- a transaction needs to involve a change of ownership which creates, or liquidates, an asset or liability;
- the asset or liability must represent actual claims that are legally in existence; contingent assets and liabilities are not recorded.

When an asset is created it is recorded in the capital account as a debit entry, while a liability is recorded on the credit side. The general structure of the capital account is shown in table 3 overleaf.

[4] With the adoption of the IMF's 5th edition *Balance of Payments Manual* the other main changes that will occur are as follows: there will be a new capital account with expanded coverage of financial items; and there will be a 10 percent equity holding rule for direct investment (against the current 25 percent used). The adoption of the 5th edition is expected to be completed by 2001. In July 1998 Statistics New Zealand will publish a developmental series of the balance of payments with migrant cash transfers reclassified.

Table 3
Components of the capital account

Component	Assets (debit)	Liabilities (credit)
Direct investment outflow	x	
Portfolio investment outflow	x	
Other capital outflow	x	
Official reserve assets[5]	x (increase)	x (decrease)
Direct investment inflow		x
Portfolio investment inflow		x
Other capital inflow		x
Net errors and omissions		x

The capital account debits and credits are classified into four categories:

- direct investment;
- portfolio investment;
- other capital;
- and official reserves.

Capital investment transactions of New Zealand individuals are not included due to the difficulty in collecting data.

3.1 Direct investment

Direct investment capital comprises all capital transactions, that is in both debt and equity, between enterprises in a direct investment relationship, ie where an investor owns 25 percent or more of the equity. Direct investment capital flowing into New Zealand enterprises by non-resident investors is recorded as a liability for New Zealand (a credit entry). Conversely, direct investment capital invested in a non-resident enterprise by New Zealand investors is recorded as an asset (a debit entry).

A distinction is made between long-term capital and short-term capital. Long-term is defined in terms of an original contract maturity of more than one year, or with no stated maturity, eg perpetual debt and most equity. Short-term capital is payable on demand, or with a contract maturity of one year or less.

3.2 Portfolio investment capital

Portfolio investment in New Zealand by foreign investors (capital inflow) is recorded in the capital account as a credit (increase in liabilities). Conversely, New Zealand's portfolio investment capital overseas (outflow) is recorded in the capital account as a debit (increase in assets).

Portfolio investment comprises mainly private investment in long-term bonds and corporate equities which is not classified as direct investment (because there is not a 25 percent or greater ownership share). Portfolio investment includes investment in securities issued by the

[5] As a matter of accounting practice, decreases in official reserve assets are shown as a negative debit entry.

government and private sectors, and held by non-residents, whether directly or through nominee companies.

3.3 Other investment capital

Other capital consists of all financing and investment transactions not included elsewhere in the capital account. The transactions recorded are those with unrelated parties, ie there is no ownership relationship. The transactions recorded consist of changes in assets and liabilities of the banking system, private companies, and the government sector.

3.4 Official reserves

Reserves are financial claims on non-residents that are available to the Reserve Bank and the New Zealand Treasury. Five categories of reserve are recorded: monetary gold; IMF special drawing rights; reserve position at the IMF; Reserve Bank overseas reserves; and Treasury overseas reserves.

3.5 Net errors and omissions (residual)

In order to balance the balance of payments accounts a balancing item is needed. This captures errors and omissions resulting from:

- the variety of data sources used to construct the balance of payments, and differences between accounting balance dates which some firms follow and source data survey requirements;
- the possibility of error in reporting and compilation by survey respondents;
- the fact that some transactions are not captured.