An introduction to the United Kingdom balance of payments

Introduction

The balance of payments is one of the UK's key economic statistical series. It measures the economic transactions between UK residents and the rest of the world. It also draws a series of balances between inward and outward transactions, provides a net flow of transactions between UK residents and the rest of the world and reports how that flow is funded. Economic transactions include:

- exports and imports of goods, such as oil, agricultural products, other raw materials, machinery and transport equipment, computers, white goods and clothing
- exports and imports of services such as international transport, travel, financial and business services
- income flows, such as dividends and interest earned by foreigners on investments in the UK and by UK residents investing abroad
- financial flows, such as direct investment, investment in shares, debt securities, loans and deposits
- transfers, which are offsetting entries to any one-sided transactions listed above, such as foreign aid and contributions to EU budget.

Closely related to the balance of payments is the international investment position series of statistics. The international investment position measures the levels of financial investment with the rest of the world, inward and outward.

International statistical standards

The Office for National Statistics (ONS) follows the international standards relating to balance of payments and international investment position statistics. There are several reasons for this. First, domestic and foreign analysts will be assured that the UK's official balance of payments and international investment position statistics comply with objective, coherent international standards that reflect current, global analytic needs. Second, the UK is a member of the international community and international users need comparable data for analysis between countries. Third, the UK, as a member of the European Union, as well as organisations such as the IMF and OECD, needs to compile its various economic statistics in conformity with standards set by those organisations. Fourth, the UK can compare and reconcile its data with those of other countries. Statistics need to be as comparable as possible in order to carry out this validation.

To facilitate such consistency and to provide guidelines for its members, the IMF issued the Balance of Payments Manual. The first edition appeared in 1948 and the sixth edition in 2008. The conceptual framework of the UK balance of payments corresponds to that underlying the sixth edition of the IMF Manual, referred to as *BPM6*. *BPM6* was implemented in the UK's balance of payments accounts and international investment position statistics in September 2014. The impact on the UK's balance of payments and international investment position as a result of the introduction of new international standards for the period 1997 to 2013 was published as annex to the UK's balance of payments, Q2 2014 edition.

A process of reviewing the existing international standards started in the early 2000s with the aim of incorporating the numerous elaborations, classifications, and improvements and updates in methodology that had been identified since the publication of the fifth edition of the *BPM* in 1993, and to strengthen the theoretical foundation and linkages to other macroeconomic statistics. The production of BPM6 was conducted in parallel with the update of the System of National Accounts (*SNA*) to maintain and enhance consistency among these manuals. *BPM6* was prepared by the IMF in close co-operation with national compilers and with the Statistical Office of the European Communities, the OECD, the United Nations and the Bank for International Settlements. In 2010, the EU produced its own version of *2008 SNA,* the *European System of Accounts (ESA2010),* upon which the UK's national accounts are based and which is consistent with *BPM6*.

Conceptual framework definitions

Balance of payments

Broadly speaking, the UK balance of payments is a statistical statement designed to provide a systematic record of the UK's economic transactions with the rest of the world. It may be described as a system of consolidated accounts in which the accounting entity is the UK economy and the entries refer to economic transactions between residents of the UK and residents of the rest of the world (non-residents).

The balance of payments accounts are concerned not only with payments made but also any economic transactions during a period that give rise to a payment in an earlier or later period, for example, goods may change ownership in one period, though payment may be made in an earlier period (pre-payment) or in a later period (trade credit). They also include transactions for which there may never be a payment, for example, goods shipped under foreign aid or goods shipped between related enterprises. There is also more than one 'balance': the balance of payments is a system of accounts in which many balances can be derived, such as the balance of goods and services, the current account balance, and capital and financial account balance.

Balance of payments statements cover a wide range of economic transactions which include:

(i) goods, services, primary income and secondary income

(ii) capital transactions, such as capital transfers, and

(iii) financial transactions involving the UK claims on, and liabilities to, non-residents.

Category (i) is shown in the current account, category (ii) in the capital account and category (iii) in the financial account.

International investment position

The UK's international investment position is a closely related set of statistics. It can be viewed as the balance sheet recording the UK's stock (or level) of foreign financial assets and liabilities at a specific point in time. The net international investment position is the difference between the stock of foreign financial assets and foreign liabilities at a particular date.

Viewed more broadly, the international investment position can be shown as a reconciliation statement of the stock of investment at two different points in time by showing financial transactions and other changes (non-transaction changes) such as price changes, exchange rate effects and other adjustments that occurred during the period. Financial transactions that are included in the reconciliation statement are equivalent to the transactions measured in the financial account of the balance of payments. ONS does not currently publish a full reconciliation of the international investment position showing price, exchange rate and other changes.

Classifications such as assets and liabilities, type of investment (direct, portfolio, other investment, financial derivatives and reserve assets), and instrument of investment, are used consistently in both the balance of payments and the international investment position.

Concepts of territory and residence

In compiling the UK balance of payments and international investment position, the UK economy is conceived as comprising the economic entities that have a closer association with the territory of the UK than with any other territory. Each such economic entity is described as a resident of the UK. Any economic entity which is not regarded as a resident of the UK is described as a non-resident. The concept of residency is not based on nationality.

The UK's economic territory is defined to include the territories lying within its political frontiers and territorial seas, and in the international waters over which it has exclusive jurisdiction. It also includes its territorial enclaves abroad holding, for example, embassies, consulates, military bases, scientific stations, information or immigration offices, or aid agencies, whether owned or rented by the UK Government with the formal agreement of the countries where they are located.

The Crown Dependencies – Jersey, Guernsey and Isle of Man – are not part of the UK. Therefore transactions between UK residents and the islands are in the UK balance of payments, but transactions between islanders are not counted in the UK balance of payments. The islands are not part of the EU, so statistics relating to them are not required under *ESA2010* and they have to be excluded from the UK's economic territory to ensure full UK consistency with *ESA2010*. The Crown Dependencies are subject to their own fiscal authorities and have their own tax systems. Furthermore, there are impediments to taking up residency on the Channel Islands (the Bailiwicks of Jersey and Guernsey).

For balance of payments purposes, residents of an economy are generally deemed to have a centre of economic interest in the economy and to be resident for at least one year. The residents of the UK comprise:

- Resident general government institutions including the Scottish Government, Welsh Government, Northern Ireland Assembly and local government authorities and statutory bodies. The UK territorial enclaves (for example, embassies, consulates, military bases) physically located abroad are included in the UK's economic territory and are therefore residents. Similar entities of other countries physically located within the UK are outside the UK's economic territory and are therefore non-residents

- Resident financial and trading enterprises which include all enterprises engaged in the production of goods and services on a commercial or equivalent basis within the territory of the UK. Enterprises may be incorporated or unincorporated; privately or government owned and/or controlled; and locally or foreign owned and/or controlled. The definition of an enterprise in terms of the territory in which it is located often makes it necessary to divide a single legal entity into a head office operating in one economy and a branch operating in another economy. Resident enterprises include UK branches of foreign companies and exclude foreign branches of UK companies.

- Resident non-profit bodies, those in which individuals and/or enterprises combine, as owners, to produce goods and services within the territory of the UK for purposes other than to provide a financial return for themselves. Examples are churches, charitable organisations and representative business organisations such as chambers of commerce.

- Resident households and individuals that broadly encompass all persons residing in the territory of the UK for one year or more, whose general centre of economic interest is considered to be the UK. The UK's official diplomatic and consular representatives, the UK's armed forces, other UK Government personnel stationed abroad and their dependants, UK students studying abroad, and UK patients being treated abroad are also included even though they may all be abroad for one year or more. They are treated as UK residents since their centre of interest is considered to be the UK. Generally, the centre of economic interest of persons visiting the UK for less than one year is considered to be outside the UK and they are therefore regarded as non-residents, but if they stay for one year or more they are considered to be residents for balance of payments purposes. Irrespective of their length of stay, non-residents also include foreign diplomatic, consular, military and other government personnel and their dependants, foreign students studying in the UK, and foreign patients being treated in the UK. If an individual maintains residences in the UK and another economy, they are considered to be UK residents if they typically spend more time in their UK residence than their foreign residence during the year.

Double-entry system

Rules for the UK double-entry system

Credit entries, changes in all economic resources provided by the UK to non-residents, including:	**Debit entries,** changes in all economic resources received by the UK from non-residents, including:
Exports of goods and services	Imports of goods and services
Income accruing to the UK from non-residents	Income accruing from the UK to non-residents
Transfers that are offsets to debit entries	Transfers that are offsets to credit entries
Financial liabilities of the UK to non-residents	Financial claims of the UK on non-residents

	Examples of UK double-entry recording	Credits	Debits
1.	Sales of goods (value 100) to non-residents for foreign exchange (that is, goods provided and bank payment (a bank deposit) received in an account held abroad)		
	Goods	100	
	Bank deposits, foreign currency assets		100
2.	Purchase of goods (value 120) from a non-resident using trade credit (that is, goods received and a claim on a resident (trade credit liability) provided)		
	Goods		120
	Trade credit liabilities	120	
3.	Food aid (value 5) provided to non-residents (that is, goods provided and transfer imputed)		
	Goods	5	
	Secondary income (transfer)		5
4.	Repayment of a loan (value 25) by a resident company to a non-resident lender (that is, liability to a non-resident reduced and a reduction in bank deposits held abroad)		
	Loan repayment	-25	
	Bank deposits, foreign currency assets		-25

Conceptually, an economic transaction has two sides: something of economic value is provided and something of equal value is received. The balance of payments reflects this in a double-entry recording system of credits and debits. When an economic value is provided (for example, UK exports a car) a credit entry is made, and when the corresponding economic value is received (for example, a payment for the car) a debit entry is made. For example, when an exporter sells (provides) goods to a non-resident, the exporter may receive cash (a financial asset) or another type of financial asset (for example, a trade credit claim) in return. The export is represented by a credit entry in the current account and the financial asset acquired is represented by an offset debit entry in the financial account. Similar entries are made when an importer buys a car (debit) and pays for it (credit). So a credit entry represents a change in rest of world ownership of any sort of UK asset (real or financial) while a debit entry represents a change in UK ownership of the rest of the world assets.

An understanding of the double-entry recording system is necessary for a complete understanding of balance of payments statistics.

Under the double-entry system, by definition credit entries must equal debit entries. Credit entries are required for exports of goods and services, income receivable, and changes in financial liabilities. Likewise, debit entries are required for imports of goods and services, income payable, and changes in financial assets. Where something of economic value is provided without something of economic value in exchange (that is, without a quid pro quo) the double-entry system requires an offset to be imputed (a transfer entry) of equivalent value. For example, food exported as aid requires a credit entry for the goods provided and a debit transfer as the aid offset.

Sign convention in the UK balance of payments statistics

The sign convention used in presenting the UK balance of payments statistics is to give a positive sign to an increase in either credit or debit entries and a negative sign to a decrease in credit or debit entries. Balances (calculated as credits less debits) or items that are net credits have no sign, while balances that are net debits have a negative sign.

When considering making international comparisons it should be borne in mind that there is no unique or correct sign convention and other countries/institutions use variations. In particular the convention used by the IMF in their publications gives no sign to credit entries and a minus sign to all debit entries (for example, imports and acquisitions of assets).

Errors and omissions

It follows that, in principle, under a double-entry accounting system, the difference between the sum of credit and debit entries must be zero. In practice, some transactions are not measured accurately (that is, errors) and some are not measured at all (that is, omissions). Data sources used to compile the accounts often measure the credit and debit sides from different data sources and may not always do so consistently. There could be many reasons why these sources may not measure the acquisition side of the transaction and the corresponding payments, either in the same accounting period or at the same value. To restore the equality of credit and debit entries, a net errors and omissions item is included in the balance of payments accounts. The item indicates whether credit or debit transactions would be needed to balance the accounts, but does not show where the discrepancy lies. Usually the financial account is considered to be the most likely source.

Valuation

It is important that the balance of payments and international investment position statistics carry values that have economic meaning to enable useful analysis, and to provide meaningful indicators of cross-border economic activity. It is also important for the double-entry accounting system that a uniform valuation is adopted. This means that the credit and debit entries of each transaction – which in practice may be derived from independent sources – should be valued at the same price. In addition, a uniform valuation is essential to sum different types of transactions on a consistent and comparable basis. The use of a uniform valuation principle aids understanding by users. Moreover, statistics for different countries will not be comparable unless both parties to a transaction adopt the same valuation principle. It is also important to use a principle consistent with national accounting principles. For all these reasons, market price is used in UK economic statistics for valuing transactions.

Market price is the amount of money that a willing buyer pays to acquire something from a willing seller, when such an exchange is between independent parties and involves only commercial considerations. In practice, one or more of the conditions needed to establish a market price may be absent and other valuations may be used.

For the most part, the price at which a transaction is recorded in the accounts of the transactors or in the administrative records used as data sources will be the market price or a very close approximation of it. This valuation is known as the transactions price and is the practical valuation basis used in the balance of payments, both because it aids consistent recording of credits and debits and because of its usual proximity to the ideal market valuation. The following paragraph discusses a special case of transactions where market prices may not apply, namely transfer pricing between affiliated enterprises in different countries.

Transfer pricing

Where transactions are between affiliated enterprises in different countries, the prices adopted in their books for recording transactions in goods and services and any associated indebtedness and interest – referred to as transfer prices – may not correspond to prices that would be charged to independent parties. There will be some departure from the market price principle if transfer prices are different from those charged to enterprises outside the group. However there are practical difficulties in identifying and suitably adjusting individual cases. Transfer pricing to avoid tax is illegal in the UK so the distortions in the international accounts caused by transfer pricing are not considered widespread. For both reasons, adjustments to account for transfer pricing are rarely made in practice.

Assets and liabilities

As with all international investment position statistics, foreign financial assets and liabilities should, in principle, be valued at their current market price at the reference date. In practice this is not always possible and valuation guidelines are adopted in order to approximate market valuation, particularly for those financial assets and liabilities that are only rarely transacted. For example, in measuring the value of direct investment in equity capital, much of which is never traded or is traded infrequently, market value is approximated by one of the following methods: a recent transaction price, directors' value, or net asset value. Over time, this is likely to underestimate the true market value of foreign direct investment.

Unit of account and conversion

Transactions and stock positions originally denominated in foreign currencies need to be converted to pounds sterling using market rates of exchange prevailing at the time of the transaction (balance of payments) or at the reference date (international investment position). Transactions should be converted at the mid-point of the buying and selling exchange rates applying at the time of transaction. Stocks should be converted at the mid-point of the buying and selling exchange rates applying at the beginning or end of the period. In practice, the actual rate used varies according to the source of the transaction or stock

Time of recording

Transactions

The time of recording of transactions in balance of payments and international investment position statistics is, in principle, the time of change of ownership (either actual or imputed). Under the double-entry system, both sides of a transaction should be recorded in the same period. This is consistent with the principle of accrual accounting, which requires that transactions be recorded when economic value is created, transformed, exchanged, transferred or extinguished.

Change of ownership is considered to occur when legal ownership of goods changes, when services are rendered and when income accrues. In the case of transfers, those imposed by one party on another, such as taxes and fines, should ideally be recorded at the moment at which the underlying transactions or other flows occur which give rise to the liability to pay. Other transfers should be recorded when the goods or services change ownership.

For financial transactions, the time of change of ownership is taken to be the time when transactions are entered in the books of the transactors. That is taken to be the time when a foreign financial asset or liability is acquired, relinquished by agreement, sold or repaid. The commitment or pledging of an asset does not constitute an economic transaction, and no entry should be shown unless a change of ownership actually occurs in the period covered. Likewise, the entries for loan drawings should be based on actual disbursements and not on commitments or authorisations. Entries for loan repayments should be recorded at the time they are due rather than on the actual payment date.

Both sides of a transaction should be recorded in the same period. In practice the time of recording of transactions in the balance of payments and international investment position statistics will reflect the practices in data sources, and may diverge from the principle of time of change of ownership. For the UK, transactions in goods credits (exported goods) are mainly recorded at the time when goods are shipped as this is assessed to be a generally good practical approximation of the time when ownership changes. Goods debits (imported goods) are recorded when customs records relating to the movement of the goods across the frontier are processed, again in the expectation that this is the best practical approximation to change of ownership that can be generally achieved. For the remainder of the current account, the time of the recording of transactions generally complies with the time of change of ownership. Exceptions occur mainly because the record-keeping practices of some data providers may not be on this basis. Financial account transactions usually are recorded appropriately, that is, when the parties record transactions in their books. However, some transactions may be derived from information supplied by intermediaries that are not party to the transactions and may not be aware of the time of change of ownership. Also, some enterprises may adopt accounting practices that lead to inconsistent time of recording. A simple example is that different enterprises may close off their accounts at different times of day.

Stock

The time of recognising the stock of a foreign financial asset or liability follows naturally from the time of recording of a transaction in that asset or liability. For example, if a transaction is undertaken to acquire a foreign financial asset, there will also be a consequential increase in the stock of foreign financial assets at the end of that period. Of course, if the asset is disposed of before the end of the period, it will not contribute to the stocks statistics to be recorded for the period, but the disposal will have given rise to another transaction to be recorded for the period.

Types of transactions in the balance of payments

An economic transaction occurs when something of economic value is provided by one party to another. Transactions that are considered to have economic value comprise those in goods, services, income and financial assets and liabilities. The transactions recorded in a balance of payments statement stem from dealings between two parties, one being a resident and the other a non-resident. The types of transactions included in the balance of payments are exchanges, one-sided transactions and imputed transactions.

Exchanges

Exchanges are the most important and numerous type of transaction. They include transactions in which one transactor provides something of economic value to another transactor and receives in return something of equal value.

Special cases of imputation/estimation

Reinvested earnings

A number of special cases of imputed transactions feature in balance of payments compilation. One case involves the reinvestment of earnings in resident enterprises by their non-resident direct investors. These *reinvested earnings* are regarded as being paid out as investment income and then reinvested in the enterprises from which they originated. They are therefore recorded both as a component of investment income in the current account and as a component of direct investment in the financial account. It is considered analytically useful to identify these transactions separately in economic statistics because of the substantial contribution they make to the stock of direct investment finance in a country.

Financial services

A further case relates to estimation for the implicit fees associated with financial services. These include spread earnings on foreign exchange, derivatives and securities trading and Financial Intermediation Services Indirectly Measured (FISIM), which is the implicit margin resulting from interest rate differentials between borrowing and lending.

Exceptions to change of ownership

In economic statistics, transactions are considered to occur when the goods and financial assets change ownership between transactors, when services are provided by one transactor to another, or when income is earned by one transactor from another. However, there are certain situations in which no change of ownership legally occurs, but where transactions are nonetheless considered to have occurred for balance of payments purposes. The situations include financial leases and transactions between a head office in one country and a branch in another.

Financial leases

A financial lease is regarded as a method of obtaining all the rights, risks and rewards of ownership of real resources without holding legal ownership. Although legal ownership remains with the lessor during the term of the lease, all the risks and responsibilities apply to the lessee. In these cases, the basic nature of the transaction is given precedence over its legal form, by imputing a change of ownership of the resource to the lessee. As a result of this imputation, a financial liability is recognised and lease payments are classified as partly loan repayments in the financial account and partly interest in the current account, rather than as services in the current account.

Financial leases

Under *BPM5*, the value of goods entering or leaving the UK for processing and returning to the country of origin after processing was recorded on a gross basis (an exception to the change in ownership principle). That is, recording the goods both when they enter (as imports) and when they leave (as exports), even though there is no legal change of ownership of those goods. Under BPM6, goods sent aboard for processing should no longer be recorded as exports and imports of goods where there is no change of ownership, instead the processing fee should be recorded as a service. In practice this is extremely difficult to measure, so under ONS methodology the gross flows are only adjusted by the value of the service associated with processing, which is likely to only be a faction of the value of the goods themselves.

Branches

In economic statistics, it is usually necessary to split the activities of a legal entity and recognise two units, a head office in one country and a branch in another. Flows of goods, services, income and finance between the branch and its head office are therefore treated as transactions, even though they are legally part of the same unit. For example, goods and services sent from the head office to its branch are to be treated as exports of goods and services by the head office.

There are two cases where such splitting becomes necessary. The first occurs when production of goods and services is undertaken by the personnel, plant and equipment of the legal entity in an economic territory outside the economic territory of the head office, provided certain conditions apply. These conditions include: the intention to operate in the separate economy indefinitely or over a long period (12 months is used as a rule of thumb); keeping a set of accounts of the branch's activity (that is, income statement, balance sheet, transactions with the parent entity); eligibility to pay income tax in the host country; having a substantial physical presence; and receiving funds for the branch's work which are paid into its own bank account.

The second case occurs when a person or legal entity resident in one economy owns land and buildings located in another economy. Ownership of immovable assets is always attributed in balance of payments and international investment position statistics to residents of the economy in which the assets are located. Thus land in the domestic territory, which is in fact owned by a non-resident, is treated as being owned by a notional resident entity, which in turn has a foreign direct investment liability to the real owner. It should also be recalled that the territorial enclaves (for example, embassies, consulates, military bases) are regarded as part of the economic territory of the economy they represent. When these institutions buy and sell the land in these enclaves they are effectively adding to and subtracting from the economic territory of their government. Such transactions in land owned by foreign embassies are recorded in the capital account as the acquisition/disposal of non-produced, non-financial assets.

Other changes in the international investment position

In addition to the financial transactions included in the balance of payments, the international investment position reconciliation statement includes the other changes which contribute to differences between opening and closing positions for a period.

Other changes in position may occur through price changes, exchange rate changes and other adjustments. Price changes are valuation changes that occur because of changes in the market price of a financial instrument, such as a change in the price of a share or debt security, or through revaluing a company's net worth.

Exchange rate changes are due to fluctuations in the value of the pound, in which the accounts are compiled, relative to the currencies in which foreign assets and liabilities are denominated.

Other adjustments can arise from a number of causes such as write-off of bad debts, classification changes, and monetisation/demonetisation of gold. A reclassification would occur where a foreign investor's equity investment in an enterprise increased during the reporting period and the increase was sufficient to change the classification of the investor's total equity holding at the end of the period from portfolio investment to direct investment. Monetisation of gold occurs when the Bank of England monetises commodity stocks of gold and adds these to its monetary gold holdings as part of the UK's official reserve assets.

Gross and net recording

Entries for current and capital account items are generally treated so that credits for each component are recorded separately from debits. Current and capital account transactions, in this context, are described as being recorded gross.

Gross recording contrasts to the recording of a number of transactions in the financial account which are recorded on a net basis, although for direct investment and long-term trade credits and loans, gross drawings and repayments are included in the financial account. The net recording of other financial account items means that, for each item, credit transactions are combined with debit transactions to arrive at a single result – either a net credit or net debit – reflecting the net effect of all increases and decreases in holdings of that type of asset or liability during the recording period. There are several types of netting in the financial account, for example, the netting of purchases and sales within an instrument in an asset position.

Standard balance of payments classification

Balance of payments and international investment position statistics need to be arranged in a coherent structure to facilitate their use and adaptation for purposes such as policy formulation, analytical studies, projections, bilateral comparisons, and regional and global aggregations. *BPM6* contains a standard classification and list of standard components of the balance of payments and international investment position. These standards were developed taking into account the views of national compilers and analysts, and the requirement to harmonise concepts and definitions with related international statistical standards and classifications. The classification also reflects the separation of categories that may exhibit different economic behaviour, may be important in a number of countries, are readily collectable, and are needed for harmonising with other bodies of statistics.

The standard balance of payments classification comprises two main groups of accounts – the **current account** and the **capital and financial account**. Transactions classified to the **current account** include goods and services, primary income and secondary income. Within the capital and financial account, the **capital account** includes capital transfers and the net acquisition or disposal of non-produced, non-financial assets. The **financial account** includes transactions in financial assets and liabilities.

Transactions in current account and capital account items are generally shown on a gross basis (gross debits and credits separately). Transactions in financial account items are recorded on a net basis, with the exception of some direct investment transactions.

Current account

Table A, found in Part 1 of the Pink Book, shows the standard classification of the current account. Each of the broad categories is described briefly below, while individual component items are described in detail in subsequent chapters.

Goods and services are divided into separate accounts. **Goods** comprise most movable goods that change ownership between UK residents and non-residents. **Services** comprise services transactions between UK residents and non-residents, together with some transactions in goods where, by international agreement, it is not practical to separate the goods and services components (for example, goods purchased by travellers are classified to services).

Primary income refers to income earned by UK residents from non-residents and vice versa. Primary income is comprised of compensation of employees, investment income and other primary income.. **Compensation of employees** comprises wages, salaries and other benefits earned by individuals from economies other than those in which they are residents, as well as earnings from extraterritorial bodies such as foreign embassies, which often employ staff from the economy in which they are located. **Investment income** comprises income earned from the provision of financial capital and is classified by direct, portfolio and other investment income and income earned on the UK's reserve assets. **Other primary income** comprises rest and taxes & subsidies on production and on the import of goods.

Secondary Income represents the provision (or receipt) of an economic value by one party without directly receiving (or providing) a counterpart item of economic value. In plain terms, this is a transaction representing 'something for nothing' or without a quid pro quo (for example, the provision of food aid). **Current transfers** are distinguished from **capital transfers**, which are included in the capital account. Current transfers represent the offset to the provision of resources that are normally consumed within a short period (less than twelve months) after the transfer is made. In the example of food aid, the food is presumed to be consumed within twelve months of it being received. The classification of current transfers is by general government and other sectors.

Capital account

The capital account comprises both capital transfers and the acquisition and disposal of non-produced, non-financial assets (such as copyrights). The latter includes land purchases and sales associated with embassies and other extraterritorial bodies. Capital transfers entries are required where there is no quid pro quo to offset the transfer of ownership of fixed assets, or the transfer of funds linked to fixed assets (for example, aid to finance capital works), or the forgiveness of debt.

Financial account

The financial account comprises transactions associated with changes of ownership of the UK's foreign financial assets and liabilities. The main classifications used in the financial account are discussed in conjunction with the international investment position classification below.

The **international investment position** measures the UK's stock of external financial assets and liabilities, whereas the **balance of payments financial account** measures transactions in these assets and liabilities. Hence the classifications used in the financial account and international investment position need to be essentially the same.

Major classifications of the financial account and international investment position

Items in the financial account and international investment position statement are classified on a number of bases. The main ones are **type of investment**, **assets and liabilities**, **instrument of investment**, **sector**, and **original contractual maturity of financial instruments**.

A comparison of the international investment position statement and the balance of payments financial account shows one minor difference. In the category of direct investment in the financial account, the reinvestment of earnings is shown separately, whereas in the international investment position statement, where no separate market price valuation of reinvested earnings can exist, the reinvested earnings are grouped into a composite category for equity and reinvested earnings.

Type of investment

The type of investment used in the UK's balance of payments and international investment position (IIP) consists of five broad categories:

- **Direct investment** capital refers to capital provided to or received from an enterprise, by an investor in another country (that is, an individual, enterprise or group of related individuals or enterprises) who is in a direct investment relationship with that enterprise. A direct investment relationship exists if the investor has an equity interest in an enterprise, resident in another country, of 10 per cent or more of the ordinary shares or voting stock. The direct investment relationship extends to branches, subsidiaries and to other businesses where the enterprise has significant shareholding.

- **Portfolio investment** refers to transactions in equity and debt securities (apart from those included in direct investment and reserve assets). Debt securities comprise bonds and notes and money market instruments. In comparison with direct investment, it indicates investment where the investor is not assumed to have any appreciable say in the operation of the enterprise (for example, less than 10 per cent of the ordinary share or voting stock).

- **Financial derivatives** cover any financial instrument the price of which is based upon the value of an underlying asset (typically another financial asset). Financial derivatives include options (on currencies, interest rates, commodities, indices), traded financial futures, warrants and currency and interest swaps. Under *BPM6*, transactions in derivatives are treated as separate transactions, rather than being included as integral parts of underlying transactions to which they may be linked as hedges. For 2004 to 2009, financial derivatives data comprise all UK banks' derivatives assets and liabilities positions and their net derivative transactions. Prior to 2004, only estimates for the settlement receipts/payments on UK banks' interest rate swaps and forward rate agreements are included in financial derivatives data and only in the financial account; financial derivatives are not included in the IIP before 2004. From 2010, the financial derivatives data include the financial derivatives activity of UK securities dealers in addition to UK banks.

- **Employee stock options** are defined as 'options to buy the equity of a company, offered to employees of the company as a form of renumeration'. Within the financial account and international investment position tables, financial derivatives and employee stock options are presented together.

- **Other investment** is a category that captures transactions not classified to direct investment, portfolio investment, financial derivatives or reserve assets of the compiling economy. Other investment covers trade credits, loans (including financial leases), currency and deposits, and a residual category for any other assets and liabilities.

- **Reserve assets** refer to those foreign financial assets that are available to, and controlled by, the monetary authorities such as the Bank of England for financing or regulating payments imbalances. Reserve assets comprise: monetary gold, Special Drawing Rights, reserve position in the IMF and foreign exchange held by the Bank.

Assets and liabilities

A financial **asset** is generally in the form of a financial claim on the rest of the world that is either represented by a contractual obligation (such as a loan) or is evidenced by a security (such as a share certificate). Two financial assets – monetary gold and Special Drawing Rights in the IMF – are not claims on the rest of the world. They are, however, included in international investment assets because they are readily available for payment of international obligations. A financial **liability** represents a financial claim of the rest of the world on the UK. Assets and liabilities in the international investment position statement are components of the balance sheet of an economy with the rest of the world. In the financial account the asset and liability classifications in essence reflect, respectively, transactions in claims on non-residents (assets) and in claims by non-residents (liabilities).

In the international investment position, the difference between assets and liabilities is the net international investment position, also referred to as the net liability position/net asset position, depending on the balance.

For **direct investment**, in both the financial account and international investment position, the data are presented on an assets and liability basis, that is, direct investment abroad and direct investment in the UK. Direct investment abroad is derived by summing the claims of the UK direct investors on their direct investment enterprises and claims their direct investment enterprises have on the direct investor. Similarly, direct investment in the UK is derived by summing the liabilities of the UK direct investment enterprises to the direct investor and the liabilities of the direct investor to the UK direct investment enterprise.

Instrument of investment

Several instruments of investment are also identified. Some of these are only applicable to one type of capital, that is, the instrument **reinvested earnings** is only applicable to direct investment, while **monetary gold** and **Special Drawing Rights** are only used for reserve assets.

The major instruments and grouping of instruments identified in balance of payments and international investment statistics include:

- monetary gold
- Special Drawing Rights
- foreign exchange
- reserve position in IMF
- equity
- reinvested earnings
- debt securities
- financial derivatives
- employee stock options
- trade credit
- loans
- currency and deposits

- other assets/liabilities

Similar instruments may be combined into groups or combined with certain types of investment to make statistical presentations less cluttered. For example:

- trade credit, loans, deposits, and other forms of finance including all debt securities, but excluding equity capital and reinvested earnings, between non-financial enterprises in a direct investment relationship, are combined and shown only as **other capital**. Similar aggregation applies to finance between a financial enterprise and a non-financial enterprise and between financial enterprises only in case of permanent debt

- bonds, bills, notes and money market instruments within portfolio investment are shown separately but under a heading of **debt securities**

- a number of financial assets, held as part of the UK's reserves assets (currency and deposits, bills, bonds, notes and money market instruments), are grouped under the category **foreign exchange** within the reserve assets category

Foreign equity and debt

At a broader level, instruments may be combined to show foreign equity and foreign debt. Foreign equity includes equity capital, reinvested earnings and equity securities. Foreign debt is a residual item containing all other instruments. They may be compiled on a gross basis (for example, foreign debt/assets and liabilities) or on a net basis (for example, net foreign debt).

Sectorisation

Transactor units within an economy may be grouped together into institutional sectors. Units within the same institutional sector may be expected to behave similarly in their financial and other dealings and in response to differing economic and political stimuli. The principle of classification by sector, or sectorisation, in the financial account and international investment position is to identify the sector of the domestic creditor for assets and the sector of the domestic debtor for liabilities.

Four sectors are generally distinguished in the standard components of the ONS balance of payments and international investment statistics:

- **monetary financial institutions**

- **central government**

- **public corporations**

- **other**

Within the current and capital accounts, sectorisation is also applied to current and capital transfers, where a split between **general government** and **other** is used.

Original contractual maturity

The sixth edition of the balance of payments manual aims to distinguish between long-term or short-term investment. Investment longer than one year is deemed to be long-term and investment of one year or less is deemed to be short-term.

Other financial classifications

Other classifications in the financial account and international investment position include the domicile of liabilities issued by residents, drawings and repayments for long-term liabilities in the form of both trade credits and loans and the currency of assets and liabilities.

Country classification

The general principles applying to the compilation of a global balance of payments statement for the UK can be applied to the preparation of a statement for the UK's transactions with an individual country or a group of countries.

Reliability of estimates

All the value estimates are calculated as accurately as possible; however they cannot always be regarded as being absolutely precise to the last digit shown. Similarly, the index numbers are not necessarily absolutely precise to the last digit shown. Some figures are provisional and may be revised later; this applies particularly to many of the detailed figures for the latest years. For example, calendar year data for the International Trade in Services Survey and Foreign Direct Investment Survey are not available until after Pink Book publication. Therefore, the latest Trade in Services and Direct Investment data published in the Pink Book are provisional estimates and subject to annual benchmarking after publication.

The latest data when available for the International Trade in Services Survey can be found at:
www.ons.gov.uk/ons/search/index.html?newquery=international+trade+in+services+survey
The latest data when available for the Foreign Direct Investment Survey can be found at:
www.ons.gov.uk/ons/search/index.html?pageSize=50&newquery=foreign+direct+investment+survey

Symbols and conventions used in the tables

Rounding

As figures have been rounded to the nearest final digit, there may be slight discrepancies between the sums of the constituent items and the totals as shown.

Symbols

The following symbols are used throughout:

.. = not available

- = nil or less than a million

References

The internationally agreed framework for the presentation of the Balance of Payments and the National Accounts are described in the following publications:

Balance of Payments Manual (6th edition), International Monetary Fund (ISBN 978-1-58906-812-4), https://www.imf.org/external/pubs/ft/bop/2007/pdf/bpm6.pdf

Balance of Payments and International Investment Position Compilation Guide, International Monetary Fund (ISBN 978-1-48431-275-9), https://www.imf.org/external/pubs/ft/bop/2007/bop6comp.htm

European System of Accounts (ESA 2010), Eurostat. http://epp.eurostat.ec.europa.eu/portal/page/portal/esa_2010/introduction

System of National Accounts (2008), (ISBN 978-92-1-161522-7). http://unstats.un.org/unsd/nationalaccount/docs/SNA2008.pdf