Balances of Payments – Contemporary Problems

Assoc. Prof. Yordanka Stateva, Ph.D.

Summary: The article covers contemporary problems concerning the balances of payments in our dynamic world.

The first problem concerns the economic importance of the information provided by the balance of payments. In principle nowadays a company can choose how to supply foreign markets – either by traditional export or by locating production on foreign countries' territory. For quite a long period of time American companies have been locating production in many foreign countries. By doing this they actually "export" merchandise without it getting registered in the trade balance of the USA as an export. Under these circumstances can the balance on goods trade be considered a measure for national competitiveness?

On the basis of officially used methodology, the problem concerning the American trade deficit, respectively the surpluses of the biggest trade partners of the USA has been analyzed.

A very important question in the context of the global disbalances concerns the period of time they can be sustained. A comparison with the Bretton – Woods system is very useful in this respect.

The analysis of the balances of payments of the emerging markets is an important part of the article and that includes Bulgaria's balance of payments and the impact of the world financial crisis.

Key words: balance of payments, current account deficit, global disbalances.

JEL: F30, F40.

The present paper discusses actual issues related to the balance of payments in the contemporary dynamic world of complex economic and political relationships and connections. Necessarily, some issues of the balance of payments of Bulgaria as a country-member of the EU are also included in the presented analysis.

Every country prepares a balance of payments in the form of a statistical table, which includes its international transactions; the purpose is to present to the respective authorized bodies the information, which is at the base of important decisions related to the economic policy of the country.

For the first time, a balance of payments was prepared in the United Kindom in 1819 in the form of a register of the international transactions of the country. In 1947, after the Second World War, the United Nations published a balance of payments scheme as an official document. Later, the IMF developed on the basis of this scheme a unified methodology for drafting a balance of payments, valid for all countries – members of the Fund. The IMF introduces regularly changes in the developed scheme and at the moment, there is a new sixth edition of the IMF Balance of Payments Manual (Revision 2008) responding to the necessity of updating different elements of the concept and, specifically, the structure of the balance of payments according to the dynamic changes in the world economy and the global financial system.

This is the time horizon within which the scheme has been prepared and updated and **important elements of the theoretical basis of the balance of payments** have been defined and perfected. In general terms, they can be presented as follows.

The balance of payments can be described as a summary table containing information on the international transactions of a country for a certain time period, usually one year. Firstly, the international transaction includes exchange of commodities, services, or financial assets between residents of different countries. However, the balance of payments includes also transactions, in which foreign country residents do not participate directly and this is the case when the central bank of a country sells part of its foreign-exchange reserves to commercial banks in the same country. Secondly, the million single transactions between country residents and the rest of the world cannot be manifested and registered separately in the balance of payments. As a summary table, the balance of payments includes the international transactions of the country in a few main categories [1]. First main part – the current account – includes all sales and purchases of commodities and services, investment income and unilateral transfers. This part represens the link between the international transactions of the respective country and its national income.

The second main part – the capital and financial account – reflects the changes in relation to financial assets (without the official reserve assets) and, in particular, in relation to foreign financial assets owned by residents and, respectively, the national financial assets, owned by non-residents. The change in the reserve assets of the central bank is an expression of official state policy, and not of market forces, the latter being, therefore, excluded from the capital and financial account and are contained in a specific section.

The transactions in the first two sections of the balance of payments – the current, capital and financial account, are performed with commercial motivation (except for unilateral transfers) and independently of any reasons related to or caused by the balance of payments condition. Transactions with official reserve assets are set apart in a third section because of their characteristic and functions – they are the most clearly expressed balancing items – a result of the balance from the previous two sections – and they are used exactly for reasons related to the balance of payments, being totally the expression of the official state policy.

Each international transaction, included in the balance of payments, is determined from the beginning as credit or debit transaction. In general, transactions are credit, if they include receipts from non-residents, while debit transactions include payments to non-residents. For example, the export of goods and services, unilateral transfers received from foreign countries, as well as capital inflow, are defined as credit transactions. The import of goods and services, unilateral transfers to foreign countries, capital export, are debit transaction. At the same time, the value of each international transaction is entered in the balance of payments twice – once as a credit and second as a debit or vice versa, accounting for the really existing two sides of each transaction. The balance of payments is prepared on the basis of the so called principle of double-entry bookkeeping.

The terms passive and active balance of payments are incorrect from the economic point of view. The balance of payments, as its name suggests, is always balanced from the accounting point of view. Passive and active balances can be registered for certain items only. Without entering into details and presenting the development of different concepts, nowadays the balance of payments is usually represented by the current account balance.

In general terms, these are the main principles of preparation of the balance of payments. In practice, the technology of this process comprises quite complicated procedures; many issues are the target of economic analyses and changes for a long period of time. The variety of problems, respectively, the offered solutions, are a result of different concepts and their development – which are at the basis of the discussed topic.

The contemporary dynamic economic reality brings about many questions concerning balance of payments and, respectively, requires answers to them. One of the most important issues can be defined as follows – what is the **economic meaning of the information provided by the balance of payments**, isn't it more correct nowadays to consider that the balance of payments is more concealing than revealing the international economic activity of the companies in the respective country, as well as national competitiveness. In this respect, the question follows to what extent can the macroeconomic decisions in the country be considered as well grounded from the economic point of view on the basis of official data from the balance of payments.

In the contemporary world, a company can in principle choose how to supply foreign markets – by traditional export or by locating its production on the territory of another country or countries. When, for example, an American company locates its production in Japan or in some European country, the commodities produced and sold by the American company in the respective foreign country, are not registered as export in the balance of payments of USA – there is no crossing of frontiers.

The development of the trend towards depreciation of the US dollar to the euro in the last few years placed the emphasis on problems related to the falling competitiveness of export commodities from the eurozone, sold in dollars. European companies, including large automotive producers, had to make important decisions with respect to locating their production or increasing the production that is already located in the USA, while bringing down their European business, respectively, traditional export. When BMW and other European companies increase their production in the USA, while decreasing the production of cars located in Europe, when large European companies in many other sectors decide to locate their production in the USA and, in this way, to supply goods to the American market instead of the traditional export from Europe, as its competitiveness goes down because of the unfavourable trend in the exchange rate, continuing for years, which influences the trade balance of the respective European countries as export decrease. This also means lost jobs in the country exporting industries, with all following unfavourable social and other economic consequences.

There has been a long period of time, during which American companies were locating their production in many foreign countries in the world and, thus, they in fact “exported” their commodities, without this being reflected in the US trade balance as export, however. A justified question arises as to what degree the trade balance is an indicator (a criterion) of national competitiveness unter the described contemporary conditions? The trade balance can be treated only as an indicator of the ratio between the values of commodities produced within the national economy that have left the country and the value of the imported commodities produced on the territory of foreign countries. In this case, it is important to underline that the export commodities are produced in the respective national economy mostly using national resources. Such an indicator is undoubtedly meaningful. The international economic activity of local companies, however, can take different forms, respectively, the trade balance is just one of the indicators of national competitiveness. If the export, done by American companies by locating production in other countries was also taken into account, then the trade balance of USA would register a considerable surplus.

What is, at present, the real situation with the American trade balance, taking into account the officially applied methodology, and what are the reasons to deal with this issue. The issue of **the American trade deficit**, respectively, the surpluses of the largest US trade partners, the discussed link between changes in this respect, and the constantly depreciating dollar during the last few years are the target of economic analyses in many publications. The American trade deficit is described as the most well-known and, respectively, the most important disbalance in the world economy [2]. The USA registers a trade deficit since 1976, and the largest part of this deficit is due to the disbalance in trade with two countries – China and Japan. Another important issue of interest concerning the American balance of payments in general, in the conditions of the continuing global financial crisis, is **the dependency of the American economy on foreign capital.**

During the last years, a conclusion is often made that the depreciating dollar is a part of a natural process of decreasing the American trade deficit. Theoretically, the weak dollar creates economic incentives to increase the export. The data show that the export from USA increased by 17 % in 2007, respectively, the trade deficit decreased by 11 % compared to its record level for 2006. Nevertheless, the USA trade deficit amounted to more than 700 billion USD for 2007, which amounts to 5.1 % of the country’s GDP. And as the American import is almost twice as big as the export, the conclusion follows that a further depreciation of the US dollar is needed in order to further decrease the trade deficit [3]. Data about the large trade surpluses of Japan, the eurozone, China, Russia, Saudi Arabia in the trade with the USA, are used as an additional argument. The surplus of Japan in the trade with the USA is higher than 100 billion USD, for the eurozone, it is 40 billion USD, China has about 250 billion USD trade surplus, and Russia – 140 billion USD – the same as Saudi Arabia. The conclusion can be made that the weak dollar has not caused any trade problems for the main partners of USA in the international trade, respectively, the effect of the depreciating dollar, in reality, is not exactly the one expected theoretically. In this respect, papers exploring **the link between the applied currency regime, respectively,**

the exchange rate and the changes in the current account deserve attention**.** According to the established and usually accepted theoretical principle, a floating exchange rate can ensure an automatic regulation of the balance of payments of the respective country. In general, this theory takes into account the following mechanism: the depreciation of the national currency creates economic incentives to increase exports, while the import becomes more expensive and, respectively, decreases. And if a country with floating exchange rate just leaves its national currency become cheaper on the market, and this is what the USA did for several years, the described mechanism will automatically result in the correction of the large trade deficit. For a country with a fixed exchange rate, this mechanism cannot be applied unless an official devaluation measure is implemented. These are the theories from the world of textbooks. At the same time, the latest empirical studies carried out by economists on the current account balances of 170 countries in the world for the period 1971 – 2005 do not confirm the theoretical principle that countries with floating exchange rate have more flexible current account balances than countries with fixed exchange rate [4]. The conclusion follows that it is not advisable to count on the exchange rate for correction of trade disbalances, especially if they are significant. What the usage of the exchange rate instrument can achieve is to support an already existing trend with respect to the trade balance.

The fact that follows shows **the dependency of the American economy in general, and particularly of the balance of payments of the country, on the inflow of foreign capital**. Nowadays, the value of the issued American Treasuries is about 4 trillion USD, and more than a half are owned by foreign investors. In order to implement the anti-crisis program for the financial sector, adopted in October 2008 by the US Congress at the amount of 700 billion USD, the American authorities intend to issue Treasuries up to this value, which would be offered on capital markets. Until now, the largest holder of American Treasuries is China, which has purchased bonds from the American government at the total of about 1 trillion USD. Here again, the US counts on the interest of Chinese and other foreign investors. If such interest is not manifested, there will be no incoming flow of foreign capital – or at least not the necessary amount. In this case, the reaction of the authorized institutions in the USA would be by all means directed towards raising the interest rate, but nowadays the American economy in its fight with the recession requires and imposes just the opposite as a interest rate measure. Using the interest rate and, more precisely, manipulating the interest rate takes place in the presence of counteracting, complicated, and contradictory goals and interests.

What is **the state of the balance of payments of the EU as a whole**? The EU has registered a current account deficit – for the first quarter of 2008, this deficit equals 23.7 billion EUR, which represents 0.8 % of GDP. Only for June 2008, the total EU trade deficit (27 countries) was at the amount of 20.1 billion EUR (for comparison – in June 2007 the deficit of the EU was 9.1 billion EUR). The contribution of Bulgaria is significant in this respect – the negative trade balance of our country is 3.9 billion EUR for June 2008. The EU trade deficit is the highest in the energy sector – 148.6 billion EUR for the period January – May 2008, compared to 100 billion EUR for the same period of 2007 [5]. At the same time, it is worth paying attention to the fact that the picture is quite varicoloured for the different countries-members of the EU. The United Kingdom has the highest trade deficit, followed by Spain and France. Germany has the highest trade surplus, followed by Holland and Ireland.

It is interesting, first of all, to analyse the state of the balance of payments of Germany, which is the largest European economy. The main issues related to global disbalances usually boil down to the high current account deficit of USA and the trade surplus of China. It is almost an unknown fact that Germany trade balance surplus is higher than the one of China and in 2007 it was 6 % of the country's GDP. As a member of a monetary union with unified currency, Germany cannot use the exchange rate in its function of a rebalancing instrument [6]. The reason is that, in this respect, the economic needs of the countries-participants are significantly different. Among the 15 in the eurozone (from 1 January 2009 they become officially 16), there are such countries like Spain, France, Portugal, Greece with significant current account deficits. For example, the current account deficit of Spain in the beginning of 2008 equals 100 billion EUR, which amounts to 10 % of its GDP [7].

Actual economic analyses of Germany – the largest exporter in the world and one of the most important engines of economic growth in the eurozone and in the EU as a whole, reveal problems in relation to the impact of the global financial crisis, respectively, economic difficulties that are arising and becoming deeper. 65 % of the German export is for the EU. The slow-down of economic growth in the United Kingdom, France, Italy and other countries in the eurozone, which jointly absorbed up to 2/3 of German export, is at the basis of the decrease of this export. Nowadays, at least, this effect cannot be compensated by the increase of internal demand and consumption and for the second quarter of 2008 the registered decline of the German economy is 0.5 % (compared to the first quarter) [8]. At the same time, economic forecasts show that for 2008 Germany will still remain exporter number one in the world. Every third job in this country is dependent on the export.

The other large economies in the EU – France and Italy have serious problems in this aspect. The current account deficit of France for 2007 increased by 78 % compared to 2006 and this is a result mainly of the higher trade deficit.

The United Kingdom is one of the large European economies, a member of the EU which, however, has always had a special opinion on the currency problems of the Union. It is also one of the EU countries with serious balance of payments problems. The current account deficit of the United Kingdom in the early 2008 reached the record level for a time of peace of 4 % of the country's GDP. The high household and government spending contributed to this result. According to the opinions of economists, published in Financial Times, the United Kingdom cannot afford to go on endlessly borrowing from the rest of the world amounts equivalent to 4 % of the country's GDP [9]. The attention in the analyses is directed towards the exchange rate in its role of a rebalancing mechanism, as far as the United Kingdom does not participate in the eurozone and can afford using the exchange rate instrument in this regard. The numbers and conclusions are the following. According to most economic models, a 10 % decrease of the nominal value of the British national currency can be associated with a decrease of the current account deficit approximately by 0.5 % of GDP. Taking this into account, as well as the fact that the British pound has already depreciated by about 10 % with respect to other international currencies in the first half of 2008, in order to clear the current account deficit only on the basis of this mechanism, the British pound must further depreciate by 70 %. In reality, the depreciation of the British pound can contribute to a decrease of the current account deficit, but this mechanism alone is not sufficient for overcoming the problem. Secondly, the attention is directed towards household spending and a considerable decrease of this spending is forecasted for the years 2008 and 2009 down to levels reached during the recession in the early 1990s – a fact, which will influence the demand of imported commodities towards a decrease. Thirdly, the analysis examines export revenues. During the last ten years, the export from the United Kingdom to continental Europe has increased by about 2.5 % annually on the average, while for the previous decade this percentage was about 8 %. Continental Europe is a buyer of about 70 % of British commodities and a possible conclusion is that the United Kingdom bears the consequences of low demand on its main markets – a problem, which is likely to get more serious. The price increase of British export commodities also contributes to the problems with the United Kingdom's balance of payments as this increase during the last years was bigger in comparison with the prices of its main competitors. The rate of increase of wages in the national economy, as well as the strong national currency, have also contributed to the declining competitiveness of British export.

In the analysis of international trade flows, respectively, the state of the balance of payments of different countries, what should be taken into account is the important fact of the openness of the economy, i.e. the differences in the dependency of different countries on international trade. France, Germany and other European countries are much more dependent on international trade relationships than the USA. For many European countries, the annual volume of import and export equals 30 – 40 % of the respective GDP. For USA and Japan, the annual volume of import and export is usually from 10 % to 20 % of the country's GDP. Only for comparison – in Canada this indicator is higher than 50 %.

Many other countries have serious problems with current account deficits, respectively, payment deficits, and are looking for different means and mechanisms to deal with these problems. **The current account of the world as a whole is not balanced – high and constant deficits are registered instead.** It can be said that is a global aspect, **the issue of the so called missing surplus** comes into focus**.** The problem is as follows. The world as a whole has a significant balance of payments deficit. And this deficit – in higher or lower amounts – is permanently present for a long period of time, which means a constant practice of non-registering credit items for the world as a whole. A research paper on this problem by an IMF team ends with the conclusion that the majority of the missing surplus is made of undeclared, respectively, unregistered interest rate revenues from foreign countries. Interest rate revenues realized by the respective holders of accounts in foreign countries are very difficult to identify, therefore, they remain undeclared. The expressed opinion on the main reason for the so called missing surplus is also supported by the fact that its amount increases when the interest rates in the world as a whole raises and, respectively, decreases when interest rates go down. The IMF paper distinguishes another reason in the fact that a great part of the trade fleet in the world is registered in countries, which do not declare their revenues form freight [10].

The next important issue in the context of global disbalances is about **the possibility that they can be sustained for indefinitely long time**, and this case is related in particular to the high current account deficit of the USA and the respective surpluses of a group of countries. On this issue, it is very interesting to follow the comparison made with the Bretton-Woods monetary system, operating from the end of the Second World War until the early 1970s. In the conditions of this system, the USA were the "core", and the countries of Western Europe and Japan – the "periphery". Countries of the "periphery" were motivated to maintain the external value of the US dollar – the national currency of the "core". Long time after the break-down of the Bretton-Woods system, the USA continue to be in the role of a "core", while the "periphery" already includes emerging markets in Asia – China at the first place. These countries manifest a clear tendency to follow a policy of generating economic growth through export incentives using as an instrument the manipulation of exchange rates. In this case, the used method is an intended undervaluation of the national currency, which is a factor for stimulating export growth and, respectively, would also bring about current account surplus. Building up trade surpluses, the countries of the "periphery" supply credit to the"core", accumulating reserves in US dollars. Irrespectively of the low return, these countries use the large USA financial market with high liquidity, stimulating in this way the development of their export sectors. This situation continuing for many years explains the interest of countries from the "periphery", same as in the conditions of the Bretton-Woods post-war monetary system, to continue with the US dollar, in order to preserve the value of their reserves, respectively, their international competitiveness. This situation has already gained the name of Bretton-Woods II [11]. In the conditions of Bretton-Woods II as well, the USA continue to exploit their privilege of living "beyond their own means" thanks to the exclusive statute of their national currency in the international monetary system [12].

During the last years, however, the action of factors counteracting Bretton-Woods II can be clearly discerned. There are already more countries in the "periphery" and the composition of the group is heterogeneous, so their economic and political interests are more difficult to balance. The trend towards depreciation of the US dollar during the last few years, definitely creates an incentive for the countries with larger dollar assets as a part of their reserves to get rid of them or at least reduce the volume of these assets in order to avoid losses from further depreciation of the dollar. The country issuing the dollar itself has been applying for long time the approach characterized as "benign neglect" – the USA just watching how their national currency, which is also the most important international currency, becomes cheaper at the international markets, without expressing special interest in maintaining the external value of the dollar – by the efforts of the FRS alone or in coordination with other central banks. And all this occurs in the presence of an actual alternative to the dollar with already strong position – the unified European currency "euro". The conclusion being made is that countries from the "periphery", having realized the high price they pay in order to maintain this situation, are more and more inclined to start actions for change. Most probably, it would be difficult to maintain for long time the global disbalances in the aspect presented here. In this case, the situation depends most of all on US policy, in particular, to what extent they will succeed in reducing their huge current account deficit to a more acceptable level. The key moment in this case is that the above mentioned deficit corresponds to the accumulation of dollar reserves in the countries in the "periphery". These dollar reserves are equivalent to foreign claims on American assets, i.e. the countries from the "periphery" in this way actually give credit to the USA and are also objectively motivated to maintain the external value of the national currency of the "core". Under Bretton-Woods I, countries from the "periphery" were motivated to support the exchange rate of the dollar through the system of fixed exchange rates (the dollar in its centre, and respectively, the other currencies with parities fixed in gold or in dollars, the exchange dollar-gold rate was also fixed in the form of official gold content of the dollar and official price of gold). Under Bretton-Woods II, countries from the "periphery" are motivated to support the dollar to the extent they are bound by the mechanisms of the global disbalances and, in particular: the huge American current account deficit results in high volume of dollar reserves, whose owners, being concerned about the value of their own reserves, indeed practically take care of the US dollar.

Economic analyses go beyond such a conclusion and relate global disbalances to the contemporary financial crisis. Some actual numbers and links in this respect are presented below.

In the last seven years to March 2008, global foreign-exchange reserves have increased by 4 900 billion USD (4.9 trillion USD), and only the reserves of China have increased by 1.5 trillion USD. In reality, 70 % of global foreign-exchange reserves have been accumulated during this period. The most part of these are accumulated by countries acquiring the US dollars and, in this way, collecting American liabilities. This monetary flow finances the American trade deficit, respectively, the current account deficit of the USA. What is, though, the effect of this deficit on the American economy. At each given level of internal demand, the result from the trade deficit is a decrease of national production. In such circumstances, USA needs increase of internal demand in order to compensate for the reduction (of national production) effect of the external trade deficit. What is necessary in this case is spending to be higher than income. Households turn out to be the most important group within the national economy in this relation and it is the increase of the debt of American households that is at the basis of the credit crisis that started in the USA – i.e. this is considered to be a direct result of the huge trade deficit. This was followed by FRS measures, which in practice have an impact on China and all other countries in the informal dollar zone. These FRS measures, however, may be appropriate for the USA, but not for the other countries and in reality lead to new liabilities accumulation.

Economic analyses indicate that Bretton-Woods II is on the way of following the fate of Bretton-Woods I mostly because of the accumulation of huge disbalances and tensions [13]. During the last years the reserves of Asian central banks, nowadays about 4300 billion USD (4.3 trillion) and mostly of China and Japan, together with the petrodollars have supplied the USA with huge liquidity. This liquidity was directed to American Treasuries and debt securities of the two mortgage giants Fannie Mae and Freddie Mac. As a result of this huge liquidity overflow, the interest rates in USA stayed low, while the prices of real estate grew relentlessly because of high demand. For many years Asia has financed the American budget and trade deficit. Indeed, most of all the USA have helped China to become "world's workshop", importing for a long time large quantities of cheap Chinese commodities. Thanks to these processes, China had the opportunity to develop high rates of growth. This was export-led growth. Mainly because of this factor, only for 2007, the economic growth in China was 12 % [14]. For the last 15 years, Chinese export to the USA has increased by the impressive 1600 %. As a result, China and other Asian countries piled up huge dollar reserves and securities, denominated in dollars. As it was already explained, this is in practice American debt – claims on American goods and services, delayed in time. Indeed, China gives credit so that the USA would realize in this way the import of more and more Chinese commodities. In the conditions, when this economic growth source and engine has dropped significantly in China, the attention there must be directed towards increasing internal consumption. In China, internal consumption amounts to 1/3 of national production, while for the USA this indicator is 70 %. USA already import much less than before and China must find and develop a new economic growth source and engine called increased internal demand.

As a consequences of the years of cheap import, the inflation in the USA has also remained at a low level and this maintained the illusion that both goals: high economic growth and low inflation – can be achieved simultaneously for unlimited period of time.

Nowadays, because of the global financial crisis, the described processes are in stagnation. For the first time in the last 25 years in August 2008 Japan registered a monthly trade deficit in its trade with the USA, after a 22 % export decrease in this direction.

A very live issue of the contemporary disbalances in the world is related to the price of oil, respectively, the huge amounts of **petrodollars** received by exporting countries and the tension for the balance of payments, which arises in this respect for importing countries. The numbers show how serious and wide-ranging is this problem. At prices for the first half of August 2008, the oil-importing countries have paid to producing and exporting countries about 1500 billion USD (1.5 trillion) per year (only for oil) – this amounts to 2.5 % of the value of the world GDP. As indicated by Financial Times, this is the largest income transfer in history. The value of oil on the planet at current prices for August 2008 is 162 000 billion USD (162 trillion) and this is higher than the total value of the financial instruments of equity markets – 52 300 billion USD (52.3 trillion) and bond markets – 67 000 billion USD (67 trillion). Indeed, the value of oil in the world is almost equal to the total value of all traded financial assets, which is calculated at about 167 000 billion USD (167 trillion). Many questions arise in this context, among which the question whether it is possible at all to overcome the problem of global disbalances in the foreseeable future and, next, how the oil exporting countries will use their huge accumulated petrodollar surpluses [15]. In the world economic history, two precedents of the recycling of suddenly formed huge petrodollar surpluses are analysed and the conclusions are not encouraging. The first is from the 1970s, when the large part of the petrodollars flew to emerging markets mainly in Latin America through the American bank system and these financial flows were at the basis of their economic growth, which was interrupted in the 1980s as a result of the development of serious debt crises of Latin American countries. The second precedent is from the early 21 century, when petrodollars started to turn mainly into debt, maintaining in this way a low level of interest rates – this being at the basis of the USA real estate market crisis, which grew into a global financial crisis. We are now expecting the results of the possible realization of a new idea for the direction of a part of the accumulated petrodollars by Persian Gulf countries towards the IMF credit resource.

The problems of emerging markets regarding the balance of payments are an important part of the research topic. The first question concerns the evaluation, respectively, **the economic interpretation of the current account deficit** for the countries of this category**.** The analysis of the problem is in the context of the correlation between savings and investment in each individual country and, respectively, with the current account balance. The answer to this question takes into account many factors. A discrepancy between savings and investment in a country is a normal occurrence. It is important to underline in this case that for an average or low income country, for a developing economy, the discrepancy between low savings and high investment results in a current account deficit. The deficit practically shows what part of investment in this economy is financed by foreign savings. This means that an important factor determining the dynamics of the current account balance of a country is its degree of economic development. In principle, a developing economy should have a high level of investment in order to maintain high and stable economic growth. It is normal if this high investment level is above the level of savings in the country, which on its turn naturally leads to current account deficit. In the presence of low investment potential drawing from internal savings, it is the flow of foreign capital that is at the basis of the current account deficits. In this sense, such countries accumulate deficits because of high, respectively, increasing investment flows. The capital inflow is determined in this case by a fundamental and constant factor and this is the higher return compared to the return on capital in countries where this capital comes from. We can immediately present data for Bulgaria in this respect. Investment in Bulgaria grew from 9.9 % of GDP in 1997 to 36.8 % in 2007, while the level of savings has been relatively stable at about 15 % of GDP. [16] The difference between savings and investment in Bulgarian economy was financed exactly by the inflow of foreign capital.

For Europe and, in particular, for the EU, the principle remains valid that European integration and, in particular, accession to the EU breaks the chains between savings and investment for an individual country – because of the fact of the liberalized capital flow within the Union. Another study presented in the article from the newspaper "Capital" quoted in the beginning of this paper, makes the conclusion that a currency board or the participation in a monetary union leads to higher disbalances of current accounts of the respective countries [17]. The author defends the opinion that monetary and financial integration normally results in higher capital flows between participating countries and that bigger disbalances of current accounts – especially for countries with lower level of development, are indeed one of the benefits from participating in a monetary union and the application of a currency board, as these systems are associated with stability and predictability.

The above mentioned analysis presents a very important point of view on **the current account deficit of Bulgaria.** In this case, one must take into account the necessity of examining both sides of this economic state. On one hand, the current account deficit is often treated as the symptom of problems, but at the same time, it is in many cases the other side of economic growth. And high and stable economic growth is a path with no alternative for Bulgaria in order to reach real convergence within the EU.

The latest facts on the balance of payments of Bulgaria are the following. The current account deficit for 2007 equals 6.2 billion EUR, which is 21.6 % of GDP. For 2008, this deficit will reach up to 24 % of GDP and the expectations are that the trend will be stable for 2009 and 2010. Bulgaria is the country in the EU with the highest current account deficit as a percentage of GDP and this position in the list will probable remain the same during the next one or two years.

The main components of the current account are the trade balance, the balance of services and unilateral transfers. The trade balance of Bulgaria for 2006 ended with a deficit. The export of commodities was at the value of 13.4 billion EUR, and the import reached 20.8 billion EUR. The increase of the export for 2007 compared to the previous year was 11.7 %, and for the import this percentage was 18.5 %. The trade balance for the period January – August 2008 was negative, at the amount of 5.7 billion EUR and compared to the negative balance for the same period of the previous year this is an increase of 31.4 %. The trade balance is again the main factor for the current account deficit.

The balance of services includes transport and tourism with their revenues and expenses as main components. For 2007, the balance of services is positive and revenues are higher than expenses by a little more than 1 billion EUR. The surplus is almost totally due to the positive balance of tourism. A trend considered as unfavourable is that the increase of the trade deficit for 2007 compared to the previous year is 3.8 %, while the increase of the net foreign currency revenue from tourism for the same period is 0.2 %. Such development means that tourism cannot be counted upon for covering the external trade deficit.

Unilateral transfers from Bulgarians working in foreign countries to their relatives in Bulgaria increased in 2007, reaching almost 2 billion EUR.

Finally, the current account deficit is covered by the foreign investment inflow. For 2007, the foreign investment in Bulgaria is 5.69 billion EUR, which represents 19.9 % of GDP. For 2006, the investment and its share were, respectively, 4.36 billion EUR and 17.4 % of GDP. The analysis of investment flows shows that the real estate market only has attracted capitals from foreign countries at the amount of 2.15 billion EUR; another 704 million EUR are invested in construction. In practice, 45 % of foreign investments have been connected with the real estate market, which, however, is exhausting its growth potential. 1.74 billion EUR, which is 30.6 % of all foreign investment, are in the field of financial services.

A characteristic of investment flows described as unfavourable is the fact that only 25 % of all foreign investment are directed to the productive sector [18].

In 2008, when the financial crisis expanded and became a world crisis, a question was brought up, concerning many countries, among which some EU members with strong dependence on foreign investment – Bulgaria, Spain, Portugal and others. Should they be considered to be more under a threat in the conditions of the global financial crisis nowadays because of the decreased inflow of foreign capital. In this respect, analogies are being made with the financial crisis that began in South-East Asia in 1997, and quickly became a world crisis when the foreign investors started a massive withdrawal of their capitals from Asian countries and this resulted in worsening their financial and economic problems [19]. The current account deficit, especially if its level is high in the conditions of a world financial crisis, represents an additional risk for the respective national economy. For this risk not to occur in reality so that the decrease of the external incoming flow of capitals does not provoke a payment crisis, it is necessary that the country continues to be attractive for foreign investment – there are many conditions for this and they are different in nature. In general, the following principle can be defined with respect to the current account deficit of any country, including Bulgaria – the key moment in this case is how this deficit is financed. If the current account deficit is financed by (or mostly by) direct foreign investment and this financing can be considered stable in time, the problem can be dealt with and in practice, the positive aspects of this state are more clearly manifested than the negative ones. The trend for Bulgaria, however, is not good in this respect. For 2005, the coverage of the current account deficit by direct foreign investment is over 100 %, for 2007 this percentage is 78.1 %, and for the first five months of 2008, direct foreign investment covers 55.7 % of the current account deficit. For January – May 2008, the direct foreign investment decreased also as a percentage share of GDP. For the first five months of 2007, direct foreign investment in Bulgaria was 2.02 billion EUR, which amounts to 7 % of GDP. For the same period of 2008 these investments are at the amount of 1.705 billion EUR, or 5.2 % of the country's GDP. This is a decline of about 15 %.

During the last eleven years, the foreign direct investment in Bulgaria has been about 24 billion EUR. It is at the basis of the economic growth, the increasing employment, etc. The development of the global financial crisis 2007 – 2009 results in serious changes in international markets and this already influences the investment flow to Bulgaria. The real estate sector, which was for a long period of time one of the engines of growth in Bulgaria, shows distinctive symptoms of stagnation. The direct foreign investment in Bulgaria to real estate and construction have decreased most of all compared to other sectors of the economy in the first half of 2008.

The trade deficit of Bulgaria for the first half of 2008 (January – June 2008) equals 8.424 billion BGN. The deficit is highest in the trade with Russia. A trade deficit at the amount of 1.5 billion EUR would provoke serious concern even if it was registered in a country that is much larger than Bulgaria. Another fact from the balance of payments, which requires our attention, is that the EU represents a net exporter of foods for Bulgaria [20].

The analysis should also include the influence of another unfavourable factor on the balance of payments of Bulgaria during the last few years and this is the exchange rate EUR/USD [21]. One of the few countries, with which Bulgaria has had a positive trade balance, are the USA. In 2006, the export of Bulgaria for the USA was higher than the import by 58 %. For 2007, the export surplus is still in place, but at 32 %. For the first three months of 2008, the balance in the trade with the USA is already negative, amounting to 25 million BGN. The export of Bulgaria for the USA has been decreasing also because of the exchange rate factor – prices of Bulgarian export commodities increased in US dollars as a result of the depreciation of the dollar with respect to Bulgarian lev. At the same time, dollar receipts from export are converted into lower amounts in national currency and thus economic incentives for Bulgarian exporters decrease. The weak dollar favours the import, as prices of American imported commodities decrease in Bulgarian leva and the result is usually higher demand from Bulgarian consumers. The problem resulting from the depreciation of the dollar during the last few years turned out to be very serious not only for Bulgarian companies trading with the USA, but also for those trading with Latin America, Arab countries, and others, described as dollar markets for Bulgaria. Put into numbers, this development is as follows. 40 % of the foreign trade of Bulgaria is with countries outside the EU and for one half of them the trade is in US dollars [22]. The conclusion that can be made is that for different reasons (which are now beyond the coverage of the present paper) the most important exchange ratio in the world – EUR/USD, has a significant influence on Bulgarian business as well, respectively, on the external trade position of the country.

Taking into account that all economic indicators of Bulgaria should be analysed first of all in the context of developments in the EU, respectively, the eurozone, the following data deserve our attention. For every 1 % slowdown of economic growth in the eurozone, the economies of the newly accessed countries in the EU slow down by 0.5 %. Demand in the eurozone representing 65 % of the export of the new countries – members of the EU, is indicated as the most important factor for their export and, respectively, for its increase. A priority goal in the activity of the ECB is maintaining price stability in the eurozone and, in particular, restraining the inflation rate within 2 %. Taking into account that the inflation in the eurozone in the middle of 2008 was calculated at 3.6 %, expectations were formed in this respect for an increase of the interest rate from the part of ECB. At the same time, the unfolding of the world financial crisis, which seriously affects the European economy, brought about the application of the opposite measure with respect to the interest rate. Assessments have been already published reasoning that the eurozone is technically in recession. The slowdown of economic growth in the eurozone countries has consequences for the export of countries like Bulgaria – their export, being by all means dependent on the economic activity in the EU, respectively, the eurozone [23]. As more than half of the export of Bulgarian companies is directed to EU markets, the decrease exactly of this export in the conditions of recession of the European economy would negatively influence the economic activity in Bulgaria as well. The considerable drop in investment activity in the contemporary conditions for an economy dependent to a great extent on the incoming flow of foreign investment also should be taken into account.

Literature

1. Salvatore, Dominick, International Economics, John Wiley & Sons Inc., USA, 2007, p. 451.

2. Authers, John, The Short View: Global imbalances, 10 April 2008, FT.com.

3. Feldstein, Martin, The dollar is falling at the right time, 27 March 2008, FT.com.

4. Slavov, Slavi, Breaking myths, the newspaper "Capital", 19 – 25 April 2008 , p. 33. The quoted study is by Chinn, Menzie and Shang Jin Wei, A Faith-based Initiative: Do We Really Know that a Flexible Exchange Rate Regime Facilitates Current Account Adjustment?, Working Paper, January 2008.

5. According to Eurostat data, See The EU registers higher trade deficit, Money.bg, 18.08.2008.

6. On German economy and its problems related to the balance of payments see Ralph Atkins, Unbalanced engine, 21 May 2008, FT.com.

7. Crawford, Leslie, After the bust, a time for adjustment, 11 June 2008, FT.com.

8. Gyurova, Svetlomira, The Wind of Recession, the newspaper "Capital", 23 – 29 August 2008, p. 26.

9. Cohen, Norma, Warning on current account deficit, 6 May 2008, FT.com.

10. Salvatore, Dominick, International Economics, John Wiley and Sons Inc., 2007, p. 476.

11. See the review of the book of Barry Eichengreen, Global Imbalances and the Lessons of Bretton Woods, Finance and Development, IMF, March 2008, p. 52.

12. Muenchau, Wolfgang, Trichet justified in diverging from the Fed, 8 June 2008, FT.com.

13. Wolf, Martin, How imbalances led to credit crunch and inflation, 17 June 2008, FT.com.

14. Economic analysts indicate that even if China looses 4 % of its economic growth as a result of the world financial and economic crisis, the country would still realize the remarkable 8 % economic growth. But if the USA and Europe register a decrease of this economic indicator by 4 %, for them this would mean falling into a deep recession. See David Pilling, America's chance to kick its Asian addiction, FT.com, 1 October 2008.

15. Guha, Krishna, Two challenges highlight the scale of the bonanza, Financial Times, 11 August 2008, p. 3.

16. Hristov, Kalin, Wisdom and madness of investors, the newspaper "Capital", 20 – 26 September 2008, p. 32.

17. See the quoted article in the newspaper "Capital". The study is by Slavov, Slavi, Do Common Currencies Facilitate the Net Flow of Capital Among Countries?, Working Paper, November 2007.

18. Iliev, Petar, The Real estate market supports the balance of payments of Bulgaria, the newspaper "Banker", 19 March 2008 and Nikolov, Ivaylo, Alice in the country of negative trade balance, the newspaper "Capital", 17 – 23 May 2008, p. 28.

19. Sheffer, Dorotea, The Global financial crisis will go on for a long time, the newspaper "Capital", 1 – 9 May 2008, p. 32-33 and Juan Jose Fernandes-Ansola, Albert Jeger, The necessary budget surplus, the newspaper "Capital", 1 – 9 May 2008, p. 26.

20. See The trade deficit – 8.424 billion BGN from January to June, Money.bg, 10.09.2008.

21. See the article by the author "The exchange rate EUR/USD and the currency risk for European business", Journal "Banks, investment, money", issue 3-4/2008.

22. Valkanov, Nikolay, In the shadow of the weak dollar, the newspaper "Capital", 31 May – 6 June 2008, p. 30.

23. Valkanov, Nikolay, In the eye of the financial storm, the newspaper "Capital", 21 – 27 June 2008, p. 28.