# GLOBAL ECONOMY (ECONOMICS)(GE)

# and
# World Economic Relations (WER)

# CONTENT:

1. General definitions and terms of GE.
2. Theories of the world trade (WT).
3. WT regulation. Free trading and protectionism. INCOTERMS 2010.
4. Economic integration.
5. Currency. International monetary system.
6. Transnational companies.

# Part 1.
# General definitions and terms of GE.

# The difference between similar terms:

## • *economic/economical*

***Economic*** pertains to the economy**.**
***Economical*** means not wasteful.

## • *economy/economics*

The ***economy*** is the relationship between production, trade and the supply of money in a particular country or region (*The economy is in recession).*

***Economics*** is a science that studies economies and develops possible models for their functioning (*He studied economics at the LSE (London School of Economics).*

The ***world economy*** or ***global economy*** is the economy of the world, considered as the international exchange of goods and services that is expressed in monetary units of account (money).

In some contexts, the two terms are distinguished: the "international" or "global economy" being measured separately and distinguished from national economies while the "world economy" is simply an aggregate of the separate countries' measurements.

# <u>A subject matter of GE is WER.</u>

## *WER:*

- trade of goods and services;
- capital flow;
- labour migration;
- intellectual property trade;
- currency relations;
- credit relations (World Bank, International Monetary Fund );
- co-operation of production (multinational companies/transnational corporations).

# BACKGROUND AND FORMATION PERIOD OF GE:

1. Definition of GE and global market.

2. International division of labour (IDL)

and factors of production.

3. Groups of countries in GE.

**IDL** - the allocation of various parts of the production process to different places in the world.

**2 main processes of IDL:**

- **specialization**
- **co-operation**

# GENERAL MEANING OF THE TERM «GE»:

- a system of world economic relations, national economies` cooperation;
- A combination of different economic sectors and branches of national economies;
- national economies` unity and world economic relations that help to make a complete and stable system.

# Stages of GE's formation:

1. Age of Discovery
2. Before the 1st World War
3. Between 2 World Wars
4. From the 2nd World War to the 80th
5. Nowadays

List of the 25 largest economies

by GDP (PPP) at their peak level of GDP in Millions US$[

| Rank | Country | Value (USD$) | Peak Year |
|---|---|---|---|
| — | *World* | 126,688,083 | 2017 |
| 1 | China | 23,194,411 | 2017 |
| — | *European Union* | 20,852,702 | 2017 |
| 2 | United States | 19,417,144 | 2017 |
| 3 | India | 9,489,302 | 2017 |
| 4 | Japan | 5,420,228 | 2017 |
| 5 | Germany | 4,134,668 | 2017 |
| 6 | Russia | 3,938,001 | 2017 |
| 7 | Brazil | 3,306,570 | 2014 |
| 8 | Indonesia | 3,257,123 | 2017 |
| 9 | United Kingdom | 2,905,392 | 2017 |
| 10 | France | 2,833,064 | 2017 |
| 11 | Mexico | 2,406,199 | 2017 |
| 12 | Italy | 2,303,108 | 2017 |

# GE – a system of Goods, Services and Capital exchange between Buyers (Customers) and Sellers.

## Attributes/ peculiarities/ characteristics of GE:

- Entirety/ unity
- Hierarchy |ˈhʌɪərɑːki|
- Self-adjustment/ self-regulation
- Adaptation

# World Trade theories:

1. Mercantilism
2. Absolute advantages
3. Comparative advantages
4. Heckscher-Ohlin theorem
5. Technological gap by Posner and Product Life-Cycle Model by Vernon

## Part 2.
## Theories of WT.

# Adam Smith VS David Ricardo:

- 2 countries and 2 items of goods (labour costs):

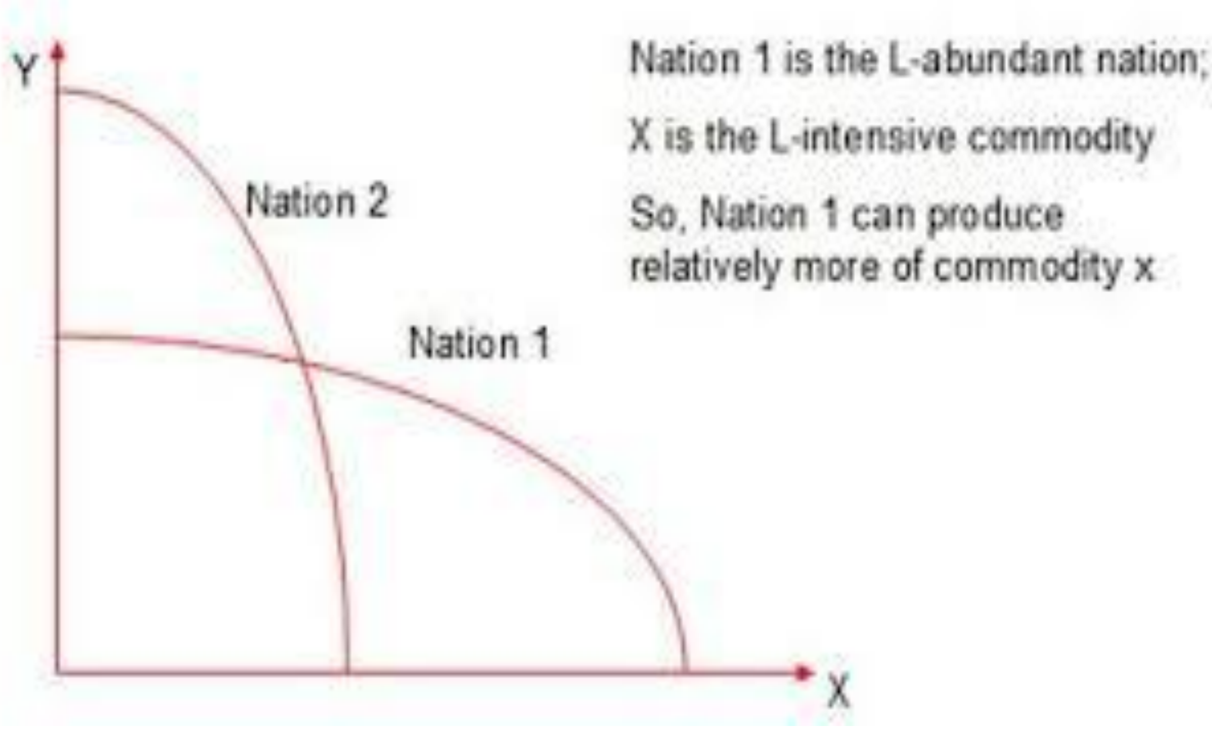
| | cloth | wine |
|---|---|---|
| England | 100 | 120 |
| Portugal | 90 | 80 |

- Alternative costs for the cloth in England are lower than in Portugal: 0,83 instead of 1,125 per a unit of wine.
- The same situation is with wine for Portugal to export: 0,89 instead of 1,2 per a unit of cloth.

# Basics of Heckscher Ohlin theory:

- 2 countries
- 2 items of goods – cloth and food
- 2 resources – Labour and Land (to produce the items) (you can also take Capital instead, but you should change an item of goods – cars for example)
- 2 production possibility curves (combination of 2 goods` max production with full usage of production factors in a country)
- 2 indifference curves (geometrical combination of 2 goods with equal utility)
    - There are also some assumptions☺

The H-O theory says that countries will export products that use their abundant and cheap factor and import products that use countries` scarce factor.



# C. Illustration of the Heckscher-Ohlin Theory

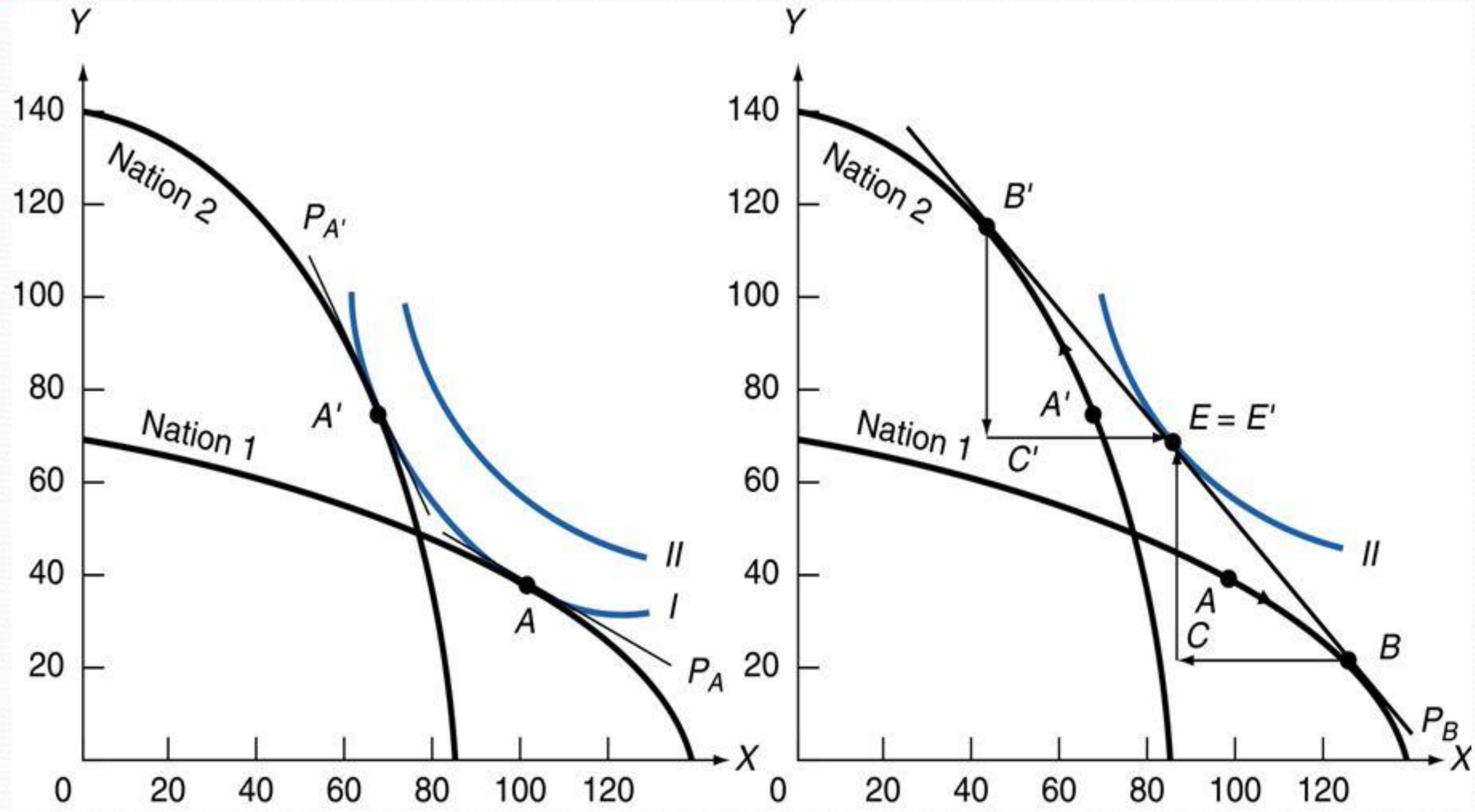
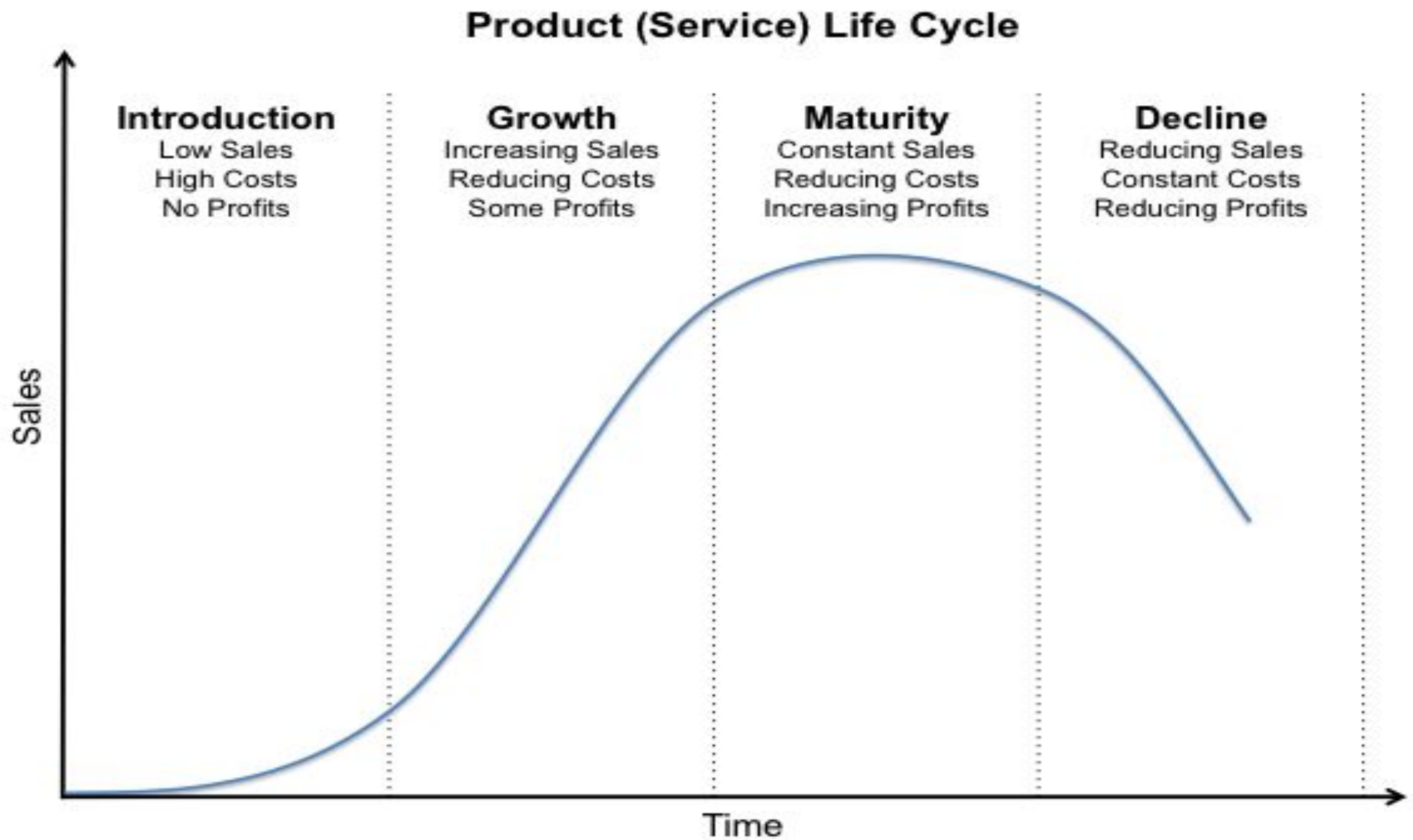



**FIGURE 5-4** The Heckscher-Ohlin Model.

# Product Life-Cycle Model by Vernon



## Part 3.
## WT regulation. Free trading and protectionism. INCOTERMS 2010.

# 2 ways to control world trade by a state : free-trade & protectionist practices. World trade (for tradable goods):

**PROS**

- It`s profitable (beneficial).
- Usually customers get quality goods for a lower price.

**CONS**

- Domestic goods can`t meet competition, with low demand and production level.
- As a result people don`t get a salary (are not paid) and their ability to pay goes down (reduces)

# FREETRADING

| PROS | CONS |
| --- | --- |
| • Market saturation with cheap & quality goods<br>• Growing of foreign tax payments (fiscal charges)<br>• New workplaces | • Guess what)<br>• Addiction to (dependence on) imported goods<br>• Bull market or it simply raises prices…. |

# What`s the difference between tradable and non-tradable goods:

- A price for TG is defined by a ratio between demand & supply;
- A balance of D&S for NTG is more important for there`s no opportunity to substitute them with foreign goods;
- Local (domestic) prices for TG and their change (rise & fall) usually depends on foreign one.

# To trade or not to trade?

| A kind of goods | A type (TG or NTG) |
|---|---|
| Agriculture (+fisheries) | + |
| Raw materials (mining) industry | + |
| Processing (manufacturing) industry | + |
| Utility and building services, traffic infrastructure | - |
| Wholesale and retail trade, hotel and catering business | - |
| Military industry | - |
| Social services (education and health) | - |

# Tariff and Non-tariff Regulations (the Customs Code of the Customs Union – the RF)

- Duty rate (custom tariff)
- Customs duties
- Customs Commodity Code (FEACN - Foreign Economic Activity Commodity Nomenclature)

- Licensing
- Quota allocation (setting quotas) *(+voluntary export restrictions)*
- Certification
- Safeguards (special safeguard measures:
  - special custom duty
  - antidumping duty
  - countervailing (compensatory) duty

# Eurasian Economic Union

- is an economic unionis an economic union of states located primarily in northern Eurasia.
- The Treaty aiming for the establishment of the EAEU was signed on 29 May 2014 by the leaders of BelarusThe Treaty aiming for the establishment of the EAEU was signed on 29 May 2014 by the leaders of Belarus, KazakhstanThe Treaty aiming for the establishment of the EAEU was signed on 29 May 2014 by the leaders

# Duty VS Fee (Charge)
# Import VS Export

- ad valorem duties
- fixed (specific) duties
- combined (mixed) duties

- customs processing fee
- charge for clearance
- terminal handling charges

# Russia VS other countries

1. General rate of duties
2. Most favoured nation treatment
3. Preferential duties

# Let`s count all our customs payments:

- Customs value (cost)
- Customs duty
- Excise tax
- VAT
- Customs fee (charge)

# How much is the fish? No, Spanish fizzy wine

| Payments | Rate | Sum |
|---|---|---|
| 1. Customs value | - | 2000€ (per 500 liters) |
| 2. Customs duty | 12,5% | 250€ |
| 3. Excise tax | 27 rub/liter | 198€ |
| 4. VAT | 18% | 441€ |
| Customs fee | 375*2 | 11€ |
| Total payments | - | 900€ (+45% from the CV) |

# How can customs value be estimated (calculated, defined, assessed)?

The methods of customs valuation, in descending order of precedence, are:

- Transaction Value (TV)* of Imported Merchandise
- Transaction Value of Identical Merchandise (goods, commodities) – 90 days
- Transaction Value of Similar Merchandise – 90 days
- Deductive Value
- Computed Value
- Derivative Method

* TV is the price actually paid or payable for the goods when sold for export to the country of importation

# Deductive Value:

Domestic price (Customs Union) –

1. Agent commission (broker`s fee, profit %)
2. Transporting (transfer, move, haul, shipping) costs + cargo-handling costs + insurance costs
3. Customs payments (duties, taxes, fees)

# Computed Value:

## <u>Goods estimated (calculated) value</u>

=

1.Operating (production) cost (expenditure) – all we need to produce smth – materials, energy, labour, depreciation etc.

+

2. Move & insurance costs

+

3. Packaging costs

+

3. Selling and administration costs

+

4. Agent commission

# Defined terms in Incoterms: (International Commercial Terms)

## - define obligations, costs, and risks involved in the delivery of goods from the seller to the buyer
## - don’t define price payable, currency or credit items

- **Delivery**: The point in the transaction where the risk of loss or damage to the goods is transferred from the seller to the buyer
- **Arrival:** The point named in the Incoterm to which carriage has been paid
- **Free**: Seller has an obligation to deliver the goods to a named place for transfer to a carrier
- **Carrier**: Any person who, in a contract of carriage, undertakes to perform or to procure the performance of transport by rail, road, air, sea, inland waterway or by a combination of such modes
- **Freight forwarder**: A firm that makes or assists in the making of shipping arrangements;
- **Terminal**: Any place, whether covered or not, such as a dock, warehouse, container yard or road, rail or air cargo terminal
- **To clear for export**: To file Shipper’s Export Declaration and get export permit

# FROM «E» TO «D»:

- **EXW – Ex Works (named place of delivery)** maximum obligation on the buyer and minimum obligations on the seller

- **DDP – Delivered Duty Paid (named place of destination)** maximum obligations on the seller and minimum obligations on the buyer

The Economic Integration between two countries is a measure of how much two or more countries work together, or give preference to each other.

Micro-aproach: MNC (TNC)

Macro-aproach: interstate organizations and integration associations

# Part 4.
# Economic integration.

# Economic integration:

- is the unification of economic policies between different states;
- the partial or full abolition of tariff and non-tariff restrictions;
- lower prices for distributors and consumers with the goal of increasing the level of welfare

**Economic integration** is an economic arrangement between different regions, marked by the reduction or elimination of trade barriers and the coordination of monetary and fiscal policies. The aim of economic integration is to reduce costs for both consumers and producers, and to increase trade between the countries taking part in the agreement.

The *more integrated* the *economies* become, the fewer trade barriers exist, and the more economic and political coordination there is between the member countries.

# What is the basis of economic integration?

- Comparative advantageComparative advantage refers to the ability of a person or a country to produce a particular good or service at a lower marginalComparative advantage refers to the ability of a person or a country to produce a particular good or service at a lower marginal and opportunity (alternative) cost over another.

- Economies of scale refers to the cost advantages that an enterprise obtains due to expansion. There are factors that cause a producer's average cost per unit to fall as the scale of output is increased. Economies of scale is a long run concept and refers to reductions in unit cost as the size of a facility and the usage levels of other inputs increase.

# Degrees of economic integration:

- Preferential trading area
- Free trade area (North American Free Trade Agreement)
- Customs union
- **Common market** **can be united into one degree**
- **Economic union**
- Economic and monetary union
- Complete economic integration

These differ in the degree of unification of economic policies, with the highest one being the completed economic integration of the states, which would most likely involve political integration as well.

# Additional info about degrees:

- A "free trade area" (FTA) is formed when at least two states partially or fully abolish custom tariffs on their inner border. To exclude regional exploitation of zero tariffs within the FTA there is a rule of certificate of origin for the goods originating from the territory of a member state of an FTA.
- A "customs union" introduces unified tariffs on the exterior borders of the union (CET, common external tariffs).
- A "monetary union" introduces a shared currency.
- A "common market" add to a FTA the free movement of services, capital and labor.
- An "economic union" combines customs union with a common market. A "fiscal unionAn "economic union" combines customs union with a common market. A "fiscal union" introduces a shared fiscal and budgetary policy. In order to be successful the more advanced integration steps are typically accompanied by unification of economic policies (tax, social welfare benefits, etc.), reductions in the rest of the trade barriers, introduction of supranational bodies, and gradual moves towards the final stage, a "political union".

# Pros and Cons of Economic Integration:

- **Trade benefits:**
  - a reduction in the trade cost;
  - an improved availability and wider selection of goods and services;
  - a greater purchasing power
- **Employment, technology and capital:**
  - a market expansion;
  - sharing of technology;
  - cross-border flows of investment
- **Political cooperation:**
  - stronger economic ties;
  - a peaceful conflicts` resolve.

- **Trade diversion**
- **Erosion of national sovereignty***
- **An obligation to adhere to rules on trade, monetary policy and fiscal policy**

* Sovereignty, in fact, was one of the key debates in the United Kingdom's decision to leave the European Union (EU) in 2016.

# Measuring Economic Integration

The methodology for measuring economic integration typically involves the combination of multiple economic indicators, including:

***1. trade in goods and services,***

***2. cross-border capital flows,***

***3. labor migration and others***.

It also includes measures of <u>institutional conformity</u>, such as membership in trade unions and the strength of institutions that protect consumer and investor rights. *A standardized ranking of European Union countries shows that Finland, Austria, Spain and France are the most integrated into the EU.*

# Part 5.
# Currency. International monetary system.

**Currency** refers to a particular authorized monetary system, monetized in specific units (euros, dollars, pesos, etc.) which may be given international value by their exchange values in foreign exchange.

Each currency typically **has a main currency unit** (the dollar(the dollar, for example, or the euro) and a **fractional unit**, often defined as $^1\!/_{100}$ of the main unit: 100 cents of the main unit: 100 cents = 1 dollar of the main unit: 100 cents = 1 dollar, 100 centimes of the main unit: 100 cents = 1 dollar, 100 centimes = 1 franc of the main unit: 100 cents = 1 dollar, 100 centimes = 1 franc, 100 pence of the main unit: 100 cents = 1 dollar, 100 centimes = 1 franc, 100 pence = 1 pound, although units of $^1\!/_{10}$ or $^1\!/_{1000}$ occasionally also occur. Some currencies do not have any smaller units at all, such as

**Convertibility of a currency** determines the ability of an individual, corporate or government to convert its local currency to another currency or vice versa with or without central bank/government intervention.

Based on the above restrictions or free and readily conversion features, currencies are classified as:

- **Fully convertible** When there are no restrictions or limitations on the amount of currency that can be traded on the international market, and the government does not artificially impose a fixed value or minimum value on the currency in international trade. The US dollar is an example of a fully convertible currency and, for this reason, US dollars are one of the major currencies traded in the foreign exchange market.

- **Partially convertible** Central banks control international investments flowing in and out of the country, while most domestic trade transactions are handled without any special requirements, there are significant restrictions on international investing and special approval is often required in order to convert into other currencies. The Indian rupee and Renminbi are examples of a partially convertible currency.
- **Nonconvertible** Neither participate in the international FOREX market nor allow conversion of these currencies by individuals or companies. As a result, these currencies are known as blocked currencies. e.g.: North Korean won Neither participate in the international FOREX market nor allow conversion of these currencies by individuals or companies. As a result, these currencies are known as blocked currencies. e.g.: North Korean won and the Cuban peso.

In the foreign exchange market, **a currency pair** is the quotation of the relative value of a currency unit against the unit of another currency.

1. direct quotation or price quotation
for example, USD 1.00 = EUR 0.851 in the Eurozone

2. indirect quotation or quantity quotation
for example, EUR 1.00 = USD 1.17 in the Eurozone

# Example:

<u>Russian ruble is the national currency.</u>

**Direct quotation** is 57,03 USD/RUB which means you can buy1$ for 57 rubles.

**Indirect quotation** is 0,017 RUB/USD and this means you can pay 1 ruble and get 0,017 $ for it)

# Lets find the cross-rate for the Russian ruble:

- The C-R is an exchange rate between two currencies, in which the home country's currency is not included. In the U.S.A., the euro/yen rate would be considered a cross rate, while in Europe or Japan it would be considered a primary pair.

- For the Russian Federation:

1 EUR = 68.98 RUB

1 USD = 59.28 RUB

**So the C-R for EUR/USD is 1,1636.**

# An exchange-rate regime (ERR)

- is the way an authority manages its currency is the way an authority manages its currency in relation to other currencies and the foreign exchange market is the way an authority manages its currency in relation to other currencies and the foreign exchange market. It is closely related to monetary policy and the two are generally dependent on many of the same factors.

There are 3 basic types of ERR:

1. a ***floating exchange rate***, where the economy dictates movements in the exchange rate;
2. a ***pegged float***, where a central bank keeps the rate from deviating too far from a target band or value;
3. a ***fixed exchange rate***, which ties the currency to another

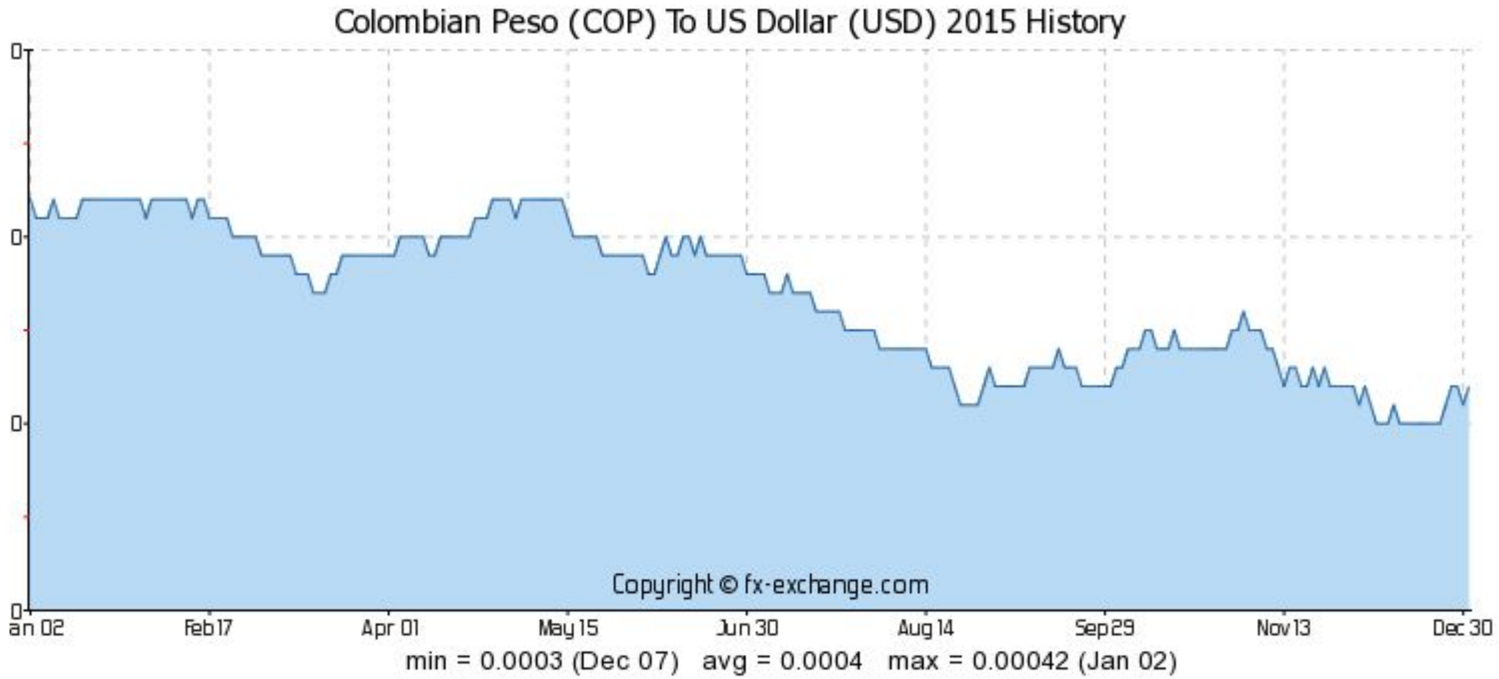
- **Floating rates** are the most common exchange rate regime today. For example, the dollar, euro, yenthe dollar, euro, yen, and British pound all are floating currencies.
- However, since central banks frequently intervene to avoid excessive appreciation or depreciation, these regimes are often called *managed float* or a *dirty float*.
- **Managed float regime** is the current international financial is the current international financial environment in which exchange rates is the current international financial environment in which exchange rates fluctuate from day to day, but central banks is the current international financial environment in which exchange rates fluctuate from day to day, but central banks attempt to influence their countries' is the current international financial environment

- **Pegged floating currencies** are pegged to some band or value, either fixed or periodically adjusted. During the 1950s and most of the 1960s, for example, the United States pegged the dollar to gold ($35.00 was equal to one ounce of gold), and most other countries had pegged their currencies to the dollar (the German Mark was fixed at four marks equal to one dollar for much of this time).
- The **band of fluctuation** is the range within which the market value of a national currency is the range within which the market value of a national currency is permitted to fluctuate by international agreements, or by unilateral decision by the central bank.

**Fixed rates** are those that have direct convertibility towards another currency.

In case of a separate currency, also known as a currency boardIn case of a separate currency, also known as a currency board arrangement, the domestic currency is backed one to one by foreign reserves. A pegged currency with very small bands (< 1%) and countries that have adopted another country's currency and abandoned its own also fall under this.


US Dollar (USD) To Euro (EUR) 90 Day History
0.86
0.85
0.85
0.84
0.84
0.83
Jul 22
Aug 04
Aug 17
Aug 30
Sep 12
Sep 25
Oct 08
Oct 21
Copyright © fx-exchange.com
min = 0.8306 (Sep 08) avg = 0.8451 max = 0.859 (Jul 24)


Colombian Peso (COP) To US Dollar (USD) 2015 History
0
0
0
0
Copyright © fx-exchange.com
an 02
Feb 17
Apr 01
May 15
Jun 30
Aug 14
Sep 29
Nov 13
Dec 30
min = 0.0003 (Dec 07) avg = 0.0004 max = 0.00042 (Jan 02)

# International monetary systems (IMS)

**International monetary systems** are sets of internationally agreed rules and supporting institutions, that facilitate international tradesupporting institutions, that facilitate international trade, cross border investment* and generally the reallocation of capital between nations.

* is an investment is an investment in the form of a controlling ownership is an investment in

# What do IMS provide?

- Confidence
- Sufficient liquidity for fluctuating levels of trade
- Means by which global imbalances can be corrected

# International monetary systems over two centuries

| Date | System | Reserve assets | Leaders |
|---|---|---|---|
| 1803–1873 | Bimetallism | Gold, silver | France, UK |
| 1873–1914 | Gold standard | Gold, pound | UK |
| 1914–1924 | Anchored dollar standard | Gold, dollar | US, UK, France |
| 1924–1933 | Gold standard | Gold, dollar, pound | US, UK, France |
| 1933–1971 | Anchored dollar standard | Gold, dollar | US, G-10 |
| 1971–1973 | Dollar standard | Dollar | US |
| 1973–1985 | Flexible exchange rates | Dollar, mark, pound | US, Germany, Japan |
| 1985–1999 | Managed exchange rates | Dollar, mark, yen | US, G7, IMF |
| 1999- | Dollar, euro | Dollar, euro, yen | US, Eurozone, IMF |

# Competing ideas for the next international monetary system

| System | Reserve assets | Leaders |
|---|---|---|
| Flexible exchange rates | Dollar, euro, renminbi | US, Eurozone, China |
| Special drawing rights standard | SDR | US, G-20, IMF |
| Gold standard | Gold, dollar | US |
| Delhi Declaration | Currency basket | BRICS |

# By the way, what`s about the Russian ruble?

As for the ruble, in spite of high oil prices it`s under pressure:

1. Low demand for federal (loan) bonds
2. High demand for the foreign currency both by Russian corporations and the RF` Ministry of Finance.

All the rent income is spent on buying currency in order to increase the foreign exchange reserves.

3. Geopolitics

# Part 6.
# Transnational corporations.

# Transnational Corporations

**Transnational corporations** - those corporations which operate in **more than one country or nation** at a time - have become some of the most powerful economic and political entities in the world today.

While global in reach, these corporations' home bases are mostly concentrated in the Northern industrialized countries, where 80% of all transnationals are based. **The US, China, Germany, Japan, France and the UK** make up the **top six economic entities** followed by Italy, Brazil and Canada. But despite their growing numbers, power is concentrated at the top. i.e., the 300 largest corporations account for *one-quarter of the world's productive assets*.

The London-based campaign group said the 10 biggest corporations – including **Walmart**, **Apple and Shell** – make more money than most countries in the world combined.

# The United Nations has justly described TNC as "the productive core of the globalizing world economy."

Their **270,000 foreign affiliates** account for most of the world's industrial capacity, technological knowledge, international financial transactions, and ultimately the power of control.

1. **In terms of energy**, they mine, refine and distribute most of the world's oil, gasoline, diesel and jet fuel, as well as build most of the world's oil, coal, gas, hydroelectric and nuclear power plants.

2. They extract most of the world's **minerals from the ground.**

3. They manufacture and sell most of the world's **automobiles, airplanes, communications satellites, computers, home electronics, chemicals, medicines and biotechnology products.**

4. They **harvest** much of the **world's wood and make most of its paper.**

5. They **grow** many of the world's **major agricultural crops**, while **processing and distributing much of its food.**

# Sustainable Development Goals (SDGs) and TNCs

- The globalization of economic activity in general, and the growing role of **transnational corporations (TNCs)** in particular, have increasingly directed attention toward the environmental consequences of these developments. That is to say given their dominance of politics, economics and technology, it is not surprising to find the big transnationals deeply involved in most of the world's serious environmental crises
- **Emerging-market multinational enterprises (EMNEs)** play an increasingly important role as investors in developing economies. When certain conditions are met, their foreign investment can contribute to host-country progress towards **the Sustainable Development Goals (SDGs).**

# The Sustainable Development Goals (SDGs).

- Goal 1: No Poverty
- Goal 2: Zero Hunger
- Goal 3: Good Health and Well-Being
- Goal 4: Quality Education
- Goal 5: Gender Equality
- Goal 6: Clean Water and Sanitation
- Goal 7: Affordable and Clean Energy
- Goal 8: Decent Work and Economic Growth
- Goal 9: Industry, Innovation and Infrastructure
- Goal 10: Reduced Inequalities
- Goal 11: Sustainable Cities and Communities
- Goal 12: Responsible Consumption and Production
- Goal 13: Climate change
- Goal 14: Life Below Water
- Goal 15: Life on Land
- Goal 16: Peace, Justice and Strong Institutions
- Goal 17: Partnerships for the Goals

# What are the functions of TNC?

- Importing and exporting goods and services
- Making significant investments in a foreign country
- Buying and selling licenses in foreign markets
- Engaging in contract manufacturing—permitting a local manufacturer in a foreign country to produce their products
- Opening manufacturing facilities or assembly operations in foreign countries

# The 5 Cons of Multinational Corporations.

1. **The Market Dominance of Multinational Corporations** - The market dominance of multinational corporations makes it hard for the local small firms to succeed and thrive. For instance, there are arguments stating that the larger supermarkets squeeze out a notable margin of the local corner stores that lead to lesser diversity.
2. **Consumer's Expenses** - Companies are usually interested at the consumer's expense. The multinational companies commonly have the power of monopoly that gives them the chance of making excess profit.
3. **Pushing Local Firms Out Of Business** - In the developing economies, these giant multinationals use the economies of scale for pushing the local firms out of their businesses.
4. **Criticized For Using "Slave Labor"** - Multinational corporations are being criticized for using the so-called slave labor wherein the workers are paid with very small wages.
5. **Environment Threat** - For the sake of profit, these global companies commonly contribute to pollution as well as make use of the non-renewable resources that can be a threat to the environment.

**WHAT DO YOU THINK ABOUT THE STATEMENT BELOW:**

Transnational Corporations are one of the primary agents of Global Capitalism and many have been criticized because of the social and environmental harms they cause in the pursuit of profit.