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.

7. Balance of payments.

8. Offshores.

9. Intellectual property (IP) and investment.

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**).

<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 OF GE:

1. 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

Part 2.

Theories of WT.

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

Adam Smith VS David Ricardo:

- 2 countries and 2 items of goods (labour factor – units of labour per a item of goods):

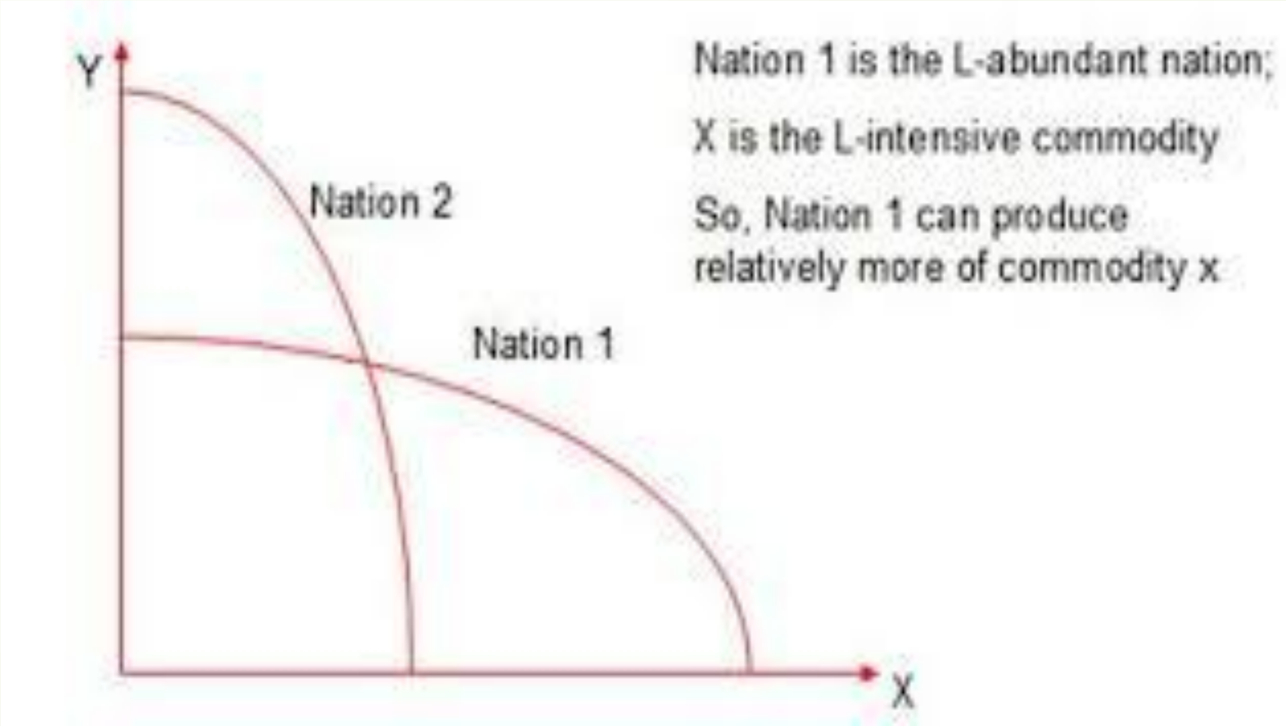
	cloth	wine
England	100	120
Portugal	90	80

- 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 (and expensive) factor**.



C. Illustration of the Heckscher-Ohlin Theory

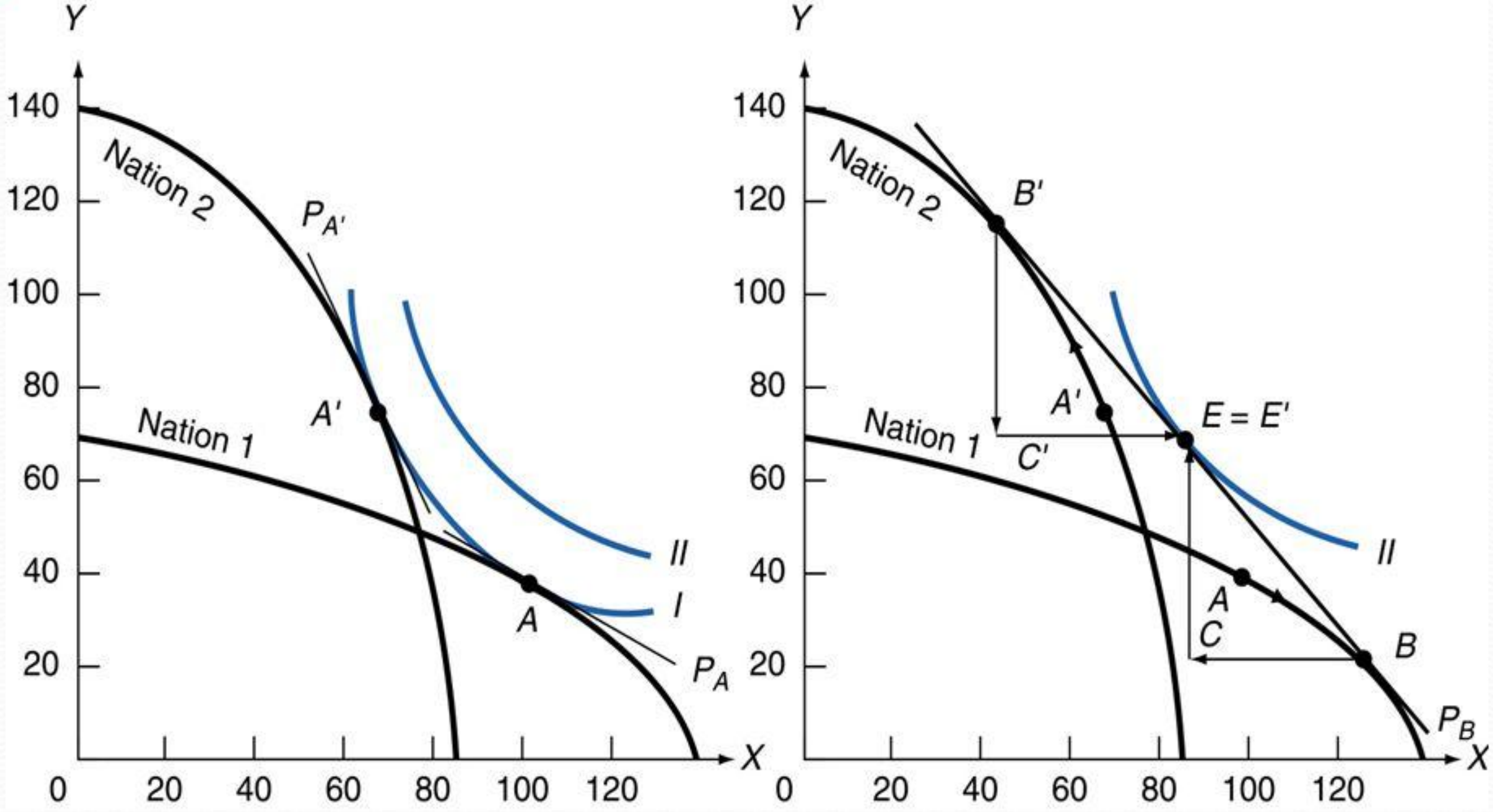
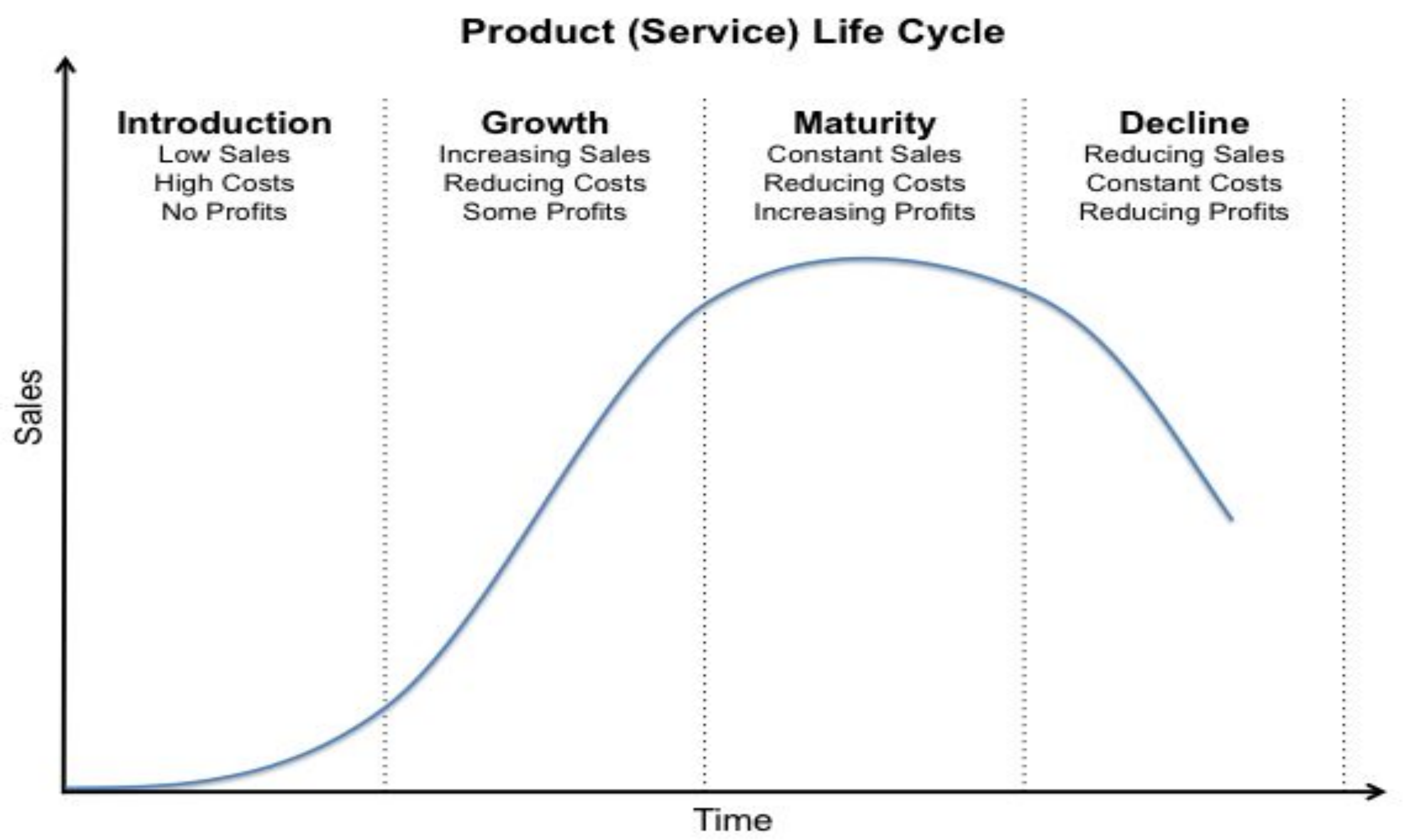


FIGURE 5-4 The Heckscher-Ohlin Model.

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): is it worth trading?

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

- Market saturation with cheap & quality goods
- Growing of foreign tax payments (fiscal charges)
- New workplaces

CONS

- Guess what) – think about domestic enterprises ☺
- Addiction to (dependence on) imported goods
- Bull market or it simply raises prices….

What`s the difference between **tradable (TG)** and **non-tradable goods (NTG):**

- A price for TG is defined by a ratio between demand & supply (D&S));
- 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)	-

WTO… What's wrong with it?

- an intergovernmental organization that regulates international trade
- deals with regulation of trade in goods, services and intellectual property
- a framework for negotiating trade agreements
- trade should flow as smoothly, predictably and freely as possible
- free trade on industrial goods and services
- retention (stoppage) of protectionism on farm subsidies to domestic agricultural sector

- 2012….How long and difficult was it…
- Is it worth doing that?

5 principles of WTO:

- Non-discrimination (MFN)
- Reciprocity (mutual agreement or win-win ☺)
- Binding and enforceable commitments (legitimate obligations)
- Transparency (clarity)
- Safety values (trade restrictions)

Let`s have a small talk about world trade regulation…

Should it be regulated at all? **No doubt, it should.**

So… world trade is a little bit limited but not ultimately restrained)

Eurasian Economic Union

- is 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 Belarus, Kazakhstan and Russia, and came into force on 1 January 2015.
- Treaties aiming for Armenia's and Kyrgyzstan's accession to the Eurasian Economic Union were signed on 9 October and 23 December 2014, respectively.

4 degrees of freedom given by EAEU:

- Goods
- Services
- Capital
- Labour

Tariff and Non-tariff Regulations (the Customs Code* of the Eurasian Economic Union)

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

* A standard act which regulates goods transfer through customs border of a country (customs union, economic union and etc.)

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

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

How does Russia trade with 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 (sparkling) wine

Payments	Rate	Sum
1. Customs value	-	2000€ (per 500 liters)
2. Customs duty	12,5%	250€
3. Excise tax	36 rub/liter	240€
4. VAT	20%	498€
Customs fee	375 rub*2	10€
Total payments	-	998€ (+49.9% 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:

Goods estimated (calculated) value

=

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
- **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 fowarder**: 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

Part 4.
Economic integration.

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

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 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 (NAFTA)- before, now - USMCA)
- Customs union
- **Common market**
- **Economic union**

can be united into one degree

- 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 (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 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 institutional conformity, 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.*