International finance is defined as the set of relations for the creation and using of funds (assets), needed for foreign economic activity of international companies and countries.

Assets in the financial aspect are considered not just as money, but money as the capital, i.e. the value that brings added value (profit). Capital is the movement, the constant change of forms in the cycle that passes through three stages: the monetary, the productive, and the commodity. So, finance is the monetary capital, money flow, serving the circulation of capital. If money is the universal equivalent, whereby primarily labor costs are measured, finance is the economic tool.

The definition of international finance as the combination of monetary relations, that develop in process of economic agreements - trade, foreign exchange, investment, etc. - between residents of the country and residents of foreign countries, is not exhaustive. It does not reflect all the essential features, that are generated by the set of conditions outside the company (i.e. the external environment of the international business), which effects on their activity in practice.

These specifics lie in the fact of the relation between the international financial actions and the set of temporary and spatial risk factors (currency, credit, investment, political) caused by uncertainty and fluctuations in exchange rates of securities, the comparative difference in inflation and interest rates in different countries, the uncertainty of the economic policy of the country. Uncertainty and increased risk are exacerbated by the fact, that international company has a small effect on the business areas in which it operates. However, while choosing alternative financial decisions in the international business area, we cannot dispense with the analysis of the value of future costs and revenues of time (term commercial transactions), space (geographically remote) and the uncertainty caused by the need to work with a large number of currencies, taking into account the differences in interest rates and inflation, legislation and political systems in many countries.

This feature of international finance is represented in such determination. International finance, as a subject of special disciplines, reflect the economic aggregate of time and uncertainty, regarding the decisions, that touches several different countries, taking into account that every sovereign country has its own currency, business laws and political systems.

International finance is one of the main subsystems of the world economy, which makes a decisive impact on the national and global economy. At the same time, the international finance functions as a integral system, the elements of which are:

- the international monetary system, which is characterized by the components: the national and reserve currency, international collective currencies, the conditions of mutual convertibility, currency parity, exchange rate, national and international regulatory mechanisms of exchange rates;
- international payments that serve the movement of goods and factors of production, financial instruments, and the balance of payments, which reflect all the transactions related to international payments;
- international financial markets and the mechanisms of trading by specific financial instruments - currency, loans, securities;
- international taxation, as the method of mobilization of funds;
- international financial management of TNC, where international investment, risk management, financial management etc. take the main place [Fig. 1.1).

To the main functions of international finance belong:

- Distribution function, which is the mechanism of international finance carries cash distribution and redistribution of world product. Due to the international finance cash flows are created, distributed and used, different needs of the world economy are met.

Distribution function is intended to promote the organization of the balanced and efficient global production and development of all the sectors of the world economy with the aim of the most complete satisfaction of necessities of the world community.

International financial environment includes:

- International payments
- International finance
- International investment
- International financial markets

Fig. 1.1 Components of International Financial Environment

- The control function, the general essence of which is to monitor the production and distribution of global social product in money form by recording and analyzing its motion. The result of this function is making decisions on international finance and development of current and strategy international financial policy;
- Regulatory function is associated with the intervention of international monetary and financial institutions with the help of finance in the process of production;
- Stabilizing function is to create stable conditions for economic and social relations in the global system.

International financial transactions are carried out in the international financial markets and solve the problems of organizing and managing money relations in the formation and using of the funds within the global financial environment. The objects of financial operations are the various financial assets: national and foreign currency, securities, real estate, precious metals. The major international financial transactions are the real money transfer, operations with capital, investment and speculation operations.

International transactions develop dynamically in modern conditions, transforming the financial systems of individual countries as well as the links between financial systems of these countries.

To the competence of international finance belong:

- Analysis of the financial sector on a global scale;
- Determination the interaction of financial transactions on a global level and consideration the international financial transactions as a continuous process with regular changes;
- The development of new financial methods, that affect the regional financial system and facilitate its integration;
- Analysis of financial activities at different levels: national, regional, global.

International finance contributes to the internationalization of social-economic and monetary relations on the accumulation, distribution and redistribution of internationalized financial resources and international financial flows. The influence of international financial relations on the development of economic relations makes through the internationalization of all the set of structural parts of trade, currency and credit relations system, the mechanism of securities and investments. The proportions of international exchange are formed on this basis, so integral unity of components of the global market and a unified system of international monetary financial and credit relations is achieved.

1.2. International financial flows

There is always movement of capital from one country to another in the global economy, creating global financial flows.

International financial flows are the set of financial transactions. The subject of these transactions is the money capital. These flows serve international trade in goods and services, and capital reallocation between countries. Financial flows contribute to the expansion of the types of foreign exchange transactions, foreign investment, activation of securities transactions and other financial instruments, by providing international redistribution of financial resources.

The movement of cash flow is defined by relationships between economic agents of different countries, state and foreign governments and international organizations. The mechanism of this movement is established on the basis of international agreements, as well as the influence of economic laws.

The types of international financial flows can be classified according to the following criteria: the economic activity according to the structure of the balance of payments, the economic relationship between the non-residents, the terms of financial transactions, the form of ownership of the sources of financial flows (Fig. 1.2) [9, p. 14].
1.5 The world financial market

The global financial market is the system of market relations, which provides the accumulation and redistribution of international financial flows. The global financial market is traditionally divided into the international currency markets, international debt markets, international securities markets, each of which includes Euromarkets (the markets of euro deposits, the markets of euro credits, the markets of euro shares, the markets of euro bonds and euro bills). There is another model of the financial market, when according to the criterion “the timing of property rights”, the financial market divided into the money market (short-term obligations, which are high liquidity) and capital market or the stock market (long terms of securities’ sale).

The simplified structural of international financial market is given below in the Fig. 1.3.

The structure of the world market is very complicated and it is not always possible to draw a clear line between its components. Thus, the international bond market is a part of the international securities market according to the first criteria, and is the part of the international debt market – according to the second; international market of property titles is an element of the international securities market and the part of international capital market at the same time.

The purpose of the international financial systems is to ensure the efficient allocation of the available amount of free capital between the final users (investors). Financial markets are the mechanism that connects those, who offer money, and those who are looking for them, to make a deal. Through the financial institutions – the intermediaries between lenders and borrowers, which help to increase the efficiency of distribution of free cash flow. They (institutions) offer services in a professional manner, related to a combination of demand and supply of capital. They give such services to firms, citizens and governments and operate in a legal and fiscal space. It should be noted, that in the narrow sense under the financial institution we can understand financial organizations. In the wide sense – normative order, the system of currency and financial transactions of these organizations.

- A modern world financial market is characterized:
  - by significant amount of financial resources and transactions on a twenty-four hour basis, mostly standardized. It involves subjects with high ratings;
  - by elimination of restrictions on financial flows across the national borders, such as capital controls and limiting of circulation of foreign currencies. For example, OECD countries liberalized almost all types of capital flows, including short-term transactions, carried out by companies and individuals according to the “code of liberalization of capital movements” operating in the territory of countries - members of the OECD;
  - by the high level of information technologies’ usage, which reduces transaction costs between countries;
  - by the use of various financial instruments.

International capital flows are more than the international flow of goods and services by 5 times. International capital mobility intensifies the instability of exchange rates as a result of the more quickly cash moving than changes in interest rates. Exchange rates have become more volatile in the national macroeconomic policy. The high mobility of capital has led to increased interdependence of national economies, has weakened the autonomy of national policies, despite the existence of floating exchange rates.

The following features characterize basic tendencies that are observed in the world financial market:

- Creation of currency unions around the major currencies. A currency union is a group of countries based on the monetary and economic prevailing of the states that head this union, by fixing to their currency the currencies of participating countries of union. Such factors influence on the creation of currency unions:
  - trade (a country, that leads a union comes forward as a general trade partner of other member countries);
  - financial (most member countries are the debtors of the main country, or of the third countries, or have mutual debts);
  - economic (a country that leads a union is most industriously developed);
  - political that was founded historically and firmly linked the participating countries of currency union.

A dollar currency union was created in 1939. The economical dependency upon the USA, countries of Latin America and Canada entered to it. With the implementation of euro in 1999 there was created a currency union of euro. However, countries of euro and USA were not interested in the expansion of the
spheres of turnover of the currencies. That is why they restrain the integration intentions of countries with relatively weak currencies, the unstable banking and financial systems, and with not enough developed financial and stock markets.

There is the possibility to form the new currency union in Southeast Asia. It can be organized by means of the coming around the Japanese Yen, or Chinese Yuan, or by the combining of several currencies to create an “Asian euro”.

2. The structure of financial market instruments changes in favor of the real instruments sector - corporate securities and their derivatives. Currency loses self-importance, as an instrument of financial markets. Daily turnover of transactions on the foreign exchange market increased by 4.5 times in 2011 compared to 1990, and in the bond market - 8 times. There is the rapid growth in the sector of corporate securities.

3. Equity markets are the key structure-creation factors of the financial sector. The banking sector has the second role after the mechanism of redistribution of funds on stock market. Thus, according to the “Financial Time”, banks loans accounted for only 25% of the funds, which have been involved in business and by governments all over the world.

4. The growth of the relationship between finance and the real economy. The issue of securities is the primary way of mobilizing funds (investment funds) for new industrial companies. Due to the further improvement of the functioning of the financial market, its mechanisms provide redistribution of funds in favor of the most profitable and promising companies. The 60% of the annual investment in the economy is invested in companies in the field of information technology in the USA.

Stock market turns to the technological progress catalyst in the real sector and provides the growth of productivity. The shares of the companies, that are related to Internet technology has the greatest demand in the stock market. Such companies develop modern means of communication and information systems assurance programs for biotechnology, pharmaceuticals, and genetic engineering firms and so on.

5. The sake's growth of technological upgrading of the financial markets based on internet technologies that erase the national boundaries and actively promote set of the direct links between investors and issuers, regardless of their nationality.

6. Changes in the Ideology of the activities of international financial institutions. These organizations are focused on increasing of the responsibility of developing countries, for the stability of national markets and refuse to carry out the role of the guarantor of stability on their financial markets.

7. The sharp increase and dominance of speculative operations in global financial markets. The speculative operations constitute over 95% of all the financial transactions.

CHAPTER 2
THE GLOBAL FINANCIAL SYSTEM

The combination of financial markets and financial institutions, which operate in a legal and tax environment of international business, creates the global financial system (Fig. 2.1).

![Diagram of the Global Financial System](image)

**Fig. 2.1 The main components of world’s financial system**

The participants of the global financial system that intermediate the bulk part of international financial flows are:

- national stakeholders - corporations, banks, specialized credit and financial institutions, including insurance and pension companies, stock and commodity exchanges, government;
- international participants - international corporations, multinationals, international banks, TNCs, specialized credit and financial institutions, large stock and commodity exchanges, international monetary and financial institutions.

The commercial banks take the central role in the global financial market, due to the broad field of financial activities. Liabilities of banks consist mainly of deposits with different maturities of assets: loans (by the corporations and states), deposits in other banks and bonds.

The corporations (especially of TNCs) conduct operations to attract foreign sources of capital to finance their investments: sale of shares, loans, sale of debt funds of the corporation in the international capital market. Corporation bonds, denominated in the foreign currency not of the financial center, in which this bond is called euro-bonds.

Non-bank financial institutions conduct operations to diversify their portfolios of foreign assets.

Central banks are included to the global financial markets through the means of currency intervention. Government agencies borrow funds abroad, produce government bonds. The governments of developing countries, as well as companies owned by the state, take loans from the commercial banks of foreign countries.

2.2. Functioning of the global financial system in the globalization process

The current global financial system operates and develops in conditions of financial globalization. Financial globalization - the objective process of the integration of a large part of capital in different countries, strengthening of their interconnectedness. Its main features are the availability of large financial resources of TNCs and TNB, high intensity of cross-border financial transactions of the global financial system’s members, the emergence of new mechanisms and instruments of international financial transactions and the formation of the world market, through which the international market and beyond-market redistribution of financial resources works.

The driving forces of financial globalization are the deepening of international financial integration, the formation of international financial institutions system, development of financial innovations.

International financial integration is the process of unification of financial services, banking operations; liberalization of customs procedures; unification of coordination through the international financial and credit institutions, electronic system of payment instruments, movement toward global monetary system with an only world money. The aim of international financial integration is removing barriers on the movement of financial capital. In the last few years significant legal restrictions were eliminated on the way of the capital movement. The financial markets of developed countries integrated to the global financial system, which allows them to direct increasingly large amounts of capital not only to their economies, but to the economies of developing countries and transition economies.

EU has the major progress in financial integration. Its concept of single financial area includes:

- total liberalization of payments and capital movements
- open access to market of banking, insurance and other financial services of partner countries to the companies and EU countries
- the harmonization of banking tax and other legislation of the investment
- the increase of control over the activities of the national credit and financial institutions and protection the interests of investors
- the ensure of publicity and transparency of existing law

The formation of the EU single financial market is the reason of the increasing the intensity of intra-regional capital migration. Consequently, the ratio of total cross-border private capital flows (the sum of the import and the export of capital, including direct, portfolio and other investment) and GDP in the EU to assess the World Bank is 40%. This value over all developed countries is 30% (p. 23).

Financial integration with the opening of financial markets is beneficial to countries:

- there are broader sources of investment finance to supplement domestic savings, ordered to the countries;
- open capital markets contribute to the growth of effectiveness of domestic financial institutions and the conduct of reasonable macroeconomic policy;
- reducing financial constraints, open capital markets allow countries tune to implement the settlement of payments in order to correct imbalances, caused by external shocks;
- creditor countries have more opportunities for diversification of investment and risks;
- the system of multilateral trade is supported, as a range of possibilities broadens for diversification to the portfolio of securities and for the effective placing of global savings and investments.

Now there is no single method to measure financial openness, but it must take into account differences of control and types of transactions. Such method was offered by the specialists of institute of the World Banks.

The measuring of financial openness includes adjusting or limitation of both operations with checking accounts and by the accounts of capital flow (in all 27 operations, information about that is contained in the annual report of IMF). The basis of the calculation of the index of financial openness is a 5-level scale with a range from 0 to 2 for each item that indicates the degree of openness ("0" - a high degree of regulation, and "5" - a high level of liberalization) defined as follows:

0.0 - laws, regulations that impose quantitative or other regulatory restrictions on the specific operation (such as licensing or requirements on redundancy), which means a total ban on such operations;
0.5 - laws that impose quantitative or other regulatory restrictions on the specific operations that imply a partial ban on such operations;
1.0 - laws, regulations, which require that the conduct of a particular transaction was approved by the authorities, or provide, under certain conditions, its taxing on a large scale.
and vice versa, the development of relationships between the sectors of the market are the hallmarks of international financial integration. In terms of financial integration, financial institutions establish branches in major financial centers to serve the borrowing, lending, and investing and for the provision of other financial services. Financial institutions provide significant benefits to both investors and borrowers, but they are subject to risk. Therefore, investors are more oriented to sectors of the world market with high yield and low risk regions with high risk-low yield interdependence.

International financial institutions are the branched network of international currency-credit and financial institutions. The preconditions for the creation of these institutions are the institutionalization of economic life, the development of transnational corporations and TNCs, development of international forms of the currency-credit regulation; increasing instability of currency and financial system.

The main objectives of the international financial institutions are the stabilization of the global financial system, and the management of international financial system. International financial institutions aim to improve the stability of the global financial system, and assist in solving international financial problems. Their financial resources present considerable part of streams of official international help.

The system of international financial institutions includes world-class organizations (IMF, World Bank Group, which includes the International Bank for Reconstruction and Development; International Finance Corporation, International Development Association; etc.). The globalization of financial markets characterized by the development of financial innovations, the creation of new financial instruments (Euro-dollar certificates of deposit, foreign exchange swaps, zero-coupon eurobonds, syndicated loans in the euro currency, euro notes etc.) and the introduction of new technologies. Financial innovations improve the quality and speed of international financial transactions, and their terms. These innovations help banks, and other participants in financial markets, to save from all over the world and send money to the borrower under the terms of the highest profit and lowest cost. Investment banks have the opportunity to sign contracts in bonds and in foreign currency, through the system SWIFT. Commercial banks use letters of credit through electronic systems of payments from their headquarters to foreign offices.

The growth of global capital flows enhances financial competition between countries, affects the reduction of government interference in the operation of domestic financial markets, and leads to the liberalization of international capital movements. Thus, the global financial system is almost independent of governmental control and regulation. Less than 30% of the securities of the countries of the G7 countries are controlled by the state or subject to the public interest. From country to country moves more than 3 trillion dollars per month on the global financial market. Of these, 2 trillion dollars - the money are not controlled by the state or other official institutions. In the private sector have more resources than the central banks of major developed countries. Therefore, private capital defines the situation on the global financial market, rather than national governments. Private capital, according to the International Financial Institute, mostly directed at the developing market economy. Thus, in 2011, private capital flows to these countries amounted to more than 25% of all global investments. Especially significant capital inflows were observed in China and Russia.

The growth of revenues to China connected with the expectation of the rejection of fixed exchange rate of the yuan to the dollar, and move to the floating exchange rate, and in Russia - Russian banks interest in foreign loans in order to strengthen the ruble. A positive characteristic of the inflow of private capital into developing market economies is a significant diversification of the composition of the world's financial market. In this case, have developed the world's financial centers based on the huge domestic markets, conducting international operations. These centers are New York, London, Zurich, Luxembourg, Frankfurt am Main, Singapore, Hong Kong, Bahamas, Panama, Bahrain and Dubai. These are international banks, banks consortia, exchanges, which engaged in international foreign exchange, credit, transactions with securities and gold - in the centers.

Global financial centers (SFTS) occur in countries where:
- permanent currency-credit;position;
- there are the developed credit system and well organized exchange;
- moderate taxation;
- favorable currency legislation, that allows access of foreign borrowers and securities to exclusive quotation;

2.3. The main global financial centers

The national currency, credit and equity markets that are closely interconnected with those global market, constitutes the core operation of the global financial market. In this case, have developed the world's financial centers based on the huge domestic markets, conducting international operations. These centers are New York, London, Zurich, Luxembourg, Frankfurt am Main, Singapore, Hong Kong, Bahamas, Panama, Bahrain and Dubai. These are international banks, banks consortia, exchanges, which engaged in international foreign exchange, credit, transactions with securities and gold - in the centers.

The largest world financial centers are New York, London, Tokyo [15, p.44]. New York is the only foreign capital market and the main primary source of euro dollars. This is the main feature of this financial center. The market of bank loans is the main place of the operation of this financial center. International activities of major U.S. banks are connected not only with credit operations, but also with investment. Banks offer their clients a variety of securities transactions, place securities in the primary market, act like brokers on the secondary market.

Effectiveness of the New York capital market is achieved by issuing new bonds by the domestic financial institutions at a low price compared to other foreign markets.

Foreign Exchange Market is poorly developed. But it is considered the world's largest centers for currency trading by such indicators as turnover volume and number of currencies traded.

The stock market takes an important place. This market is one of the giants of international financial markets. On the New York Stock Exchange shares of 2.826 companies traded with the total value of $19.8 trillion. The daily volume of transactions about 500 billion dollars. In 2012, the net profit of exchange presented 2324 million dollars, that on 13% more, than in 2011p. [31]. This market presents a large variety of financial instruments: stocks, bonds, mutual fund shares, depositary receipts, debt securities, convertible, code - shares, forms, swaps, warrants and more.

The securities market of New York, as well as the overall U.S. stock market is attractive to investors around the world by the absence of taxation for the non-residents of the USA. Non-resident does not pay anything, where the resident pays 35%. The most significant feature of the stock market is well-functioning regulatory legislation. It is the most effective and rigorous in the world. Investment companies and funds are constantly monitored by the organizations that issue licenses. The gold market does not play a significant role.

An important factor that determines the role and position of New York as the world financial center is the investors' confidence. This is expressed in large volumes of FDI. According to the Department of Economics and Statistics of the United States for the period 2000-2010 FDI in the United States totalled $1.7 trillion, in 2010 - $194 billion, which is an absolute record among all countries of the world.

London is the financial center of Europe. It is the world's largest financial center with equally well developed markets of short-term loans and long-term loans, powerful exchange, good insurance and freight business and others. The dominance of international component over the national is inherent to London. The basis of its financial strength is not national, but international foreign exchange market and loan market. One of the features is the ability of banks, stock exchanges, broker's bill quickly respond to any new situation, financial innovation and liberal legislation. London as a world financial center is divided into four main gold, currency, stock and medium-term deposits and insurance.

The gold market operates since 1919, as a consequence demonetization of gold. Gold got property to be a mainly ordinary commodity with a price that is expressed in cedo-customer.

London's foreign exchange market is the largest in the world. 30% of all contracts with the currency pass through its currency exchange, and the volume of foreign exchange transactions is about 1000 billion a day. Each year, the foreign exchange market increased by 39% (New York by 5%). The maximum freedom of exchange operations contributed to the transformation of London to the leading global foreign exchange market.

The restrictions of freedom in other world financial centers are not allowed currency markets to reach the competitive level. The market of bank credit takes a leading position in the world. There are many foreign banks in London. British banks have a wide network of foreign subsidiaries. Due to the concentration of large world banks in London, this financial center became the chief of the loan transactions, where borrowers can receive any amount of money. The UK is the main borrower of international credit market in London.

British firms and companies get from American banks in London 4 times more foreign exchange than from the British clearing banks. The orientation of the London international credit market to the needs of the UK accounts for its specialization in the field of short and medium-term loans. London successfully competes with other markets in the field of international trade securities. The transformation of the London Stock Exchange to the International Stock Exchange, equipped with fully automated systems, was one of the reasons for the success. London Stock Exchange acts as a quotation center in the international sphere.

London Stock Exchange is the most international stock exchange in the world. There are a lot of selling foreign companies: more than 445 international companies from 63 countries are listed in London. London Stock Exchange includes a number of markets: governmental securities market, the market of shares and bonds, the local firms and companies, the market of foreign securities, the market of South African gold mining companies and others.
Tokyo is becoming an international financial center after 1970. The strengthening of its position was contributed by:
- the increase of producing of government bonds, which were the reason of the development of the secondary market;
- the issuance of bonds in yen by foreign lenders in Tokyo, and later - in foreign currency;
- the liberalization of yen and capital markets, which allowed foreign banks and companies, the traders of securities, actively work in the securities market;
- increase in foreign investment in Japanese bonds and shares;
- growth of the money market. There is the most activity of foreign participants, observed on-call loans market (it is a short-term trade loan, which is paid by the borrower on the demand of the creditor), certificates of deposit and short-term commercial paper.

Tokyo is a major Asian Pacific Region (APR). It is a major international currency market, due to the large daily turnover of foreign exchange, especially in transactions yen / dollar.

Tokyo Stock Exchange is one of the largest exchanges in the world, but the center gradually losing its place to New York as a marketplace for the issues of foreign companies doesn't change. Foreign investors believe, that the listing rules of the stock exchange are too hard and the enforcement of publication rules cost very expensive. Generally exchange serves the positions. Authorized Japanese banks (foreign exchange banks) and foreign banks operate in Tokyo. These banks are engaged in the lending of industry and trade in yen and in foreign currencies, the banks give foreign loans to Japanese companies through their parent companies. Lending export bank. Forex foreign banks carry out the operations in accordance with the direction of the regulatory framework of services and derivatives (in 2001) gave Hong Kong the opportunity to become the financial economic zone of the Asian investments.

Such conditions help Hong Kong to be an international financial center.

Hong Kong takes the 9th place in the world by the size of the economy, 11th - in the list of the largest exporters of services, the fourth - in terms of shipping. GDP per capita is higher than in the UK, Canada and Australia. Hong Kong is an independent customs area, an international center of commerce, finance and information. Foreign assets of the banking sector occupied fifth place by volume in the world. Hong Kong ranks 6th place in the world by the volumes of exchange. The stock market is the largest in Asia after Japan by the level of capitalization. Hong Kong is attractive because of the official position regards to FDI, liberal tax system, the relative simplicity of corporate law requirements. Small transaction costs, low interest rates, a small risk of changes in exchange rate, free capital movement are typical for Hong Kong.

Singapore is the financial center with international reputation, which focuses its work on the Asia Pacific region. The factors of its development are Tokyo market deregulation in the mid. 80s, creation of an efficient business infrastructure, price competition, qualified personnel, strategic location, allows the investors to make transactions with financial centers of the Asia-Pacific region as well as with European and American centers. In 1990, Singapore became one of the first financial institutions in the world in 1968. This allowed foreign banks to operate as offshore banking units.

There are many major and most respected world financial institutions in Singapore. It is an important center for capital management and ranks the fourth place among the major currency trading centers in the world after London, New York and Tokyo.

Banks provide not only traditional banking activities, but other activities that are regulated by the financial authorities of Singapore (Monetary Authority of Singapore - MAS). For example, providing accounting and consulting services carry out insurance mediation service clients in the stock market. There are about 30 activities, that are fixed in the relevant piece of legislation and the banks need not obtain a separate license.
CHAPTER 3
GLOBAL MONETARY SYSTEM AND THE PRINCIPLES OF ITS OPERATION

3.1 Concept and types of currency

Currency is any product, which is able to function as a medium of exchange in international payments. In the narrower sense – currency is the cash, which passes from hand to hand in the form of banknotes and coins.

Currency provides communication and interaction of national and world economies. Currencies are divided into national currency, foreign and international (regional) – depending on the origin (status).

The national currency is the legal tender of the country: money in the form of banknotes, coins and in the other forms. The money, that is in circulation and are legal tender in the country, as well as vouchers or other securities (stocks, bonds, their coupons, tokens, national currency exchange (drafts), promissory notes, credit, checks, bank orders, certificates of deposit, savings books, and other financial and banking instruments) denominated in the currency of that country.

The national currency is the basis of the national monetary system.

Foreign currency accounts of foreign countries are credit and payment resources that denominated in foreign currency and are used in international payments.

International (regional) currency – international or regional unit of account, the resource of payment and reserve. For example, SDR (SDR – Special Drawing Rights), which are international means of payment, are used by the IMF for the callless international payments. SDR could be used by means of the notation in special accounts, and by the unit of account of the IMF. Euro is the regional international unit of account, which was introduced within the European Monetary System in 1999. Euro is the accounting unit of the EU.

Non-convertible currencies of local and foreign exchange reserves of the country. Central banks of different countries accumulate and save reserves for international settlements in foreign trade and foreign investments in reserve currency.

There are weak and strong (soft) currencies – in relation to the movement of exchange rate of other currencies. Hard currency has a stable exchange rate. The concept of hard currency is often used as the synonym for convertible currency.

There are cash and non-cash currencies – in relation to the material form.

According to the principle of building – there are “basket” type and usual currencies. Currency basket is the method of commensurability of weighted rate of different currencies in a specific set of economic relations. The determination of the parts of currency basket, the size of exchange components, i.e. the number of units of currency in the set are the important factors of currency baskets calculation.

Important characteristics of currency are the degree of its convertibility – the ability of residents and non-residents to exchange national currency to foreign currency free and unlimited and the ability to use the foreign currency in transactions with real and financial assets. The degree of convertibility is universally proportional to the volume and stiffness of exchange restrictions that are practiced in the country. On this basis (usage conditions) currency can be fully convertible, partly convertible and non-convertible.

Freely convertible – the currencies of the countries, completely canceled currency restrictions and freely exchanged for all kinds.

Partly convertible – the currencies of the countries, which impose currency restrictions for a certain range of foreign exchange transactions.

Currency restrictions are different acts of official bodies, which directly lead to a narrowing of opportunities, to increasing of costs or to the appearance of undue delay in the implementation of foreign exchange and payments in accordance with international agreements. The main principles of foreign exchange restrictions include:

- centralization of foreign exchange transactions in Central and authorized banks;
- licensing of foreign exchange transactions;
- complete or partial blockage of foreign currency accounts;
- limited convertibility of currencies.

The degree of currency convertibility depends on the scope of foreign exchange restrictions. There are two types of the scope: the current account of balance of payments or equity transactions.

Convertibility for current operations is the lack of restrictions on international transactions, which are related to trade in goods, services, income transfers and transfers.

The following forms of currency restrictions are used at current account transactions of the balance of payments:
- the freezing of proceeds of foreign exporters, which were obtained from the sale of goods in the country, limiting of their opportunities for disposal of these assets;
- the mandatory sale of foreign currency receipts of exporters in whole or in part to the central and authorized banks;
- limited sale of foreign currency to importers;
- the restrictions on forward purchases of foreign currency by importers;
- the prohibition of sale of goods abroad in local currency;
- the prohibition of payment for imports of certain goods in foreign currency;
- the regulation of the terms of payments for exports and imports and more.

Convertible for capital transactions – the lack of restrictions on international transactions that involve the movement of foreign direct and portfolio investment, capital grants. The currency restrictions, that limit the export of capital and stimulate capital inflows to support the exchange rate, are used in case of the passive balance of payments.

This is the limiting of the export of national and foreign currency, gold, securities, loans, control of credit and financial markets, limiting of the participation of national banks in providing international loans in foreign currency; forced removal of foreign securities owned by residents and selling these securities for currency total or partial suspension of the repayment of external debt or the opportunity to pay in national currency without the right to transfer abroad.

There are some measures, which could be done in case of active balance of payments, to decrease the capital flows into the country and to increase the exchange
The quotation method is used for the analyzing of the dynamics of exchange rates. The exchange rate is the price of money, so its changes mean appreciation or depreciation of money. The national currency is expensive, when the exchange rate determined by direct quotation, is reduced: was 54010 UAH for 1 $, became 51210 per 1 UDS; the growing purchasing power of the hryvnia growth from 0.1851 dollars for 1 UAH (1.54010) to 0.1953 dollars for 1 UAH (1.51210). It is implied in case of the exchange rate of the hryvnia in the exchange rate.

The procedure of the quotation in the form of fixing, where interbank exchange rate is determined and recorded, in the way of the sequential matching of supply and demand for each currency—used on many currency markets. The rates of purchase and sale, or the average course between that is recorded as official are determined by using of data, which was noticed in previous sentence.

3.3.1. Types of the exchange rates
Several types of account of the exchange rates are used to assess the rate of economic development.

1. The nominal exchange rate. This is the rate between two currencies, i.e. the relative price of two currencies (the offer to exchange one currency into another). For example, the nominal exchange rate of the dollar to pound equals U.S. 5 2.00 / 1 pound.

2. Determination of the nominal exchange rate is consistent with the general definition of the exchange rate and is set on the currency market. It is used in exchange contracts. It is the simplest and most basic definition of the exchange rate. However, it is not convenient for long-term forecasting, because the cost of foreign and local currency changes in case of the change in the general price level in the country.

3. Real exchange rate. This is the nominal exchange rate, adjusted for relative price levels in our country and in the country, whose currency is used is quoted process with the national currency.

The real exchange rate is a comparison of the purchasing power of two currencies.

This is the formula, which is used for its calculation:

\[ S = \frac{P_e}{P} \]

where \( S \) - the real exchange rate; \( P_e \) - nominal exchange rate; \( P \) - price index of the foreign country; \( P_e \) - price index of our country.

The real exchange rate is the ratio of the consumer basket abroad, transformed to foreign currencies into national currency, using the nominal exchange rate (the nominal exchange rate, multiplied by the price index for foreign countries) and consumer price basket of the same goods in our country.

The real exchange rate, adjusted for inflation, for both countries. If the inflation rate in the country is higher than in the foreign country, the real exchange rate will be higher than the nominal.

3. Nominal effective exchange rate. It is calculated as the ratio between the national currency and the currencies of other countries, weighted according to the proportion of countries in currency transactions of the country. It is expressed by the formula:

\[ S^e = \frac{\sum (P^e \times W_i)}{\sum W_i} \]

where \( S^e \) - nominal effective exchange rate; \( \sum (P^e \times W_i) \) - sumation sign of indexes for i countries; \( W_i \) - the country's market share of the country's country's share in country's country.

The real effective exchange rate shows the averaged dynamics of the movement of national currency against several currencies, and reflects the change in price levels in country.

4. Real effective exchange rate. This nominal effective exchange rate, adjusted for changes in price levels or other indicators of production costs, which shows the dynamics of the real exchange rate of the country to the currencies of countries - major partners.

It is expressed by the formula:

\[ S^r = \frac{\sum (D^r \times W_i)}{\sum W_i} \]

where \( S^r \) - the real effective exchange rate; \( D^r \) - the index of the real exchange rate of the current year compared to the base year of each country, which is the trading partner.

The index \( S^r \) is considered like a major indicator that characterizes the generalized dynamics of major currencies rates. Trends of their development are projected on the index \( S^r \).

If \( S^r \) of the currency rises, exports become more expensive. In values are reduced, and imports become cheaper and its size increases, i.e. the competitive position of the country deteriorates in the global market. So \( S^r \) is the indicator of the competitiveness in the global market.
3.3.2. Cross-rate and trilateral arbitration

Every currency has more, than one exchange rate, but so much, how many, how many currencies there are in the world. Exchange rates having different numerical expression are connected by trilateral arbitration. A trilateral arbitration is an exchange operation of two exchange rates of the third one, with the aim of gaining income, using a difference between the exchange rate and cross-rate.

The cross-rate is the course of exchange of two currencies (A and B) through the third currency (C). We can determine cross-rate by the conversion of the currency “A” at first in the currency “C”, and then – the currency “C” in the currency “B”.

\[
(A / C) \times (C / B) = A / B
\]

(3.4)

The actions of arbitragers create additional suggestion of one currencies and additional demand on foreign currencies. A close agreement between arbitragers results in the fact, that an income from the arbitraging is so small, that the exchange rate and cross-rate are practically equal. At the same time a trilateral arbitraging creates the mechanism, which even demand and supply on currency in all currency markets. In consequence of this, an expert always promotes the raising of currency cost in the country in case of its measuring in currencies of other countries. An import reduces the cost of currency, regardless of the direction of exports and of the country, an import comes from.

Cross-rates are the secondary indexes. We can calculate them through the basic courses of currencies in relation to the dollar. There are three methods of cross-rate calculation, taking into account the type of quotation to the dollar (direct or indirect) [11, p. 10].

1. The 1st method: the calculation of cross-rate for currencies with direct quotation for US dollars (a dollar in the base of quotation for both currencies). We must divide an exchange rate, which is the currency of quotation, on the currency, which we use as the base of quotation for the calculation of the cross-rate. For example, it is needed to find the cross-rate of the Canadian dollar and Japanese yen (CAD/JPY). The quotation of currencies through the Canadian dollar for US dollars (USD/CAD) equals 1, 568, and the Canadian dollar to yen (USD/JPY) – 107.34. The cross-rate of CAD/JPY will be 107.34 / 1.568 = 68.72.

2. The 2nd method: the calculation of the cross-rate for currencies with direct and indirect quotations for US dollars, where the dollar is the base of quotation of for one of the currencies. For the calculation of the cross-rate we need to multiply the dollar exchange rates of those currencies.

For example, if we needed to find the cross-rate of pound sterling to the Ukrainian UAH (GBP/UAH). The exchange rate of GBP/USD = 1,5890 (direct quotation), the exchange rate of USD/UAH = 5,4250 (direct quotation). The cross-rate of GBP/UAH = 1,5890 / 5,4250 = 0,2928.

The 3rd method: the calculation of the cross-rates for currencies with indirect quotations for US dollars, where a dollar is currency of quotation for both currencies. For the calculation of the cross-rate we need to divide the exchange rate of the basic currency into the exchange rate of quotation currency. For example, it is needed to define the cross-rate of the pound sterling to the Australian dollar (GBP/AUD). The exchange rate of GBP/USD = 1,5820, exchange rate of AUD/USD = 0,6596.

Cross-rate GBP/AUD = 1,5820 / 0,6596 = 2,3967.

There are cross-rates, which are the most popular, pound sterling to Japanese yen, euro to Japanese yen, euro to the Swiss franc. The market of cross-rates in Ukraine is presented by a few currencies: pound sterling to the UAH, Russian ruble to the UAH, euro to the UAH. The determination of other cross-rates is not popular, because the trade contracts consist mainly in the dollars of the USA.

3.3.3. The regimes of the exchange rates:

There are three main regimes of the exchange rate in international practice: fixed, floating (flexible), compromise.

The regime of the fixed exchange rates - is the system, which characterizes by the features: the exchange rate is fixed, and its changes, which are the results of the changes of demand and supply, could be eliminated by the stabilization measures of the state. The classic form of the fixed rates is the "gold standard" currency system, where every country installs the gold content of the monetary item. The exchange rates are the fixed correlations of gold maintenance in currencies.

The fixed exchange rate can be fixed by different ways:

1. Fixing of the national exchange rate to the rates of the most important currencies in the international calculations.
2. Using of the foreign countries as legal means of payment.
3. Fixing of national exchange rate to the currencies of other countries - general trade partners.
4. Fixing of national exchange rate to collective currency units, for example, to SDR.

There are the advantages of fixed exchange rate:

- stable exchange rate provides a reliable basis of company for planning and pricing,
- it limits a domestic money and credit policy,
- it positively influences on the financial markets and financial instruments, which are developed enough.

There are disadvantages of fixed exchange rate:

- in case of lack of credibility to fixed exchange rate, it may be involved in speculation, which could be the reason to stop the usage of fixed exchange rate,
- there is no reliable method to define the optimality and stability of the chosen course.

On the whole, the system of the fixed exchange rates allows settling the short-term problems, related to the high level of inflation and deflation of national currency. The currency regime in United Kingdom is unacceptable in a long-term period, because the divergences in the rates of production productivity increase do not find an adequate reflection in relative price changes and allocation of resources between the different branches of commodity and services. As a result disproportions are accumulated in the structure of national economy.

As a rule, the market (floating) exchange rates operate in countries with a market economy and high level of profit.

Flexible or free floating exchange rates regime - is the regime, where the exchange rates of currencies are determined by the demand and supply. The market of currencies is counter-balanced by means of price, i.e. rates mechanism.

The advantages of free floating exchange rates are that the exchange rate can be appropriately corrected in the way, which gives the opportunity to remove unbalanced payments. This process is happened due to free oscillation of demand on currency and its supply, speculators do not have the opportunity to get an income due to a central bank, there is no necessity to carry out currency interventions by the central bank.

The disadvantages of market exchange rates are:

- the freedom of independent domestic monetary policy could be broken (for example, if the government hasn’t tools to stop decrease in the exchange rate, it can lead inflation, fiscal and monetary policy).
- Compromising exchange rates regime – is the regime, where the elements of fixing and of the floating exchange rates are combined.

The determination of currency market is carried by the motion of currency rates only partially. It can be:

- the maximum of fixed rate through minor changes in the economy, and in case of fluctuation in the currency, it may lead to the depression of currency and establishment of the new official fixed course:
- managed float of currencies, when the authorities change the exchange rate gradually, while a new parity will not be attained. It can be a) "crawling peg" - daily devaluation of national currency on the earlier arranged and declared size; b) "crawling peg" - a decline of the exchange rate on the defined size with earlier declared periodicity;
- the "managed float" - daily devaluation on the not earlier declared size. The government takes measures to adapt the economy to the new situation.

When the proposal does not comply with the demand in terms of the set official rate, the currency trade cannot be conducted. Legally, the exchange rates of black market are used. The offshore exchange rate behaves to the unofficial cost of the managed currencies, operation with them are conducted in offshore zones.

The choice of the regime of exchange rates depends on the aim of economic policies. In the regime, when the achievement of full employment belong a primary purpose, and inflation does not get the special importance, advantage can be devoted to the floating exchange rates. When the avoiding of inflation is the main aim, the exchange rates are often fixed. Essentially, the problem of comparative advantages of the fixed and floating exchange rates is the problem of optimal combination of unemployment and inflation.

The degree of depending of the national economy from the processes taking place in the global economy, depends on the chosen regime of currency regime. If a country in a large measure yields to the threat of internal instability and in a less measure depends on external, the best exchange rates for such country are fixed. In the case when a country in a considerable extent depends on the world market, and an internal economic situation and national macroeconomic politics are relatively stable, the best option is the floating exchange rate.

Countries with the deficit of balance of payments are more interested in flexible exchange rates, in these countries, whereas the influence of the monetary and fiscal policy. The flexible exchange rates are recommended for the countries that are specialized on the export of narrow set of foods, demand on that depends on economic position of importing countries.

It is possible to say in the most general view, that we must pay much attention to the optimal combination of the evaluation of currency policy in the modern world. The currency policy is an instrument of economic integration and is the tool of protection from the negative and destructive influence of the world economy on the national economy.

3.4. The equilibrium exchange rate

3.4.1. Demand and supply of foreign currency

A concept of the equilibrium exchange rate is important in the study of mechanism of determination of exchange rate. The analysis of exchange rate is performed by the usage of the instruments of the demand and supply of foreign currency at the currency market.

Demand for foreign currency arises as a result of necessity to buy commodities and services abroad. Demand for the currency of any country at the currency market means, that there is the demand of foreigners for goods and services of this country. The state of demand on currencies depends on a price of the offered commodity. More customers will buy the commodity, when the price of this commodity will descend.

The currency of a self-sufficient country is needed by the buyers, who want to get foreign commodity by means of the exchange of foreign currency for the national currency, at the market price, i.e. at the exchange rate. Demand of the currency of the seller of commodity depends on the currency price (at the currency market).

Supply of currency from the side of selling country is the result of necessity to buy commodities (i.e. the demand of the commodity) from the country-bayer of commodities.
In a market economy the price of currency ranges under the act of demand and supply. If the course of exchange is too high, the currency supply is higher, than demand of currency and the price on currency is low. If the price is too low, the demand of the currency is more, than the supply, so the exchange rate is higher. As a result of such fluctuations, the price of equilibrium of currency or market price is created. A market price - is the exchange rate, when the supply of currency and the demand are equal on the currency market (Fig. 3.1).

![Diagram](image)

**Fig.3.1. The determining of the market value of currency (equilibrium exchange rate)**

### 3.4.2. The dependence of prices on the change of exchange rate

Understanding of essence of exchange rates and of types of their quotation allows to compare the export price of commodity to the cost of import market and to find out, if the sale of that or other commodity or service at the certain foreign market is advantageous, or not.

Devaluation of national currency reduces the costs of national commodities, that is shown in foreign currencies (commodities become cheaper). It assists the height of export, which becomes more competitive. At the same time prices on foreign commodities, that is shown in national currency rise and the imports of them decrease. The national commodities, with prices expressed in foreign currency, become more expensive as a result of the appreciating exchange rate on the national currency (commodities are more expensive for the foreigners). Then export goes down and becomes less competitive. The prices of foreign commodities, which are expressed in the national currency, fall down and their import grows at the same time.

### 3.5. Forecasting the exchange rate

#### 3.5.1. Factors influencing the exchange rate

Long-term fundamental factors, that determine the path of exchange rates, are processes, which take place in the field of national production and turnover. It is, first of all, the comparative (in relation to a world level) labor productivity, and, accordingly, charges of production, long-term growth rate of GDP, place and role of country in world trade and capital exports.

Relatively more rapid increase of the labor productivity in a separate country (relative increase of the labor productivity) in a long-term plan results in the increase of relative purchasing power of national money as relation to commodities and in accordance with the increase of rate of exchange of this country. This circumstance gives an opportunity to forecast long-term development of exchange rates.

When there is the growing of the charges of production (lower labor productivity) compared with world, import grows more rapidly, compared with export. This process is the reason of depreciation of national currency, and vice versa. This factor got the same "parity of purchasing power" (PPP) of currencies. Currencies are compared according to the international price of the determined amount of commodities and services, represented by one or another currency.

During international and world economic relations such correlation of both currencies sets. According to this correlation the certain sum of money can be changed on identical in composition and volume the "market basket" of commodities and services in both countries. It is the parity of purchasing power of currencies, i.e. such level of the exchange rate of two currencies, that even the purchasing power of each of them, if the other things being equal.

The increase of national income of country results in the increase of demand for the imported goods generates demand of the currency of country-importer and tendency to depreciation of national currency. And the increase of export, related to the increase of national income in other country, generates a tendency to the increase of currency national exchange rate of country-exporter.

Inflation is one of the factors of the turnover sphere, which determine the long-term tendencies of motion of exchange rate. The rates of inflation comparatively with the rate of depreciation of leading currencies are very important. Higher national inflation rates, if everything else being equal, is the reason of the decline of exchange rate of this country in relation to countries that have relatively not high rates of depreciation of money. In case of inflation the change of exchange rate is clearly nonlinear, unlike the real course-changing in case of relative change of the labor productivity.

If in first case, the monetary policy can influence the exchange rate toward its increase (reduction of emission of money, increase of rate of the borrowed interest rate), then in the second case - the facilities, sent to the increase of the labor productivity to the level that provides a competitiveness in the world market.

One of factors that determine the path of exchange rates is a relative level of the real interest rates, i.e. of nominal interest rates accounting for the size of inflation.

The relative level of the real interest rates regulates the flows of capitals between countries. The increase of interest rates does the country attractive for investing of financial, as a result suggestion of foreign currency and demand of the national currency increase. Low interest rates limit or cause the outflow of capital, demand of foreign currency decreases - as a result. Accordingly conducts itself and exchange rate. In the first case it tends to the increase, in the second - to the decline. Thus, strong inflation and low real interest rates result in depreciation of currencies.

The state of the balance of payments effects on the exchange rate. As a rule, passive of balance worsens the position of that or other currency in the world market, because the demand on foreign currency exceeds its supply. An asset improves the situation, as supply of foreign currency exceeds the demand of it.

The short-term volatility of exchange rates depend on a psychological factor - market "expectation" of participants of currency market (disserting of bankers, dealers about the prospects dynamics of currencies exchange rates, currency interventions etc.). Market "expectation" generates different sort of speculation on currency markets, including speculative motive of capitals. Expectation of further decline (increase) of exchange rate leads to the stronger decline (increase) of the exchange rate.

Currency intervention, i.e. interference of central banks and treasuries in currency operations, is conducted both with the aim of increase and with the aim of decline of exchange rate. The decisions about exchange rate are made at the National Bank. If the aim is the increase of currency national exchange rate, banks and treasuries make sale foreign currency and purchase national currency. If a country is interested in the decline of the currency exchange rate, then there is reverse process - the mass buying of foreign and sale of national currency. Currency intervention can influence on motion of exchange rates only temporarily. The degree of its efficiency depends on the volume of money of the specially created currency funds.

The decline of currency national exchange rate assists the discharge export of commodities. However the currency dumping brings additional revenue only when there is the external currency depreciation, i.e. reducing its exchange rate, ahead of internal devaluation, i.e. a fall in purchasing power of money in the country. Only in this case, selling a commodity at previous price (or lower) in foreign currency, exporter change this currency for the greater amount of the national currency as a result of fall in the exchange of the last. It allows buying more equipmenst, raw material, labor force at the national market for the expansion of production.

Banks, firms, TNC do the prognostications of exchange rate. The aim of prognostication is an improvement of insurance of currency risks and increase of efficiency of decisions in international financial management.

#### 3.5.2. Models of the determination of exchange rate

The prognostication of tendencies of changes of exchange rates maybe, first of all, on the basis of PPP, which binds prices in national currency with the exchange rates (PPP - equality of purchasing power of different currencies at the unchanged level of prices in each of countries). There are theories of absolute and relative parity of purchasing power.

It becomes firstly established in the theory of absolute parity of purchasing power, that the exchange rate between currencies of two countries equals the relation of price level in these countries:

\[
R_{a} = \frac{P_{1}}{P_{2}}
\]

where \(R_{a}\) – an exchange rate,
\(P_{1}\) – level of domestic prices (the price of the consumer basket in your country)
\(P_{2}\) – level price abroad (the price of the consumer basket in a foreign country)

The theory of relative parity of purchasing power asserts that the change of exchange rate between currencies of two countries is proportional to the relative change of prices levels in these countries, so inflation is taken into account.

\[
R_{p} = R_{a} \times \frac{P_{1}^{\prime}/P_{1}}{P_{2}^{\prime}/P_{2}}
\]

The expected changes of rate of exchange under the act of change of interest rates depend on those forces that influence on interest rates. First of all it regards the inflation.

Irving Fisher, an American economist, proved the relationship between interest rates and inflation in detail. According to his theory, the growing of inflation rate leads to the growing of interest rates and vice versa. This pattern is called the "Fisher effect".

The "Fisher effect" - the ratio between the nominal interest rate (r), the real interest rate (R) and inflation rate (i) in the country:

\[
(1 + r) = (1 + R) \times (1 + i)
\]

Generalized Fisher effect is used for two or more countries. Generalized Fisher effect: difference in inflation rate between the two countries is the difference in nominal interest rates, i.e.
The "international Fisher effect" explains the moving from interest rates to exchange rates. The "international Fisher effect" shows that the expected percentage change of the exchange rate is a function of different interest rates in two countries. The "international Fisher effect" is presented by the equation:

\[
\frac{\pi_e}{\pi_d} = \frac{1 + \pi_f}{1 + \pi_e}
\]

where \(\pi_e\) = interest rate in domestic currency;
\(\pi_d\) = interest rate on foreign currency;
\(\pi_e - \pi_d\) - percentage change in the spot exchange rate.

Fisher's theory demonstrates a direct relationship between the nominal interest rate, inflation and the exchange rate (see formulas 3.7, 3.9) [15, p. 41].

The systems of the national currency adjusting, as a rule, determine the subjects of the currency adjusting, the order of realization of operations with currency values, the status of currency and exchange rate, the plebiscite powers of public organs and function of the banking system in the field of the currency adjusting and currency control.

The national systems of the currency adjusting divide all participants of currency relations into:
1) residents, these are all institutional units that are on territory of this country constantly, regardless of their citizenship or belonging of capital
2) non-residents, which are all institutional units that are on the territory of the foreign rates constantly, even if they are the branches of institutional units of this country.

The objects of the currency adjusting in accordance with the order of regulation are currency turnover abroad, into exchange, and foreign currency. Under currency turnover, we must understand operations with currency values that are used by the subjects of the currency adjusting. National and foreign money signs, pay documents and securities, issued by a non-resident, and bank metals, belong to the currency values.

Monetary policy, depending on its aims and forms, is divided into current and long-term [10, p. 163].

Current currency policy – is the totality of the measures, sent to the daily, operative adjusting of exchange rate, currency operations, activity of currency market, including by means of discount and foreign exchange intervention policy.

The aim of current monetary policy is providing of the normal functioning of international and national mechanisms of the world currency system, support of equilibrium of the national economy.

Long-term (structural) currency policy envisages the long-term measures of structural character in relation to the successive change of currency mechanism.

International regulations and agreements are used for its realization, primarily within the IMF and on the regional level. Also currency reforms, that include the measures, sent to the change of key elements of the currency system, such, as an order of the international settling, mode of exchange rates and parities, use of gold and key currencies in transactions of payment. Furthermore, international and regional currency-credit and bank organizations, are used for the realization of long-term currency policy.

The forms of monetary policy are: the discount and foreign exchange intervention policy.

Monetary discount (registration) policy is the system of economic, legal and organizational measures in relation to the use of discount interest rate for the regulation of investments and balancing of payment obligations, interested adjusting of exchange rate regulation.

Foreign exchange intervention policy is the system of adjusting of exchange rate, through the purchase and sale of foreign currency in the public. The current system of intervention, currency limitations, diversification of currency reserves. Adjusting of degree of convertibility of currencies, mode of exchange rate, devaluation, revaluation are the forms of foreign exchange intervention policy.

Two tendencies fight in the currency policy. From the one side - aspiring to the more close continuous concordance, collective control under an aegis IMF on the macroeconomic indexes of development of national economies for the achievement of stability and "predictability" of exchange rates. Such approach, exhibits objectively as a reaction on the growing interdependence of national economies, generated by internationalization and integration of production and capital. On the other hand there is the desire to protect against external interference (mainly from IMF and USA) in internal economic development, to save an independent course in the national economic policy, to prevent the infringement of sovereignty.

These tendencies appear with different force in different countries and regions. The possibility and efficacy of a particular exchange rate regime determined largely by the tendencies of the currency policy. It is impossible to define currency policy, which would be the best for all countries. There is the question of the right choice of concrete policies in concrete situations, depending on tasks (problems), which stand before a country or groups of countries.

5.5 Evolution of the world monetary system

World monetary system (WMS) is the concrete form of organization of monetary relations. It is the functional form of organization of international monetary relations, i.e. the set of methods, instruments and organs (institutes), which are used for international settlements. There are the basic elements of WMS: national reserve and supranational (collective) currency units, terms of currencies mutual convertibility; standardized mode of currency parities; regulation of exchange rate regime; intergovernmental regulation of currency limitations; unification of the international payments; the regimes of world currency markets and markets of gold; intergovernmental regional and supranational organs, which regulate currency-financial connections and relations.

There are the main tasks of WMS: the regulation of international payments and currency markets, mediation of payments for export and import of commodities, services, capital and other types of international economic activity, creation of favorable terms for development of world production, international specialization and international productive co-operation.

The evolution of the world monetary system is determined by the development and necessities of national and world economy, by changes in the world economy and by periodic world currency crises. Currency crises may cause the economic and currency collapse, which are included to the separate states. His strategy and tactics are fixed in normatively-legal and methodical documents.
The development of the world monetary system passed the row of stages, each of that had been occupying long historical period of time. The main difference between world monetary systems depended on the asset, which was considered as a reserve. The equilibrium of balance of payment reached by dabant of this asset (it was: gold, dollar, exchanged into gold at a fixed course, the other currency, which played the role of international means of payment – in different time).

3.7.1. Gold and gold exchange standard

The first world currency system was the Parity standard currency system. It was legally executed by the international agreement on the conference in Paris in 1967. The conference recognized gold the only form of world money. A gold-coin (gold) standard was the base of the currency system. The gold partners were installed according to their gold content (the ratio of currencies of different countries on their gold content). All national currencies had their fixed gold contents by the system of “gold standard”. For example, English £ had its gold content, which equalled 7.323358 g of gold (since 1821). 1 German mark – 0.385422 g of gold (since 1871). The exchange rate was determined by the relation of gold content of currencies. In case: 1:2.03.

A gold-coin standard based on direct connection with gold. According to this system:
- currencies were freely converted in gold;
- the bar of gold had the opportunity to interchange on coins freely;
- gold was freely exported, imported and was for sale on international markets, the markets of gold and currency markets were interdependent;
- all countries submitted strict correlation between their gold stocks and the amount of money in turnover.

The exchange rate fluctuated in a relatively narrow range (within the limits of gold points, which were equivalent to the parity of national currency with addition or deduction of transport and insurance charges, caused by the material transfer of gold). Therefore, the system of gold standard is acknowledged as a currency system with the fixed course. The organs of currency control pursued the policy of regulations that allowed providing currency stability and the equilibrium of balance of payments.

The international payments of gold-coin standard carried by the use of the bar of gold. Currencies that were displaced into location by gold, namely in England. Gold was used only for payment of deficit of balance of payments. The part of gold diminished in money supply and fractional credit money forced gold from turnover gradually in the end of the dollars were recognized as such integrated (in 1923). The money systems of 30 countries were based on gold exchange standard.

The gold standard was the basic of the system. It based on gold and leading currencies that were converted in gold. Characteristic features of the system were:
- gold and foreign currencies were the basis of the system.
- the currencies that were suitable to exchange for gold at any time were called as reserve. The peso in the end of the dollars were recognized as such integrated.
- the currency exchange rates were based on the exchange rate:
- the currency adjustment was provided in the form of international conferences, active currency policies.
- the exchange rate standard was in the world observed from 1922 to 1928. It was undermined by a world economic crisis 1929 – 1933. As a result of crisis, a gold exchange standard collapsed. The course of many currencies decreased on a 50 – 84%. An accumulation of gold by the private persons increased, external payments were stopped, the mass of “hot” money were created, money moved from one country to other spontaneously to find speculative super profit.

It was the reason of the currency war. Currency intervention, currency dumping, currency limitations, currency bans were used in the war.

The world currency system was shocked by a new economic crisis in 1937. It was the mass devaluation of currencies. There was no stable currency before the Second World War.

3.7.2. Breton – Woods monetary system

Development of new, more efficient international currency system began in April in 1943. The leading countries of the West coordinated basic principles of the Breton Woods currency system at the international conference in布鲁特 Wood in 1944. International organization – International monetary fund (IMF) was founded, – the “obligation” of that is providing of the normal functioning of the system and observance of the principles, envisaged by a general agreement.

The basic principle of organization of currency relations according to Breton – Woods system are:

1) The Breton – Woods system was based on Gold exchange standard. The role of gold as a general equivalent, as a mean of payment and settling unit in international turnover was maintained. Parties of currencies of all participating countries must be expressed in gold, that is a general equivalent, and also in the dollars of the USA according their gold content on July. 1st 1944 – was written in Bretton – Woods agreement. However, this position was not executed in practice; the connection of all currencies with gold was indirect (through foreign currencies). Only the dollar kept an external convertibility and acted as a kind of world currency.

2) Establishing of the fixed parities, concerted within the framework of IMF. Currencies were compared and interchanged on the basis of the parities.

To provide accordance of the real currency exchange rate to the declared parity, every country could:
- guarantee convertibility of the currency in gold according to official parity (this variant was chosen by the USA, such parity: 35 dol. for 1 ounce of gold, was set in 1945).
- to support the currency exchange rate on markets in relation to other currencies within the limits of variations “+” ” ” of 1% of its parity (other countries chosen).

The exchange rates of currencies deviated from the parities unimportantly, as they were made the state and intergovernmental influence. The IMF controlled the mechanisms of the parities, according to currency interventions, mainly in the dollars of the USA. At fundamental instability, by approximations with IMF, devaluations and revaluations of currencies of the developed countries were conducted;

3) Convertibility of currencies, freedom and versatility of payments were on current operations;
4) Prohibitions of free (private) to purchase-sale of gold.

Bretton – Woods system had been operating during almost 30 years. These were the years of proceeding in the economy of Western Europe countries and Japan, “the economic miracle”, in relation to moderate inflation rates in the industrially developed countries according to currency interventions, mainly in the dollars of the USA. At fundamental instability, by approximations with IMF, devaluations and revaluations of currencies of the developed countries were conducted;

However to the extent of increase of world economy, strengthening of competitive activity, growth of inflation, sharp increase of volume of financial operations, unconnected financial transactions, and also in connection with the crisis of key currency of the system – the dollar of the USA, the Bretton-Woods system satisfied less necessity of international trade and capital flow.

Inequality of currencies was folded within the framework of the Bretton – Woods system. The dollar of the USA occupied the privileged position. It allowed the USA to cover the deficit of balance of payments in a considerable measure due to the short-term obligations of the American banks to foreign state organizations and private persons. The USA became debtors. Investment balance (capital balance sheet) was also folded not in behalf on the USA. There was an outflow of capital, and, as a result, negative balance of payments.

The chronic deficit of balance of payments resulted in fact that the amount of dollars abroad considerably exceeded gold reserve of the USA. There was a distress to the dollar and aspiration to exchange dollars for gold. The USA began to lose the dominating position in a world production and unconditional trade. The role of the countries with positive balances of payments grew (EEC, Japan and other countries). The overcoming of deficit of balance of payments of the USA in this situation would mean the reduction of international liquidity, that would bother the international settling. The USA appeared before a choice – to bear large changes or change all currency rules. The USA did a choice in behalf on the change of rules, tearing connection of dollar with gold in 1971. Except that, principles of the Bretton – Woods system undermined the development of euro market and market of eurosdollars, where the enormous amount of dollars, that practically fell out of the mode of the limitations, which were set by national currency departments and IMF, created freely. All of it created a favorable situation for currency speculations. At this terms the system of the fixed exchange rates could not effectively function.

Transition to a new currency system had began, that had get the name “Jamaican” in honor of the name of country, where basic principles of this system were established.

3.7.3. Jamaica monetary system

A transition from a gold exchange standard to the new system of currency relations occupied a few years. After the first substantial step – stopping of exchange of dollars on gold - such events happened. The floating exchange rates were entered in March 1973. All leading currencies (dollar, pound sterling, German brand, yen, French franc) floated on attitude toward each other from 1974. In the same year “Special Drawing Rights” - “SDR basket” became the new standard of value exchange. The IMF made a decision to give up fixing of official rate of gold, stopping the operations with gold in the framework of IMF, giving a right to the national currency organs to dispose of their own gold at own discretion in 1976. And finally, there was the envisaged abandonment from the fixed parities in the charter of IMF in 1978. The Jamaica monetary system was officially existed.

Basic differences of the Jamaiccan currency system from Bretton-Woods are:

1) The transmitters of world money changed. If the Bretton-Woods system used gold and key currencies as eventual warriors of setting, then the new currency system is based on SDR (collecting currency of IMF). This currency became an element in the structure of international liquidity.

2) The new currency system allows both fixed and floating exchange rates and mix of them.

3) The presence of the reserved currency blocks that, from the one side, are the participants of the world currency system, and from the other - there are the special relations between participating countries into them. The most characteristic example is the European currency system (ECS) - origination of EEC.

Muhammad Firman

University of Indonesia - Accounting

12
4. The rights for IMF on a supervision of the exchange rates are extended in the Jamaican currency system. IMF produced basic principles, which are required to perform by countries-members of IMF, during realization of course politics, for the effective functioning of international currency system on the whole. Essence of these principles is illustrated in the points:

- the rate of exchange must be economically reasonable. Countries must avoid manipulation by the exchange rate with the aim of non-admission of the necessary adjusting of balance of payments or receipt of unfair competitive edges;
- to carry out intervention with the aim of smoothing of considerable chaotic short-term course vibrations;
- take into account interests of other countries during realization of intervention.

Basic criteria were developed for determination, whether the country fulfills these principles.

The obligations were laid on the countries-members of IMF at the choice of the new currency model to reform the IMF. The influence of IMF in the decision of currency problems, national economic politics of countries-members must assist stabilizing of exchange rates.

The abolishment of gold, as an international means of payment and the manner of value, was a condition of Jamaican system. The official price of gold was canceled, and its demonetization (the devaluation of gold from functioning like money) started. Gold could be the national reserve instrument, but all payments between IMF and national currency organs were implemented only in SDR.

The principle of adjusting of exchange rates by market forces (demand and supply) was proclaimed as the theory basis of the Jamaican system. However, the exchange rates could not function in the mode of pure floating (so under the act of only market forces) Integration processes resulted in the close interfacing of the national integrated processes, in the greatest substitution of national economies to conformities of world economies, to dependence on processes that take place in the world economy, including in the field of currency. It was unclear to create optimal background for the development of international trade without the currency policy coordination.

By means of the "pure" floating it was not succeeded to attain the equilibrium of balances of payments. The floating exchange rates did not result in the autonomy of domestic economic policy. In contrast, the freely floating exchange rates strengthened intercommunication between the exchange rates and internal economic processes. Consequently, in the real practice the Jamaican currency system functioned as the system of the guided floating rates (with a tendency of strengthening of "monetary linkages" in an currency policies of separate countries).

The central emission banks do interventions for providing to exchange rates a favorable level for national interest by:
- purchase or sale of both foreign and own currency on the foreign markets;
- limitations or prohibitions of purchase or sale of certain currencies, direct control about private internal transfers, introductions of negative interest rates in relation to the foreign currency.

Despite the fact, that the Jamaican currency system has a row of negative moments, its functioning renders substantial influence on the acceleration of rates of development of the industrially developed countries and many countries of the "third world" in direction of further social-economic integration.

There are the characteristics of the modern world currency system: substantial volatility of exchange rates, in particular, in relation to the American dollar (the periods of underestimation of dollar change by the periods of rise of its cost); considerable flexibility of exchange rates, that as a rule, are regardless despite the existence of free-floating, world economy cannot be free from international interdependence, which imposes certain restrictions on national economic policy, the instability of the world currency system to the currency crises and sensitiveness to the external shocks.

CHAPTER 4
FEATURES OF MODERN WORLD MONETARY AND FINANCIAL CRISSES

4.1. Essence and types of financial crises

New quality of interdependence of participants of the world financial system is clearly manifested in the modern terms of global integration and internationalization. Their interests require maintenance of economic and political stability in the world, as a financial sphere has decisive impact on the real economy, on a level and quality of life. However, the world often facing financial crises, which are the shocks to the financial system, causing great damage to the national economy.

A financial crisis is a process of disorder of financial market when the problems of adverse selection and psychological risk result in that financial markets cease to function as a channel of financial resources transmission for parties with the best investment possibilities.

The financial crisis is accompanied by disorder of financial market which shows up in decrease in money supply, exhausted foreign exchange reserves, mass bankruptcy of credit-financial institutions, inactivity of non-financial sector and sovereign debt default [10, p.179].

During the financial crisis there are quality changes in the economic system, that cause violation of proportions in development, its halt, modification or destruction of the financial system of some countries or world markets in general.

To the characteristics of financial crises we refer:
- spreading of crises by waves, touching all new spheres of financial relations;
- they systematically embrace financial markets and institutions of financial sector;
- negative influence in medium-term and long-term on economic activity within a country and on the dynamics of welfare of the population;
- in a financial sector and on the financial markets the crisis shows up as a sharp increase of interest rate, share of insolvent banks and non-bank financial institutions, decrease of liquidity of financial relations; unprofitable model of banking and other financial activity, predominance of speculative financial activity above investment, substantial falling of stock prices, destruction of the payment system, mass losses at the market of derivatives, illiquid financial markets;
- in the field of international finance there is an out-of-control drop in the national exchange rate, mass capital flight from a country, out of control increase of external debt and overdue payments of the state and commercial organizations;
- in the field of monetary reserves there is an out of control price increase with passing to a chronic inflation; escape from national currency, prompt emergence of hard foreign currency in internal turnover;
- in the field of public finances there is a sharp falling of foreign exchange reserves and state stabilizing funds, origin of budget deficit, reduction of tax revenues and budgetary financing of the government spending, increase of internal national debt;
- realization of system risk (risk related to the change of investment climate in a country and changes in the conditions of investment market) that is accompanied by the effect of "domino", i.e. 1) crisis of financial institutions and companies of the real sector, segment of market or system of payments is passed in an growing extent through cross obligations on other groups of financial institutions and companies of the real sector, market segments and payment system, gradually embracing greater part of market; 2) crises of financial market of one or a few countries is passed to other countries, as a "financial contagion", crisis of trust of investors, that causes market illiquidity;
- crises begin not in the real sector of economy, but on stock exchanges, in the banking sector through unvalued amount of money in an economy.

There are different types of financial crises: currency, bank, stock market.

A currency crisis takes place in cases when a speculative attack on currency results in sharp devaluation of national currency or when public authorities try to prevent devaluations, selling reserves or considerably increasing interest rates.

Bank crises are connected with inability of banks to meet obligations or with active state interference, preventing the arising problems.

A bank experiences a bank run with all the depositors wishing to withdraw their deposits and in this situation cannot pay off the depositors.

During the debt crisis there is bankruptcy of the state (default) i.e. the state can not meet the obligations. Government obligations sharply lose their value and there begins a flight of capital.

During the stock market crisis there is observed an increase of price volatility of financial assets or their falling, which is connected with the change of expectations of investors. The stock market crisis, as a rule, proceeds to the next three crises.

In the conditions of financial globalization important is a question to determine the reasons of origin and development of financial crisis, then analysis forecast with the aim of prevention, neutralization or minimization of negative consequences.

There are many scientific works, where the mechanisms of distribution of financial crises are investigated, and their influence on international and national development. These problems are examined, first of all, in the theoretical models of P.R. Krugman.

A financial crisis, according to the models of Krugman, arises inside the country as a result of inefficient economic policy and begins after awareness of the irrationality by external economic agents (table 4.1).

Models of financial crisis by P.R. Krugman

<table>
<thead>
<tr>
<th>Terms of the origin of financial crisis</th>
<th>Characteristics of consequences of model application</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixing of exchange rate by a central bank to support within the limits of currency outside by interventions at the currency market</td>
<td></td>
</tr>
</tbody>
</table>
| The amount of money grows quicler than in other countries at these model, hereupon internal prices grow in relation to world prices, that expresses an export and stimulates an import. Reduction of flow of currency into the country and increase of its outflow reduces foreign exchange reserves and leads to forced devaluations. Speculators of international currency market, knowing about reduction of official reserves begin to feed money in national currency and to convert it in foreign, hoping that at the moment of loan repayment national currency will become cheaper. It accelerates devaluation and, as a rule, is reason.
Trade relations and degradation of currencies assist to the distribution of crises. Crisis in large country market-partner is accompanied by the decline of volumes of export of internal firms, by the declining of prices on assets in international market, by the outflow of foreign capital and by the crisis on the international money market. In general, the worsening of the condition of current account of the balance of payments occurs. Depreciation of currency reduces the export competitiveness of countries, market-partner, and the country, infected by a crisis, because there is a pressure on currency of these countries.

In addition, the financial interconnectedness and informative channels have an influence on infecting of countries by crisis. The investors look over the international securities and invest in one of the countries. They begin to sell financial assets with low rates, but the assets with high rates. As a result, there is destabilization, volatility of financial markets, especially in segments where foreign operations are concentrated. The dependence of some countries on the certain categories of financial assets. Due to the informative channel, large international investors (TNB, the specialized financial institutes) could know that there is a currency crisis in some country that the regime of the financial changes, sizes of countries with analogical macroeconomic indicators is shaky. Therefore, investors begin to pay high attention on the macroeconomic indexes of other countries. Countries with weak macroeconomic fundamentals could be the object of infecting of financial crises.

The most informed investors begin to withdraw the investments from the country, following their example, other investors do the same that causes the mass outflow of capital. International investors begin to search new fields of application for capital, after the leading out of the capitals from the infected country and from other countries with alike situation. There is the considerable entering of capitals in a certain sphere. However investors can lose a trust even to this sphere.

There is the received of sanctions or embargo, the withdrawal of trade agreements or boycott, the supply of goods to the market is decreased. It results in an increase of prices, and decline, as a result of which the value of bank collateral deteriorates. There is a transformation of investments from high profitable to unprofitable. There is a currency, debt and bank crisis.

World experience testifies, that the political events of 70-80’s – the cyclic devaluation of rates of the economy growing in the industrially developed countries, were the basis of occurrence financial crises at 60-90’s of XX century. The motion of "hot money", that are characterized by considerable volumes and supermobility on the world financial markets, and also appearance of new innovative products, sharply increased the demand for foreign currencies on real estate – are the basic terms of occurrence of the modern financial crises.

The first world financial crisis of XXI century (sometimes it is called "Great recession") started at the beginning of October 2008. It is the considerable worsening of financial condition on economic indicators in the most developed countries, and the recession became global at the end of this year. There were the main conditions for its appearance:

- imbalances of international trade and capital flow;
- an inadequate estimation of risks on the speculative investing in foreign financial resources and the absence of the appropriate regulatory system;
- overproducing of the basic world currency – US dollar;
- depreciation of the US dollar during 2008, as a result using this currency, as a reserve, was diminished by countries;
- the general cycle of economic development;
- overheating of credit market, mortgage crisis as a result
- the high prices on petroleum, particularly on oil;
- the overheat of stock exchange market.

There were the consequences of this financial crisis in the countries of the world: the decline in the growth and volumes of crediting, increase of interest rates, hard requirements to the borrowers, reduction of scales of the mortgage loans, price decline on energy commodities, crash of stock exchange markets, crisis of mutual, reverse in the trade, bankruptcy of enterprises and banks, reduction of workplaces and salary.

Financial crises are considered as the phenomenon of globalization in the financial sphere. Financial globalization creates the pre-conditions of aggravating of crises in separate countries in the crises of global character, so there is the contagion of countries by crisis (transfer of crisis).

There are some ways to the crisis contagion: 1) by realization of conscious actions of one country in relation to other that forms last heavy crises, decline of competitiveness of national economy and narrowing of its presence on markets, worsening of enterprise and investment climate; 2) consistent transference of crises from more developed to the less developed countries;

The outflow of capital to abroad grows in the infected countries (not less than 30 %), the capitalization of market of shares and reserves (not less than 20%), the levels of interest rate and inflation in the annual measuring present not less than 10-20%, exchange rate of national money (not less than 5%).

The transfer of crisis situations is realized through the pressure of international financial organizations, discrimination in foreign trade, artificial shortening of life cycle of products on the markets of other countries, export of out-of-date technologies, weakening of technical standards, imposing commitments on the industries that should fulfill the existing export orders, lack of new technology, that is accompanied by the worsening of situation on the market of goods, that is characterized by the increase of prices of goods, that are not competitive and that are characterized by the increase of domestic prices.

First of all, macroeconomic shocks, that are divided into shocks of the real sector and monetary shocks, influence on distribution of financial crises. The most typical shocks, that take place in the real sector, are changes of world prices of the main exported or imported commodities of certain country. Monetary shocks are related to the increasing of world or national interest rate.

The most direct price decline in the export products and the dropping of interest rate on the international credit market could significantly reduce the competitiveness of national commodity producers and their maintenance of external debts.
CHAPTER 5
INTERNATIONAL SETTLEMENTS: ESSENCE AND FORMS

The realization of international economic operations envisages the exchange of money of one country on money of other countries. There are currency relations on this basis. Currency relations are the totality of money relations, monetary payment and settlement operations between the participants of the global economy. The participants of these relations are banks, financial institutions, subsidiaries of large enterprises, brokers.

The location of currency relations in the system of world economic connections is determined by their role in making the relations of world trade and international capital, international motion of capital, influencing, from one side, on these relations, and from other, - being under their influence.

Talking about eventual reasons of processes that take place in the field of currency (first of all, movement of exchange rates), they are determined by processes, that take place in the sphere of production, and are developed under the act of changes of correlation of economic forces between separate countries or groups of countries.

The international settlements, as a form of currency relations, assist the deepening and strengthening of intercommunications between national economies. They are conducted under economic operations and generally represented in the balances of payments of all countries of the world. The international settlements create the system of adjusting of payments of money claims and obligations that arise between the subjects of international economic activity, based on policies of national, scientific, technical, and other relations. Thus, international settlements are:

- the trade-financial package at 250 billion U.S. dollars for the sake of support of international trade flows during two years;
- at least 100 billion U.S. dollars of additional loans from the confidence development fund.

Concerning the activity of regional organizations, particularly of EU, European Commission developed the Plan of European economic renewal in the end of 2008. The plan contains two key elements. These are:

- the scale and urgent budgetary stimulation of purchasing power at the level of 200 billion euro (1.5% of GDP) for the support of consumer demand, and also to assume the exit of some countries-members outside the threshold of deficit of budget set by the plan at 3%, which is necessary for overcoming the crisis;
- strengthening the competitiveness of the EU by investing in perspective innovative technologies - energy-savings, development of alternative resources, transport infrastructure etc.

The council of EU of economic and financial questions granted permission to the countries-members of EU to apply the brief rate of VAT in separate activities, and also collapse the threshold rates of accuracy of the measures, that set more hard standards of quality and transparency and envisage the realization of permanent control over their functioning from the side of public organs.

International organizations develop anti-crisis measures also. IMF negotiates with countries concerning granting them loans on the simplified chart within the framework of instrument of liquidity that envisages the brief terms of payments and more simple terms. Within the framework of efforts on a fight against the global economic crisis, IMF entered the row of new credit instruments, in particular, flexible loans (Flexible credit line).

The Executive Board of the IMF confirmed the introduction of new instrument of the operative grant of short-term loans (Short-term liquidity facility) intended for the countries with a market economy in the process of becoming (emerging markets). In the conditions of international economic crisis IMF, World Bank and Europol also declare about possibility of increasing of the sponsorship to the developing countries. A world bank expanded a willingness to increase the volume of loans to 100 bln. U.S. dollars.

Modern financial crises (in particular world) put under a doubt not only the idea of globalization, but also strategy of open market in general (now many countries declare about possibility of closing of the markets). It should be noted that Africa, China, Brazil are least affected by the crisis in 2008. The degree of globalisation is not too high in mentioned countries. The corresponding measures are accepted for prevention of world financial crises at the level of the separate state and at the international level. The main attention during the development of these measures is spared to the limitation of out-of-control inflow of speculative capital, limiting of risks for the macroeconomic stabilizing on the whole – at the state level. At an international level, the IBM system of measures must reflect the interests of world economy, to assist prevention of crises and serve to the effective functioning of markets.

The increasing of competitiveness and business activity. It is a tax cut on the income of enterprises, favorable tax treatment of investments in enterprises in studies and scientific developments, arranging on the installment system of tax debt, declare of payments on social security of workers, the exception of import of technical equipment from VAT.

8) the increasing of investments in new technologies, developments and researches, especially in those that are related to small and medium businesses;

9) the support of small and midstize businessmen that must provide proceeding in economic activity and soften the problem of unemployment. The USA extends possibilities of participation of small enterprises in the public purchasing, introduce tax incentives to increase their microcredit in overseas. The program of sponsorship of small business, which is realized by "Venturedeardebt" company, is increased (to 30 million dollars of rub.). There was the provision to expand the access to public procurement at the regional level, provide a mechanism for refinancing of loan portfolio of small and medium-sized businesses.

A central role in coordination of international efforts in relation to overcoming of crisis in global level play such multilateral forums as Group of "seven" and Group of 20. In reply to challenge of world financial crisis from the end of 2008 the Group of "twenty" conducts 5 anti-crisis summits on November 14-15th in 2008 in Washington, on April, 2nd in 2009 in London, on September 24-25th in 2009 in Petrovje, on June, 26-27th in 2010 in Toronto and on November, 11-12th in 2010 in Seoul. The anti-crisis program that included new standards became the result of realization of these summits.

1. A new structure with widespread plebiscite powers was created – it was the Financial Stability Board that was the successor of Financial Stability Forum. All the members of "Group of twenty", the members of Financial Stability Forum, and also Spain and European Commission are the members of Financial Stability Board. The main task of this structure is connection with IMF to collect and warning of risks of macroeconomic and financial instability and development of the actions sent to their minimization (it is planned to create the effective system of prognostication of financial crises).

2. The feasibility of restructuring of the regulatory systems, in the way to give to the public service an opportunity to identify and take into account microscopic financial risks, was recognized.

3. The decision to distribute the systems of adjusting and supervision under all important instruments, instruments and measures, was accepted. Important hedge funds were included in this list for the first time (funds of management of risks that are private investment funds, reserved by the normative adjusting, inaccessible to the wide circle of persons and that are followed by professional investment leaders). The hedge funds have the special structure of fee for guidance by assets, and, as a rule, serve professional investors only.

4. A failure in activity of hedge funds, as specialists determine, is one of the reasons of financial crisis.

4. New hard principles of Financial Stability Forum are installed (taking into account the features of national jurisdiction). The principles are connected with the practice of payment of compensation in the most of system arising financial institutes for management and other employees, that are responsible for high-risk financial transactions. Initiative are also supported in relation to the input of rational charts of payments of indemnifications and social corporate responsibility of all companies of financial sector. It is about the regulation of bonus payments to the management of the company and to the banks (the using of the state aid), the control of the payments.

5. The duty agreement of the Basel committee is focusing on a bank supervision (Basel of III), in relation to introduction of new bank standards of international adequacy of capital and liquidity, that must increase the rigidity of the world banking system at the financial incentives and motives to ensure economic growth, to bring down probability and sharpness of future crises and to allow to the banks to maintain (without a considerable state help) financial shocks of the same scale as during the recent world financial crisis. The system of new standards includes the leverage coefficient harmonized at an international level that must correspond to the indexes of capital taking into account risks. The coefficient envisages the decision of problem of divergence in the terms of financial requirements and obligations, and also sets buffer reserve in capital over the minimum requirement that can be used in unfavorable periods. The leaders of "Group of twenty" are determined to fully implement the new standards during the period of 01.01.2013-01.01.2010.

6. It is decided to implement measures against countries, that resume the collaboration by the above-mentioned questions, thus it applies even to "tax havens". A fight against offshore centers increases. It is declared about application of approach in relation to defense of public finances and financial system, as well as an end of era of bank secrecy. Thus, expounded readiness in relation to the improvement of mechanisms of exchange by information, that applies to tax payment.

7. The necessity of creation of only complex of the high-quality global standards of accounting is underline. It is suggested to spread informatory work with developing countries, and their participating in creation of these standards.

8. The decision about introduction of supervision was accepted, with the aim of introduction of international consultations practice code by them.

9. It is suggested to prepare the national packages of concise measures in relation to prevention of financial crises, to set strict control over financial markets.

The package of measures at 1 trillion U.S dollars was accepted to promote the economic growth and jobs, and also to trust to the financial system. The mentioned package included the following measures:

- the additional 200 billion U.S. dollars for the sake of grant of support from the side of IMF to the developing economies;
- the additional 2-30 billion of U.S. dollars as SDRs of IMF for all countries-members of the Fund (new financial mechanism of "overdraft facility");

Muhammad Firman (University of Indonesia - Accounting)
Currency position could be different. Currency position is closed when the sum of requirements equals to the sum of obligations in every foreign currency. Currency position is open when the sum of requirements in certain foreign country does not equal to the sum of obligations in this country. Thus, there is a possibility of asigning of the risk of losing or getting a profit in bank from the change in exchange rates. Opened long currency position is - the sum of requirements exceeds the sum of obligations in every foreign currency, as a result of which the bank can sustain losses of its commitment with a change in exchange rate in relation to foreign. Opened short currency position is - the sum of obligations exceeds the sum of requirements in every foreign currency. In this case, a bank can sustain losses at the increase of foreign exchange in relation to the national.

5.2 Basic forms of the international payments

The basic forms of the international payments in international trade are a commercial letter of credit and acceptance of the documents passed to the bank on encashment.

A letter of credit is a document issued by a financial institution, or a similar party, assuring payment to a seller of goods or services provided certain documents have been presented to the bank. The letter of credit names as exporter, that the bank will pay the transported products. It also names as importer, that the payment to the exporter will not be executed without verification of the accordance of documents with the terms and conditions of the letter of credit.

Procedure of realization of letter of credit operation is divided into three phases.

The 1 phase. The agreement to open a letter of credit. The suggestion is examined in relation to the terms of delivery of commodity. An exporter gives to the potential customer his suggestion and discusses the terms of letter of credit with a customer during negotiations.

The 2 phase. The commission to open the letter of credit. This phase is related to signing of documents of commodity and its payment. An importer gives to the exporter an order to supply the goods in accordance with the signed agreement of sale. At the same time he gives to the bank the commission to open the letter of credit.

The 3 phase. Using of letter of credit. An exporter supplies the booked commodity and gives to the bank documents for payment.

Commercial banks, get a certain commission from producing and payment of letters of credit.

Encashment - is a bank transaction, by means of that a bank gets monetary resources from a payer (importer). The resources belong to the client. Bank does it on the instructions of the client (exporter) and on the basis of settling documents for the commodity and material values or rendered services shipped to importer and sets off those money on the bank account of client-exporter. This form of payment is considerably widespread, as it is cheaper, comparatively with the letter of credit.

The realization of encashment is conditionally divided into three phases.

The 1 phase. The agreement about terms of encashment. An exporter determines the terms of payment in the suggestion or co-ordinates them with a customer in a contract of a purchase-sale.

The 2 phase. Issuance of encashment order and the delivery of documents. The seller shifts the ordered goods or directly to the buyer or to the agent upon receipt of the letter of credit or after the end of the contract that expires.

Cash payments for international settlements are performed mostly in case of traveling of delegations overseas, traveling of tourists or individuals who change their currency in foreign currency in banks. International payments are connected with the functioning of financial markets because of capital movement in indirect and direct investments.

Large banks play a leading role in the international settlements. The degree of their influence on the international settlements depends on:

- the scales of external economic connections of basing country,
- the application of national currency of basing country,
- the specialization, financial state, business reputation,
- the networks of banks-correspondents.

The banks use their foreign separations and press relations with foreign banks for realization of settlements. Press relations with foreign banks are accompanied by opening of accounts of "iroe" (accounts of foreign banks in this bank) and "nostro" (accounts of this bank in foreign banks). Press relations determine the order of setting, size of commission, methods of addition to the spent money.

With the aim to receive the higher income, banks try to keep minimum balance on the accounts of "nostro". They give the advantage to allocation of currency assets in the world financial market, including the European market.

 Banks usually support necessary currency positions in different currencies in accordance with the structure and the terms of next payments for timely and rational realization of the international settlements. At the end of every working day they try to balance assets and liabilities of every currency. Currency position of bank is a ratio (difference) between the sum of assets and off-balance obligations in certain foreign currency and sum of balance and off-balance obligations in the same currency. Assets are out of the bank for some period of time and assets that will be got by a bank in the future. The balance and off-balance obligations are an obligation of bank to clients and contractors on a certain day, and obligation of bank in the future.

Muhammad Firman (University of Indonesia - Accounting)
adjusting of clearing account balance with freely convertible balance, with conditional conversion (for example, after a certain period of the establishment of balance) and non-converted balance (of them cannot be exchanged for foreign currency).

Currency of clearing can be of any country. A currency risk can arise at the clearing settlements. This risk is related to the freezing of currency profit in case of the not converted clearing balances or the lose from the change of national currency.

Currency clearings have a notably influence on foreign trade. The negative consequences of currency limitations are softly because of currency clearings, because the clearings give the opportunity to exporters to use the currency profit. It is the necessity, during the change of currency clearings, to regulate foreign trade turnover with every country separately, and a currency profit can be used only in the country – clearing partner. Thus, the currency clearing is unprofitable for exporters. Instead of the need to convertible currency, they get national currency.

The clearing agreements between the industrially developed countries disappeared gradually because of the development of international economic relations. But clearings are used by developing countries.

CHAPTER 6
INTERNATIONAL PAYMENT SYSTEMS

The growth of payment transactions between banks of different countries caused the necessity of creation of standardized communication systems that would work with unified data. Such systems by which payments for goods and services are moving between banks have become international payment systems, which is essential for the efficient functioning of global financial environment.

In general, the payment system is understood as the payment organization, the members of payment system and the set of relations that arise between them during the transfer of money. Carrying out money transfer is a necessary function that payment system must perform. This is done via telegraph, telecheck, and computer networks, electronic communications.

International payment system – a payment system, in which payment organization can be resident and non-resident, and which operates on the territory of two or more countries and ensures the transfer of money from one country to another.

At functioning payment systems may face the following risks:
- credit – risk that a participant of the payment system will not be able to fully meet his financial obligations currently or in the future;
- liquidity risk – risk that a participant of the payment system will not have enough money to meet his financial obligations as is expected, although he could meet them at a certain point in future;
- legal – risk that insufficient or changeable legal basis can cause or exacerbate credit risk and liquidity risk;
- operational – connected with operational factors: technical failures and operating errors can cause or exacerbate credit risk and liquidity risk;
- system – arises from the inability of one of the participants of the payment system to meet his obligations or due to the destructions in the system, in the result of its participants or credit institutions in other segments of financial system will also be unable to meet their obligations.

Therefore, spread of problems with liquidity and stability of the system or financial markets is possible.

6.1. Basic principles of payment systems functioning

The key to financial stability is reliable payment systems. Committee on payment and settlement systems (CPSS) of central banks of the countries “Group of Ten” made an important contribution to this case. In December 1999, it published “Basic principles for systematically important payment systems” that defined conditions for efficient functioning of payment systems [19, p.625]. These principles include the following:
1. The system should be based on well-founded legal basis in all relevant jurisdictions (the laws on banking, contracts, payments, securities, debtor – creditor relations, bankruptcy, etc.).
2. System rules and procedures should provide a clear view of the impact of the system on each financial risk to the participants. They should clearly specify the rights and obligations of all parties involved, which must be provided with relevant materials in time.
3. The system should have clear management procedures of credit risk and liquidity risk, which would establish respective responsibilities of system operator and participants and provide appropriate incentives to manage these risks and their limitations.
4. The system should provide final settlement on the day of currency, preferably – during the day or at least in the end of the day.
5. System, with multicurrency offsetting shall at least ensure timely completion of daily payments in case when participant with the largest obligations fails to perform the calculation.

System of multicurrency offsetting and postponed settlement is at the risk of failure of one participant to meet his settlement obligations. This increases probability that the other participants suddenly will experience pressure of lack of liquidity. Therefore, the system must be offset at least to withstand the insolvency of a member with the lowest receivables position.
Balance of Payments is a statistical report in which a systematic form is summarized the data on international transactions of residents of the country with residents of other countries (non-residents) for a certain period of time.

The balance of payments consists of the following flow:
- A given the level of international interconnections of the country, structural changes in international transactions as it is a source of information;
- Changes in the processes of macroeconomic development of an open economy, i.e., characteristic of the balance of payments in addition to practical, has scientific value;
- Serves as a guide for government, who are responsible for economic policy, to increase monetary and fiscal measures as well as measures to stimulate competition, often as a result of the condition of balance of payments or international influence, which is fixed by balance of payments.

Balance of payments is based on certain principles arising from its purpose:
- To account for external operations. Economic operation is considered foreign economic if it occurs between the economy of one country and economies of other countries.

Economic transactions that occur between residents and non-residents include agreements which subject is goods, services, income, external financial assets and liabilities. The economic agreements, by the definition of IMF, are the economic flow that reflects the transfer of real resources (transactions in goods, services and income) as well as the creation, the elimination of external financial assets and liabilities, and the transfer of ownership of the existing external financial assets and liabilities (transactions in financial assets and liabilities).

Foreign economic transactions can be exchangeable and one-sided.

Most economic transactions that are recorded in the balance of payments, are transactable and may be one-sided as economic value to another participant and receives its equivalent cost in return. There are three types of international exchange transactions:
1. The exchange of goods and services for other goods and/or services. The exchange of goods and services is real.
2. The exchange of goods and services for cash or other financial requirements, i.e., one party to transaction is real, the other is financial.
3. Exchange of financial instruments for other financial instruments, i.e., both parties are financial transactions.

Transactions under which one participant of agreement provides economic value to another participant without the return of cost equivalent are called one-sided. There is no economic value in one of the parties in the balance of payments, a special record is made "transfers". Usually transfers have form of money or goods. Transfers appear, usually in the form of money or goods. Depending on which type belongs, foreign exchange operation, it account in the balance of payments of the country is carried out.

The definition of the subject foreign economic transaction is based on such a concept as "economic territory of the country", which is identical to the concept of "economic". It is defined by the definition of IMF – a territory which is under the jurisdiction of the government of particular country, within which labor, goods and capital can freely move. However, this area does not always coincide with the geographical boundaries of the state, because in its boundaries territorial entities outside the main state border are included: embassies, consulates, military bases, scientific stations, information or immigration charitable agencies that are located in other states and are held by the Government, which owns or rents these items.

The term "economic territory" plays a significant role in determining the first principle of the balance of payments – the principle of residency. The concept of residency is the principle of balance of payments is not based on the criteria of nationality or economic subject or on legal criteria for determining the residents of a particular state. Economic subject (economic unit), the center of economic interest of which is located outside the country or area of particular state, is the resident of that country. The economic unit has the center of economic interest in the territory of particular country. If it carries on business and economic transactions within the country and/or outside the country, it is considered a resident of this country. The terms "residents" and "non-residents" are defined in the balance of payments.

According to the IMF classification, the residents of the economy include the following business units:
- households and individuals who are the members of the household;
- legal persons, i.e., companies of different legal forms;
- non-profit organizations;
- state administration bodies of the country.

The second principle of the balance of payments – the principle of double entry. Since the balance of payments is based on the principles of accounting, each foreign operation that is recorded should be counted in two records that have the same cost value: the article of credit and the article of debit. The articles of Credit – Plus Articles (++) – display operations of "export type" by which country receives, "earns" foreign currency. The articles of debit – Minus Articles (--) – reflect the operations of "import type" by which foreign currency is spent. Credit shows the inflow of foreign currency, i.e. its proposal, while debit – spending of foreign currency, i.e. its demand.

Thus, according to the principle of double entry on credit, requires a decrease of international liabilities or receipt of foreign currency, while on debit, requires an increase in international liabilities, and debit registers increase of international country's assets or reduction of its external obligations. Each change in the debit must be accompanied by an increase in the credit, reverse versa, the transaction is recorded twice: one transaction – both debit and the second – a loan. Thus, total debit and total credit are always equal in the balance of payments. In a systematic view rules for recording the transactions in the balance of payments by debit and credit are shown in Table 7.1.
Table 7.1

<table>
<thead>
<tr>
<th>Operations</th>
<th>Credit (+)</th>
<th>Debit (-)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Goods &amp; Services</td>
<td>Export of goods and services</td>
<td>Import of goods and services</td>
</tr>
<tr>
<td>B. Incomes (wages and investment income)</td>
<td>Revenues from non-residents</td>
<td>Payments to non-residents</td>
</tr>
<tr>
<td>C. Transfers (current and capital)</td>
<td>Receiving the funds</td>
<td>Transfer of funds</td>
</tr>
<tr>
<td>D. Purchase/sale of non-productive non-financial assets</td>
<td>Sale of assets</td>
<td>Purchase of assets</td>
</tr>
<tr>
<td>E. Operations with financial assets or liabilities</td>
<td>The increase in liabilities of non-residents or decrease in requirements for non-residents</td>
<td>The increase in requirements for non-residents or decrease in liabilities of non-residents</td>
</tr>
</tbody>
</table>

The third principle of the balance of payments is the principle of a single evaluation of all transactions that are recorded in the balance of payments. Its essence is that when evaluating transactions with real and financial assets and liabilities, market prices that are consistent with the participants' economic transactions. Market price, as defined by IMF, is the amount of money that the buyer is voluntarily willing to pay for goods, services, etc., that are purchased from a seller, who is willing to voluntarily sell him the product, service, financial assets. Both parties of this agreement are independent, and the exchange between them takes place on a commercial basis. The market price is established for each operation. The market price is different from stock quotes, world market prices, current prices, i.e., prices are not the prices actually paid for the goods. There are times, when the market price cannot be set in accordance with the above criteria. This occurs during barter exchange of commodities, agreements between departments of the same multinational corporation, at international leasing operations, etc. In these cases, the evaluation of such transactions is at prices of similar agreements. Following this principle ensures the comparability of the balance of payments in different countries and items of balance of payments of each country.

The fourth principle of the balance of payments – the principle of simultaneous registration of foreign operations. Each operation must be reflected in the balance of payments on credit and the corresponding debit simultaneously. Both parties of the agreement must reflect in their system the same number that corresponds to the date of its execution. To implement this approach, it is necessary to determine the time of registration by the balance of payments. This moment can be the time of conclusion of the contract or time of transition of legal ownership on assets that are transferred. If the time of transfer of ownership is difficult to determine, it is considered the moment of appropriate accounting entry into account of contractors.

In drawing up the balance of payments it is important to establish in which monetary unit records should be kept, i.e. to determine the unit of account (estimated exchange rate). The Unit of Account should be stable, so that changes in its course during the accounting period were not reflected in the total. In addition, it must be stable for the largest possible number of accounting periods to ensure comparability and analysis of their dynamics. During preparing the balance of payments we should use the unit of account, which is used by them in internal calculations and accounting. According to the IMF, we should make the balance of payments in national currency, and then recalculate the figures obtained in the unit (USD) for the free-market exchange rate. Therefore, it is an U.S. dollars in most of the world's execution of balancing payments.

Information sources of the balance of payments are:
- The data of the State Statistics. Data of national accounts, generalized statistics on foreign trade in goods and services, statistical reporting accounts of direct and portfolio investment, quarterly reports on foreign trade in goods at prices FOB and CIF in geographical terms, indices of consumer and wholesale prices, the cost structure of export industries, data on informal trade.
- The information on the state bodies of economic policy: forecast calculations of the dynamics of key macroeconomic indicators, information on the economy as a whole and for individual sectors, reference prices of basic goods and services exported and imported, data on terms of trade, data on trade regime.
- The information of the State Customs Service: data on exports and imports of goods and humanitarian aid assessment, the data on non-formal (or spontaneous) trade.

7.2. The structure of the balance of payments

Development of the balance of payments is based on a methodology that is regulated by international standards. "Guidelines for the balance of payments", prepared by the IMF [25]. It is updated periodically, is reviewed and published. Last, the sixth edition of the Recommendations was published in 2007.

The basic BoP standard components are listed in the table 7.2.

Table 7.2

| The standard components of BoP (according to IMF) |
|-----------------|-----------------|
| Articles | Credit | Debit |
| A. Goods and services | | |
| 1. Goods | | |
| 2. Services | | |

B. Incomes
1. Wages
2. Investment income
B. Current transfers
1. General government sector
2. Other sectors
C. Capital account and financial instruments
1. Capital transfers
2. Purchase/sale of non-produced financial assets
3. Financial account
1. Direct investment
2. Current transfers
1.1. Capital transfers
1.2. Inward
2. Portfolio investment
3.1. Assets
3.2. Liabilities
3.3. Other investment
3.1. Assets
3.2. Liabilities
3.3. Reserve assets

The distribution of BoP on standard components (sections) is based on such approaches:
- Each article should have characteristics, i.e. factors or the set of factors that affect the amount of one article should be different from the factors that affect the other articles.
- The presence of a particular article in BoP should be set for a group of countries, which is reflected as changes in the dynamics of this article and in its absolute value. In other groups, the changes in payments vary significantly over time in either group of countries it is a significant percentage of the balance of payments of the group, it must be isolated in a separate article.
- Gathering information for the account under article should not have particular difficulties for preparers of balance of payments.
- The structure of the balance of payments must be such that its values were connected with other statistical systems, such as the system of national accounts.
- The number of items should not be too numerous, and the article should be subject to consolidation in the components of a higher level.

The standard components of BoP are divided into two accounts: the current account, which accounts the economic agreement on the international movement of real property, and the capital account and the financial instruments that are accounted for international transactions associated with changes of ownership in foreign financial assets or liabilities of the country (especially this operation, the essence of which lies in the presentation and settlement of financial claims of one country to other countries and vice versa).

7.2.1. Items of current account

The current account includes all operations with actual values that occur between residents and non-residents, and operations related to the provision of free or remitting values that are designed for current use. There are four main components in the structure of the current account: goods, services, and income and current transfers. Export transactions are recorded on credit side, import – on debit side. Current account includes transactions that are complied during the period. If they are reflected in BoP in future periods they do not have any effect on it.

Let's consider the main types of current operations in more detail:
1. Under the goods are meant a group of articles of BoP, which summarizes market prices on exports and imports of ordinary goods and goods for further processing (goods that cross the border for further processing, after which they return to the country - owner of the goods), repair of goods (the cost of repairing mobile equipment), the purchase of goods in ports transport organizations (fuel, food, inventory and auxiliary materials).
2. The services provided by residents to non-residents and vice versa include:
   a. Transportation (freight and passenger transportation by all types of transport, related services, support services, which include rental of vehicles with a crew, storage, loading, unloading, vehicle maintenance, pilot services, communication services, associated with passenger and freight transportation);
   b. Communications services (telecommunications, telephone, radio, email, satellite, TV, communication, postal services);
   c. Building services (construction, construction, equipment installation and repair of buildings and facilities);
   d. Other services (insurance, which are made by residents to non-residents);
   e. Financial services (financial intermediaries, receipt or payment of fees for operations of letters of credit, bank's acceptances, securities, asset management, financial leasing and maintenance of correspondent accounts, etc.);
   f. Other services (including leasing, insurance and royalty fees, services to individuals, services in the field of culture and recreation, government services, i.e. foreign trade embassies, consultancies, military missions, as well as various types of business professional, technical linked to the research activities and services).
3. Income – a group of articles, which includes payments between residents and non-residents related to the wages of non-residents, and operations, related to investment income.
Wages include salaries and other benefits, received by workers and employees outside the country where they are resident, for work performed by them for residents of other countries.

Current account transactions are divided into:

- Income from direct investment: from share participation in the capital of the company (dividends, undistributed profits of foreign branches, reinvested earnings) interest on debt liabilities (interest paid to direct investor by enterprise of direct investment).
- Income from portfolio investment: cash flows between residents and non-residents as a result of buying and selling stocks, bonds, long-term securities, government bills and other instruments of the financial market.
- Income from other investment: interest (interest and payments) in other financial requirements and obligations (interest on deposits, loans from the IMF).

4. Current transfers. This article reflects the operations of inter-member transfer of material resources, when one member of the country does not receive any cost substitution. Depending on the direction of transfers, they appear only on credit or debit.

Current transfers include: cash transfers to governments to finance expenditures, humanitarian aid, and regular contributions to international organizations, government free or costs for international organizations to provide technical assistance.

7.2.2. Items of capital and financial accounts

Capital and financial accounts show the movement of capital, export and import of goods and services are financed with the help of it. It is divided into the capital account and the financial account.

The capital account reflects changes in transfers and acquisition/sale of non-produced non-financial assets.

Capital transfers are transfers that involve the transfer of ownership of the fixed capital or debt by creditor. These include investment transfers (funds transferred by one country to another with the purpose of payment of fixed capital: purchases, buildings, structures, airfields, airports, communication networks, hospitals, etc.), transfers related to migration (migrant remittances, cost valuation of migrants’ property moved from country to country), debt cancellation by creditor (written off all or part of the debt by the bank and other state or private entity), private donations for investment purposes (for example, transfer of inheritance bequested to finance the construction of hospitals).

The article “Acquisition/sale of non-produced non-financial assets” includes operations with assets, which are not the result of production (land, infrastructure, and intangible assets: acquisition of patents, trademarks, copyrights).

The amount of transactions that reflected on this account is usually insignificant.

On the financial account it is reflected all transactions there is a transition of ownership to external financial assets and requirements of the country in which that is the emergence and repayment of financial liabilities between residents and non-residents.

The financial account is divided into two classifications, namely: transactions with financial assets and transactions with financial commitments (liabilities). Both groups, in turn, are divided into three functional categories: direct, portfolio and other investments. The composition of assets also includes such category as reserve assets.

Accounting of direct investments is carried out depending on their orientation: investments of residents abroad, showed separately (capital outflow) and investments of non-residents in the domestic economy (capital inflow).

Direct investment is divided into share capital (the purchase of shares of branch and associated establishments), reinvested earnings (reverse investments of part of undistributed profit of dividend groups and other investments (typically intra-firm credits by company of its branch and associated associations).

Thus, in the capital of direct investment is: 1) the capital invested by direct investor in foreign enterprise of direct investment and 2) capital obtained by direct investor to participate in this enterprise.

Portfolio investments are divided into two groups: operations with foreign securities (operations with financial assets) and foreign securities transactions (transactions with financial liabilities).

Depending on the type of financial instrument, transactions with portfolio investments are divided into:
1) securities transactions, confirming participation in capital (transactions in shares, certificates of participation, ADRs),
2) operations with debt securities, confirming the right of the creditor to collect the debt from the creditor: a) bonds and other long-term or perpetual debt, b) in currency market instruments, i.e. treasury bills, promissory notes, bankers’ acceptances, short-term certificates of deposit, and c) financial derivatives (options, futures, swaps).

The category of “Other investments” includes trade and bank credits and loans, including credits and loans from the IMF and the international financial institutions, financial leasing agreements, cash currency and deposits and other short-term assets/liabilities.

During the considering the capital account it is necessary to pay attention to the fact that usually crediting abroad is called “the export of capital” and foreign loans – “the import of capital”. However, crediting of foreign capital, or investments in other countries (capital outflow) mean expenditure of foreign currency reserves decreases, and thus reflects on the debit side. Getting credit (capital inflow) is an export operation, as foreign investment increased reserves of foreign currency, and therefore reflects on the credit side. So, if export of goods increased and import reduces reserves of foreign currency, the outflow (removal) of capital, i.e. investment in other countries, means spending, reducing foreign currency reserves and inflow (import) of capital, i.e. investment from other countries increases the export of foreign currency.

The most important part of the financial account is reserve assets, which include foreign assets of the country under the control of monetary authorities and at any time can be used for direct financing of payments, or the implementation of intervention on the currency market to support the rate of national currency.

Reserve assets include:
- monetary gold, which held by the central bank or the government of the country and can be credited only on the global gold markets or international organizations in foreign currency;
- Special Drawing Rights (SDRs) – a reserve asset issued by the IMF, which is shared between member-countries in accordance with their quotas. It is used to purchase foreign currency, allocation of credits and carrying out of payments.
- reserve position in the IMF, that is the amount of reserve in the capital of the IMF (25% of the country is fixed capital);
- currency assets, which consist of foreign currency, bank deposits, government securities, shares in companies, financial derivatives. Currency assets have the largest share in the structure of reserve assets;
- the other claims that include the remainder of the foreign currency.

Foreign currency reserves determine the extent of the solvency of the country. As the balance of payments is a financial report of double entry, the debit balance of all structural parts must exactly correspond to the credit. However, such coincidence is rare in practice due to incorrect entry or lack of records of certain transactions. The article “errors and omissions” was put to achieve balance and maintain a system of double entry. This article is balancing and represents the difference between the sum of all credit entries and the sum over all debit entries that reflect the time and cost differences.

3.3. Balancing items of BoP

The principle of the balance of payments (BoP), when debts equal the loan, often does not satisfy economists and it is required the balance of aggregated groups of operations within the overall balance to develop specific measures. Therefore, the balance of payments consists not only in the neutral form (in accordance with standard components), but also in analytical form. The main parameter that is used to analyze the balance of payments is the balance of BoP. Therefore, the balance of payments is divided into autonomous balance (basic) operations and balance of non-autonomous transactions. Autonomous include all private and public transactions that are undertaken without regard to the balance of payments, the implementation of which is not intended to influence it. Under balancing operations are understood actions of state bodies, especially of the central bank due to balance of payments that is used to finance the pre-autonomous transactions. Thus, the basis of the distribution of transactions is the criterion of their motivation. Balance of autonomous articles called “balance of BoP”, and depending on the positive or negative value, the balance of payments is defined as active or passive. It is used balancing article to cover the balance of BoP. Thus, the concept of balance of BoP does not apply to the entire balance of payments, and to its constituents is to balance up a particular set of transactions.

There are analytical groups of articles of balance of payments, an appropriate balance is result of which:
- The trade balance:
  - The balance of goods trade;
  - The balance of services trade;
  - Current account balance;
  - Base balance;
  - Total balance or total balance of all official settlements.

The trade balance is the difference between the payments of exports and imports of goods. If export exceeds imports, it creates a “positive balance” of trade balance. If import exceeds export, there is a trade deficit or “negative balance” of trade balance. In the most general terms, the assets and liabilities of the trade balance associated with an increase or decrease in demand for products of the country on the world market that is the economic conjuncture of the world market. The excess of exports over imports shows increasing global demand for the country, and domestic buyers prefer domestic products, which indicate the good state of the economy. In contrast, the deficit (negative balance) indicates the lack of competitiveness of the products of the country on the world market and excellence in the country of import.

However, the trade balance may be affected by other factors such as a favorable investment climate, which can cause the inflow of investments into the country, and the increase in purchases of equipment abroad, which could lead to trade deficit. In this case, the trade deficit is accompanied by economic growth.

Trade deficit may, for example, be covered by proceeds from sales of licenses, tourism, remittances of foreign workers.

The balance of services trade is the movement of services and non-commercial payments, classified as “invisible” exports and imports, comparing which forms the balance of “invisible” transactions.

Balance on current account is the most informative. It displays all transfers of assets that are associated with the movement of goods, services, investment
CHAPTER 8

STATE REGULATION OF THE BALANCE OF PAYMENTS

8.1. The concept of economic equilibrium of balance of payments

The balance of payments is in equilibrium state when the national economy is well adapted to the global economy. Under the equilibrium, we can understand the stable relationship between the economic indicators such as demand, supply, and prices of certain goods. Despite of balance of payment's balance sheet is not always in a state of equilibrium. Prices, income, exchange rates and other macroeconomic indicators of country vary to restore a stable relationship with another world in case of disequilibrium of the balance of payments. Thus, the concept of the balance of payments equilibrium is the concept of leveling market.

The balance of payments is influenced by various internal and external factors, the effect of which is not the same length of time. There is long, medium and short-term balance of payment's equilibrium. 

Long-term equilibrium provided with the lack of balance of trade in goods and services for a long period of time. Active balance of current account is evidence of that the country earns on foreign markets more than it spends. A negative balance shows that this country spends more than it earns on foreign goods. The result for the current operations has to be financed in certain way of capital movement to achieve balance: net credits from non-residents used to finance the deficit, and the surplus goes to residents credits. Current account balance indicates the international financial position of the debtor country or creditor. Country of prolonged current account deficit is a net debtor, the country that for a long time active current balance is net creditor. Thus, the presence of balance is a measure of disequilibrium of balance of current transactions.

Medium-term equilibrium of balance of payments equilibrium is provided by the absence of total balance of the current account and the balance of long-term capital. The lack of balance in the balance of trade for five years is. This balance is maintained by the mechanism of long-term credits. Breaking medium-term equilibrium is defined by the balance base state, the balance of which indicates that the country earns on foreign markets more than it spends. A negative balance shows that this country earns more than it spends on foreign goods. The result for the current operations has to be financed in certain way of capital movement to achieve balance: net credits from non-residents used to finance the deficit, and the surplus goes to residents credits. Current account balance indicates the international financial position of the debtor country or creditor. Country of prolonged current account deficit is a net debtor, the country that for a long time active current balance is net creditor. Thus, the presence of balance is a measure of disequilibrium of balance of current transactions.

Short-term equilibrium of balance of payments equilibrium observed in the absence of balance of official settlements balance. This occurs in the case when the state imposes significant restrictions on short-term capital transfers. Balance of payments equilibrium could be broken because of the imbalance of international payments for the following reasons:

- seasonal or random imbalance. Seasonal imbalance appears as a result of seasonal fluctuations of production and consumption that do not coincide in time. Seasonal variations are not long-lasting, and the deficit in one period is compensated by an excess in another one. Random imbalance is caused by unforeseen non-economic reasons. For example, flood or earthquake can cause an increase in imports, and adverse weather conditions – reducing agricultural exports.
- cyclical imbalance, which is based on the cyclical nature of economic conjuncture. As a result, there are periodic changes in supply and demand on world markets.

High rates of GDP also lead to an increase in imports of goods and services. The high GDP growth means higher incomes in the country, some of which will be spent on imports.

Interest rates affect the movement of capital. Increasing interest rates may lead to capital inflows, decline – to capital outflows.

High current spot rate of foreign currency prevents the import operations and facilitates export operations in terms of floating exchange rates. The low exchange rate favors import and exporters.

The effects of BoP disproportion can be both negative and positive. Negative consequences include: total debt, lack of necessary safety reserve of foreign currency, reducing overall welfare in the passive balance of payments. The positive effects are: the ability to develop capital by attracting foreign investments, the compensation of trade deficit by attracting long-term capital. Alternative solved problem: economic growth, an increasing employment, the fight against inflation.

The negative consequence of the active BoP is the depreciation of financial assets that accumulate, giving rise to the need to develop a program of spending of excess funds. This program may include the stimulation of the acquisition of foreign ownership, the development of foreign tourism, the revitalization of the national currency and so on. The positive result is the accumulation of currency liabilities in foreign currency, which allows the country to avoid reliance on the domestic market in case of natural disasters, temporary crop failures, decline in production.

8.2. The essence of the state regulation of the BoP

The balance of payments cannot always be in a state of disequilibrium and therefore is subject to state regulation. The material basis for this regulation is considered official gold currency reserves, the state budget, the country's participation in global economic activity as an exporter of capital, the creditor, borrower, guarantor, and the regulation of foreign economic activity by means of laws and regulations.

The state regulation of the balance of payments provides for totality of currency, financial, monetary, monetary, access to the creation of major items of balance of payments, and long-term capital.

These activities are intended to stimulate exports, reduce imports, raise capital in the country and limit the outflow of capital [2, p. 60]. They include:

- the reduction of exchange rates, the introduction of inflationary policy, the abolition of tax on internal paid to foreign owners of securities for capital inflows into the country, etc. helping to reduce deficits of BoP.
- the financial and monetary policies. Using of a budget export subsidies to exports, revaluation of import duties, the abolition of tax on internal paid to foreign owners of securities for capital inflows into the country, etc. helping to reduce deficits of BoP.

The government uses a variety of financial, credit, currency, including the revaluation of currencies, measures to promote the growth of imports and reduction of exports of goods and services, to increase exports and limit imports of capital, for the elimination of active and passive balance of payments.

The exchange rate regime impacts to achieve the equilibrium of BoP. If fixed exchange rate is implemented, the rebalancing occurs directly under the articles of BoP. According to a floating exchange rate, equilibrium is restored on currency market and exchange rate changes until it is aligned to demand and supply of foreign currencies, which leads to the current and long-term capital transfers.

There may be a situation in the country, when the government is unable to settle the balance of payments, resulting in late payments, interrupts financing. There is a so-called balance of payments crisis. In this case, a country may resort to exceptional financing, we can understand it like the transactions, which are conducted by the country that has some difficulties in the financing of the BoP deficits, and are provided with the agreement and support of its international
CHAPTER 9
INTERNATIONAL FOREIGN EXCHANGE MARKET

International foreign exchange market is the largest financial market in the world and takes an important place in the ensuring of correlation between the components of the global financial market.

Currency market – the system of currency and organizational relationships, associated with exchange transactions, international payments, and provision of foreign currency loan under certain conditions.

There are the following peculiarities of this market:
- it is non-material;
- it does not have a specific location and center;
- mechanism of its functioning – exchange of the currency of one country for the currency of another country;
- there is complete freedom of opening and closing of any position.

The opportunity to trade 24 hours online:
- it is the interbank market;
- a flexible system of trade organization and flexible strategy of payment for conclusion of agreement;
- it is one of the most liquid markets with the ability to work on it with different currencies;
- it is global because of the process of telecommunications and information science.

There are the following functions of currency market: the provision of international settlements; the insurance from currency risks; the providing of credibility in foreign currencies; the diversification of currency reserves of banks and states; the obtaining of speculative profit by market participants; the impact on government regulations of the national economy and monetary policy coordination at the level of the world economy [9, p. 110].

The participants of international foreign exchange market are commercial banks, corporations that are engaged in international trade, non-bank financial institutions (asset management firms, insurance companies), and the central banks. However, the main point of the international currency market is commercial banks, because the most transactions with currencies involve exchange of bank deposits, denominated in different currencies.

The main product of this market is a foreign currency in different forms: currency deposits, any financial requirements, identified in the foreign currency. The operations with currency demand deposits prevail on the currency market.

Demand deposits are the money, used in currency trading among banks operating on the currency market. Banking dealers hold foreign perpetual deposits in foreign currency in correspondent banks, located in countries where this foreign currency is national.

Bank in any country may sell foreign currency, giving the orders to foreign employees to transfer deposits to the buyer. The purchase of currency is carried out similarly. In this case, the seller puts a bank deposit abroad. Currency transaction acts in some way. For example, an American firm has paid 200 thousand euros for delivery of the goods to the German firm. The company instructs its bank to debit a debit and pay that sum, transferring it to the supplier to the German bank. American Bank transfers dollars at the exchange rate from the account of U.S. firms on the German bank debit in exchange for deposits in euros, which will be used to pay for the German supplier.

International currency market consists of many national markets. There are three levels of the currency market operations:

1st. Retail. These are the operations in one national market, when the bank-dealer directly interacts with customers.

2nd. Wholesale interbank trading. These are the operations in one national market, when two banks-dealers interact through currency broker.

International trade. These are the operations among two or more national markets where banks-dealers from different countries interact with each other. Such operations often involve arbitrage operations on two or three markets.

Depending on the level of currency market organization, there are distinguished exchange (organised) and off-exchange (non-organised) currency markets. Exchange market is represented by the currency exchange, and off-exchange (interbank) is represented by banks, financial institutions, enterprises and organizations.

Functions of exchange market determine the demand and supply of currency, settle exchange rates, predict their dynamic, identify the inquiry exchange rates, as well as formulate the strategy and tactics of the country’s central bank with respect to financial and monetary policy and currency regulation system. Agreements of the current nature and as durable ones are concluded on the currency markets. Exchange market is small due to its volume, as it functions primarily as a national currency market (it is approximately 10% of all currency agreements).

The activity of interbank market is directly linked to the implementation of currency transactions. Interbank exchange rates, i.e. rates that banks ask from each other, are established separately. If the interbank rates are lower than “retail” rates for customers, the difference is the income of the bank for the service. The interbank market takes about 50% of the turnover of foreign currency.

Any two currencies can participate in the operations with foreign currency, but most interbank operations are the operations with exchange for the U.S. dollar, which is considered as a key currency. Euro, Japanese yen, Swiss franc, British pound sterling also play an important role on the currency market. The demand for these currencies is occurring every second, as opposed to other currencies.

International currency market operates with significant amount of money. Its volume exceeds $100 trillion per year, the daily turnover amounted approximately $4 trillion in 2010. $5 trillion in 2011, in 2020 it is predicted an increase in the daily operations till $10 trillion, while the Alman market about 20% of all transactions, 40% on European, and 40% on the U.S. [14, P. 246].

According to the nature of operations, currency market is divided into the markets: spot, forward, swap, futures and options.

9.2. The transactions on the international foreign exchange market

There are settled various types of agreements by exchange operations on the international currency market.

Exchange operations are the agreements, concluded on the currency market for buying and selling a certain amount of currency of one country for the currency of another country at an agreed exchange rate on a specified date. The purposes of exchange operations are:

- currency exchange during international trade, the implementation of tourism, migration of capital and labor;
- the speculations (to get profit from changes in exchange rates).

Muhammad Firman (University of Indonesia - Accounting)
9.2.1. Spot transactions

Spot market — the market where the transactions of current and immediate (or cash) currency exchange between two countries provide. The two parties agree to exchange the bank deposits and carry out an agreement on the second working day from the date of conclusion of the exchange rate, fixed at the time of the conclusion of agreement. Now, by the request of customer, the currency conversion is carried out on the date of the conclusion of agreement by electronic means. Rates of immediately exchanged currency are called current (spot) rates. The operations create cash currency market.

The spot agreements are the basic currency operations, the spot rate — the basic rates. The other agreement rates on the currency market are calculated on the basics of spot rates, forward rates.

Two prices (rate) of currency are used during the exchange of foreign currency: the rate of the buyer and the seller. When you buy the currency at a bank or the dealer to pay for the currency higher price than the one for which you can sell the same amount of currency in the same bank or dealer. Banking and dealer rates of buyer — seller from which the bank and dealers are ready to pay for foreign currency. Rates of seller are the prices by which bank dealer are ready to sell foreign currency. These two rates are quoted in pairs. For example, if a bank quotes dollars as 5.437 and 5.598, it means that it is ready to buy dollars at 5.437 UAH for $1 and sell them at 5.598 UAH for $1. Higher price always refers to the seller price, and lower — to the buyer price. The difference between these rates is called the absolute spread and is used to cover the cost of bank and as the insurance from currency risks. Under the condition of instability of currency market or during the currency crisis, spread may increase from 2 to 10 times, compared to “normal” spread — 0.05-0.06% of quoted rate.

The relative spread can be calculated as the difference between the seller and buyer quotations, calculated in relation to the seller price, i.e., in percentages:

\[ \text{Spread} = \frac{\text{Selling price} - \text{Buying price}}{\text{Selling price}} \times 100\% \]

The size of spread is influenced by such factors: the status of the contractor and the nature of the relationship between contractors (the size of spread is more narrow for constant and reliable bank-contractors); market conjugation (the size of spread is usually greater during rapid changes in exchange rates); quoted currency and market liquidity (the size of spread is greater during the quotation of rare currency or by agreements on less liquid market); the amount of the agreement (a smaller spread is used under agreements in large amounts).

Currency operations of immediate delivery are the most common and accounts for approximately 60% of the currency agreements on the interbank market. These operations must be fulfilled by subjects. They are used primarily for the immediate receipt of currency for foreign trade payments.

Banks give necessary foreign currencies to their customers; provide the flow of capital and the implementation of arbitrage and speculation operations with the help of spot operations.

9.2.2. Forward contracts

Forward market — the market where term currency transactions with foreign currency could be provided. Term (forward) agreements — contracts, which are the agreements of two parties about the delivery of agreed amount of currency over a certain number of days after conclusion of the agreement at the rate, fixed at the time of its conclusion. Forward agreements are concluded out of exchange and are mandatory for implementation as opposed to futures and options.

The interval of time between the moment of conclusion and the implementation of an agreement is from 1-2 weeks, from 1 to 3 months, to 5-7 years. Exchange rate of the forward agreement is called the forward exchange rate. It is fixed at the time of signing of the agreement.

Exchange rate of the forward contract differs from the spot rate. The difference between the spot rate and forward rates is defined as the discount from the spot rate, if the rate of forward agreement is lower, or premium, if it is higher than the spot rate. The premium means that the currency is quoted more expensive by the agreement with a term exchange. The discount means that the exchange rate of forward agreement is lower than the spot rate.

The size of forward premium/discount calculated by formula:

\[ PD = \frac{FR - SR}{SR} \times 100 \]  

where FR and SR — forward and spot rates.

- time (in days) of forward agreement;

Forward agreements are carried out for the following purposes:

- the real sale or purchase of currency;
- currency exchange for commercial purposes, advance sale or purchase of foreign currency to secure currency risk;
- insurance of portfolio or direct investment from risk, which is associated with a decrease of the exchange rate;

- setting of speculative profit due to differences in the exchange rate.

Speculative operations can be performed without a currency.

Forward market is narrower than the market of cash transactions (10% of trade in currency values). Mostly, forward agreements are carried out with major currencies, by large corporations or banks with a stable reputation.

The rate expectations (increasing or decreasing rate) are not always justified and are perished at the time of conclusion of forward agreements. Thus, forward contracts are not always appropriate or not available in all types of businesses. Many businesses and many individuals are looking for alternatives to forward contracts. One of these alternatives is the swap agreement.

9.2.3. Currency swaps

Currency swap is a combination of the current (cash) and term agreements, i.e. the combination of spot contract of selling the currency (immediate supply of currency) and simultaneous forward contract of purchasing of the same currency for a specified period of time. Cash agreement is carried out on the spot exchange rate in swap transactions. The spot exchange rate in the forward contract is adjusted for premium or discount, depending on the exchange rates. So the swap rate is created on the market of currency swaps — the difference between the spot and the forward rate. Swap in fact can be agreed with one contractor, when both currency transactions are carried out with the same bank, or with different contractors. Two opposing agreements must be signed by two contractors with different dates for the same amount of value in case of agreement with different contractors.

Let's consider the example of currency swap. Bank A received a payment in the amount of $10 million on March 30th. This amount will be needed in 6 months, and so during this period it is beneficial to invest this amount in euros. Bank A decided to implement currency swap to sell 10 million euros to the foreign Bank B on the condition, that Bank B will return the same sum at a more profitable exchange rate on March 7th.

Swap transactions are convenient for banks, because they do not create an open position (purchase is covered by selling); reduce currency risks, implement hedging of forward exchange rate, can be utilized in collateralization (open currency positions in the future, that is to save the state position for a specified period in the future, the use of them is more cheap for market-takers (banks that provide spot contracts) than the conclusion of forward contracts in the case of prolongation of currency position)

Operation “swap” is used for:

- the implementation of commercial agreements: the bank sells foreign currency on “spot” conditions and buys it for some time;
- the purchase of needed foreign currency by bank without currency risk;
- the mutual credit in two currencies by bank.

Operation “swap” is hedging, i.e. the insurance of the exchange risk by the creation of counterbalances and liabilities in foreign currencies. The market of currency swaps is about 20% of the total currency trading.

9.2.4. Currency futures

Currency futures — are the contracts that certify the obligation to buy or sell currency at standardized requirements in the future at a predetermined rate. A certain amount of foreign currency must be supplied on the day of the contract implementation. Currency futures market is a market of commodity derivative instruments because not the currency is being traded, but monetary instruments (liabilities). The signing of currency contracts is provided on the stock market. Party, which is obliged to fulfill the supply of currency, is called the seller of futures contract and a party, which is obliged to transfer the funds against the supply of currency, is called the buyer. Futures contracts shall be obligatory executed.

Futures currency transactions create a special form of speculative agreements and hedging of currency risks by large banks. Currency futures account about 10% of currency transactions.

Currency futures are essentially forward contracts that provide the future exchange. However, terms and, above all, the exchange conditions differ from the conditions of forward contracts, allowing avoiding currency risk more flexibility.

The difference is:

- the agreements are carried out only for certain currencies;
- the currency futures are liquid, they can be bought and sold by most of the business entities on the stock market;
- the futures contracts can be re-sold on the futures market at any time before the deadline for their implementation;
- buyer of currency futures undertakes to buy and the seller — to sell the currency for a specified period at a rate, agreed at the conclusion of the contract;
- the futures contracts are standardized (e.g. futures contract of the British pound is concluded on the amount of 62.5 thousand pounds, Canadian dollar — $100 thousand. Japanese yen — 712,500,000 yen) and their implementation is guaranteed by guarantees (clearing house (clearing and settlement fee). This is a deposit, which is paid in cash by clients;
- the supply of currency can be occurred only in specific days;
- the standard amount of futures contract is less than the standard unit of the contract.

The effectiveness of futures is determined by spread after each working session on the stock exchange. If the seller sells currency more expensive at the time of the contract than the quotation rate at the time of the execution of this contract — the seller will win and vice versa.
Currency options are also used for speculation. Speculator – is the buyer, as we have noted above, he can use the option, or let it expire its date. He uses the option, when it is profitable for him: it means that the exercise price will be higher than the market price.

3.2.3. Speculative currency operations

Speculators intentionally affect the state of the currency market, by buying or selling currency, to achieve a certain result. The change in the exchange rate, or its appreciation. Setting the increase or decrease in the exchange rate, they can make a profit or suffer a loss. Speculative transactions are carried out on the spot market and on the forward market.

On the spot market, if the speculator wants to raise the exchange rate, he buys it, and keeps net deposit in the bank, in order to sell it in case of higher exchange rates. Speculators’ profit will be equal to the difference between the original spot rate, at which he bought the currency, and the higher rate, for which he had sold this currency.

If the speculator is planning on the decrease of exchange rate, he takes a loan in foreign currency for a fixed term, then sells it at a high rate (changes it for the national currency), and he puts the received money on deposit in the bank for earning interest. At the end of the term of the loan, if the spot rate of foreign currency is decreased, the speculator buys foreign currency at a lower rate for returning the loan. In this case, speculators’ profit is equal to the difference between the spot rate on the sale and purchasing of foreign currency.

Speculation in the forward currency market is more common and is based on the assumption of rising and falling currency spot rate, compared to the forward rate in the future. If speculator believes that the currency spot rate will be higher in 3 months, than in connection with the present-day forward rate, he conducts such operations: he buys foreign currency in the forward market for delivering in 3 months, in case of his prediction coming true, after 3 month he receives foreign currency at a low price of forward market and then he resells it at a high rate of the spot market. Speculators’ profit – is the difference between the forward rate and the spot rate, if his expectations were not met, then it makes losses. If the speculator expects that the future spot rate of foreign currency will decrease relatively to the present-day forward rate, he conducts such operations: he sells foreign currency on the forward market, buys foreign currency on the spot market for the low spot rate and then he resells it at a higher rate on the forward market. Speculators’ profit is also determined by the difference between the forward rate and the spot rate. Profound speculation makes thousands of currency forward exchange contracts, to avoid the risk of mistakes on the future spot rate, and, if the assumptions about the general nature of changes in exchange rates will be valid, its operations will be profitable.

24

Muhammad Firman  (University of Indonesia - Accounting )
The interest arbitrage operation consists of taking loan in one currency and crediting it in another one. Risks from changes in rates of exchange can be reduced by drawing up forward contracts of currency exchange for the term of loan or deposit.

Since the operation of interest arbitrage associated with the supply and demand of spot and forward transactions, this operation affects the spot and forward exchange rates [27, p. 84-86].

Interest arbitrage (e.g., transference of the U.S. dollar to the country B) consists of three operations: 1) the loan in dollars and convert it into the currency of the country B; 2) the allocation of internal currency B; 3) the drawing up the forward contract at the end of the credit for the reverse exchange of currency B to dollars.

At the end of the credit (t = 1) the arbitrageur will owe (in dollars):

\[ S_1 (1 + r_a) \text{, where } r_a \text{ is the interest rate in the United States.} \]

The bank will receive in country B:

\[ B_1 (1 + r_b) \text{ units of currency B. This currency must be converted at the forward rate (S_B/S_B) to dollars in the amount of P}(1 + r_a) \]

As the amount of foreign currency (B) equals the amount of borrowed dollars (S), divided by the spot rate (S / B), i.e., B = S/(S/B), the amount of earned money is:

\[ S(1 + r_a) \times (1 + r_b) \times (S/B) \]

Interest profit on bids equal to the internal est of earned dollars minus the amount of dollars that it owes to its creditor.

\[ \text{Profit} = (S/B) S(1 + r_a) \times (1 + r_b) - S(1 + r_a) \] (6.4)

The exchange of one currency for another affects on the supply and demand on the spot and forward markets. At the process of exchanging dollars for currency B, it is created additional demand on the spot market for currency B, which leads to the increase of value of that currency in dollars (S / B). At the forward market, the currency B is exchanged for the dollar, leading to an increase of its currency and reducing its value in currency terms (S/B). The increase in the exchange rate of the (S/B) and decrease of forward rate (S/B) reduces the profit of the arbitrageur, and at which the potential profit will be:

\[ S(1 + r_a) \times S(1 + r_b) / (S/B) = S(1 + r_a) \] (6.5)

Equation (6.5) describes the balance, which is caused by the arbitrage actions.

If we divide both sides of the equation (6.5) to (1 + r_a), we will get:

\[ (S/B) + (S/B) / (1 + r_a) \] (6.6)

This equation shows that the ratio of the forward rate to the spot exchange rate of the currency B is equal to the ratio of profitability of the United States to the one in country B.

The ratio between the spot rates, forward rates and interest rates, expressed by equations (6.6) in the interest parity.

Interest parity is expressed by formula:

\[ (1 + f) = (1 + r_a)/(1 + r_p) \] (6.7)

where \( f \) - forward rate to the currency of the country B or a discount with it.

\[ f = (S/B) - (1 + r_a) / (1 + r_b) \] (6.8)

For example, if the interest rate of the US is 8%, and the interest rate in Germany - 6%, the interest rate parity leads to the fact that the forward rate of the euro will be 1.19%, i.e.,

\[ (1 + r_a)/(1 + r_b) = f \]

The ratio of the forward rate to the spot rate for the euro will be 1.19%.

\[ (1 + 0.08)/(1 + 0.06) - 1 = 0.0189 \]

The banks lend on interest rates parity in establishing forward rates for their customers. Putting obstacles in arbitrage’s way can cause deviations from interest rate parity.

9.3. The governmental interference in the activity of currency market

Governments can influence on the exchange rate of their currencies: a) by buying and selling of large amount of foreign currency on the currency market, b) by carrying out economic policies that affect changes in demand and supply of the national currency, c) by concluding of international agreements, related to the exchange rate.

Support of the exchange rate at a certain level can make the central bank through currency intervention. For this, the central bank has to trade currency at a fixed rate to private agents of the international currency market. For example, to keep dollar exchange rates at the level of 9.00 hryvnia to the dollar, the National Bank of Ukraine should be able to buy hryvnias for this rate to their dollar reserves in any amount dictated by the market. If it is needed to prevent the fall of the national currency, the central bank must sell sufficient quantity to meet the demand.

In order to carry out currency interventions, the country must have sufficient foreign reserves, gold reserves, international money (special drawing rights, euro). Central banks, conducting currency interventions, want to slow down changes in the exchange rate to prevent abrupt changes in the competitiveness of export sectors, to prevent fluctuations in the level of employment and inflation trends.

To influence the exchange rate, governments are using two types of state macroeconomic policy:

- monetary, which affects the exchange rate through the mechanism of change in the monetary base;
- fiscal, which affects the exchange rate through changes in government spending and taxes.

The temporary increase in the money supply is currency depreciation and rising output. The rapid depreciation of currency leads to reduction of prices of the domestic product compared to the imported one. So there is the increase in aggregate demand for it, which should be covered by the increment of output. The continuous growth of the money supply influences on the exchange rate and on the output greater impact.

The disadvantage of the use of monetary policy for influence on exchange rate is that great fluctuations of money supply in the country can lead to inflation or deflation. This limits the ability to use monetary policy to regulate foreign exchange rates.

Fiscal policy – the policy, which is for changing of the level of taxation and of government spending. The policy, which causes the budget deficit or excess.

Fiscal policy can be expansionary and restrictive.

Restrictive fiscal policy is carried out by the reducing of governmental spending or by raising of taxes, or by using of these two methods. The realization of restrictive fiscal policy leads to an increase in the value of the currency. Reducing of the governmental spending and tax increases controlled by budget deficit. This leads to a decrease in demand for goods and services, which is reflected in decrease of imports, and, consequently, a decrease in supply of foreign currency and increase of its value.

Expansionary fiscal policy in the form of increase of governmental spending or saving taxes, or some combination of these two directions leads to an increase in aggregate demand. This leads to an increase in imports and, consequently, to greater supply of currency, which causes a decrease in the exchange rate.

In order to achieve macroeconomic stability, the central bank, under fixed exchange rates, cannot use monetary policy. However, fiscal policy, under fixed exchange rate, is more efficient than floating.

The government can also influence on the magnitude of the exchange rate by official statements of their intention to carry out a strategy for the exchange rate.

The purpose of these statements is to influence the expectations and behavior of the participants of currency market. The effectiveness of these statements depends on the degree of confidence in the currency market to government statements.

The government occasionally makes decisions about immediate change in the price of the national currency, expressed in units of foreign currency, in the country, where exchange rate is floating.

If the central bank increases the price of a unit of foreign currency into national currency, there is devaluation, when the central bank reduces the exchange rate – revaluation. Revaluation or devaluation means the willingness of the central bank to sell unlimited amount of national currency in exchange for foreign currency at the new rate.

Change of the value of the exchange rate under a floating exchange rate, as a result of the joint impact of market forces and government, is defined by the terms "depreciation" and "appreciation" of currency.

9.4. The Eurocurrency Market

Eurocurrency market (Euromarket) is a specific sector of the currency market. If the currencies market is a market, where the sale and the purchase of foreign currency in the country of its origin take place, eurocurrency market – is a market of deposit and crediting transactions in foreign currency outside the country of its origin.

Eurocurrency market (in the broad sense) includes markets of euroskeudos, euroskeudos, euroskeudos, euro. It is a universal international market that combines elements of currency, credit transactions and securities transactions.

Deposit and crediting operations are carried out in euro on the European market. Currencies are transferred into foreign bank accounts and banks use them for operations in all countries, including the emission of this currency by country. For example, if the Bank of France takes credit in U.S. dollars, it is the operation on the market if they put 0.82% a bank or fund in the United States, or in the Kingdom or Japan, the agreement is concluded on the eurocurrency market. Euroskeudos or euronotes – is the same name of currency in bank accounts that are not in the S. and Japan, lira, francs, marks, yen, and other currencies in other countries. So, the dollar in liabilities of the Bank of France is the euroskeudos, yen in liabilities of Bank of UK – is euronotes.

The eurocurrency, functioning in the global financial market, retains the form of the local currency and the prefix "euro" only indicates that the currency is not under the control of national monetary authorities.

Eurocurrency market emerged due to company needs of investors, in some countries and not the government's decision. He started to operate since the mid-50s, when Western Europe appeared the market of Euromarket. These are the following prerequisites for the development of this market:

- firstly, the ability of branches of U.S. banks in Europe and European banks to pay for dollars higher interest than in the U.S. In addition, dollar loans that were given in Europe cost less;
- secondly, the surplus dollars in oil-exporting countries of the Middle East and countries that preferred placement in European banks;
- firstly, the demand for dollar loans from the side of developing countries;
- fourthly, the removal of exchange restrictions in the promotion of capital by Western countries.

This led to the establishment of favorable conditions for transactions with non-residents’ deposits on the national European currency markets. Western European countries experienced an acute dollar deficit and encouraged the inflow of funds to the residents in their banks, as these deposits serve as currency credit for the countries receiving the deposits. Therefore, the accounts of aliens exempt from taxation and compulsory reservation of funds in the local central bank. To distinguish inflow to the accounts of non-residents in European banks (under the currency) from the currency units controlled by emitting their central banks, they have the prefix "euro", which became added to U.S. dollars, and then, as their development of the Euromarket, to other freely usable currencies.

Outflow of the currency regulation and tax laws of the country encouraged international banks to facilitate the full development of the Eurocurrency market.

Muhammad Firman (University of Indonesia - Accounting)
Chapter 10

The International Credit Market

Europe accounts for about 50% of Eurocurrency market transactions. The main financial centers is London (over 20% of the global volume of transactions in Eurocurrency). Now there are more than 35 centers of Eurocurrency market. Among the largest, apart from London, there are Tokyo (about 20% of market transactions), New York, Frankfurt and Mannheim (10%), Paris (7%), Zurich—Geneva (6%), Luxembourg (4%), Amsterdam, Brussels (3%) [16, p.264].

The largest banks on the Eurocurrency market are given in Table 9.1.

<table>
<thead>
<tr>
<th>Country</th>
<th>Name of the bank</th>
<th>Asset size, trill. doll. in 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>BNP Paribas</td>
<td>2.84</td>
</tr>
<tr>
<td>Germany</td>
<td>Deutsche Bank</td>
<td>2.62</td>
</tr>
<tr>
<td>Great Britain</td>
<td>HSBC</td>
<td>2.6</td>
</tr>
<tr>
<td>USA</td>
<td>Bank of America</td>
<td>2.27</td>
</tr>
<tr>
<td>China</td>
<td>ICBC</td>
<td>1.63</td>
</tr>
<tr>
<td>USA</td>
<td>Citigroup</td>
<td>1.95</td>
</tr>
<tr>
<td>Japan</td>
<td>The Bank of Tokyo-Mitsubishi UFJ</td>
<td>1.53</td>
</tr>
</tbody>
</table>

Source [25]

1. Access restrictions of borrowers. The main borrowers are TNCs, governments, international monetary and financial institutions.

2. The use of leading convertible currencies: eurodollars (60%), euroyen (6%), euro (3%) and others.

3. Using the latest computer technology. Transactions are carried out by telephone, fax with each exchange on the same day of telegraphic confirmation, which serves as a single document.

4. Specificity of interest rates. The opportunity to bid on eurodeposits of higher rates and on euroloans—below the national rates because system of reserve requirements is not covering euroloans that commercial banks are obliged to hold on interest-free deposit at the central bank and the payment of income tax on interest. Because transactions in Eurocurrency are more profitable than national currencies.

5. The emission of operations. Eurobonds (from the 70s) are placed simultaneously on the markets of different countries and TNCs used to finance investment, the government—to cover the budget deficit and refinancing of "old" loans; Eurobills (since 1981); Euroshares (1983), which does not rotate at all national capital markets and only there, where it is permitted by law, as the share—it is not only a form of credit, but also the right to a share of ownership.

6. The main Eurocurrency market attractiveness—the lack of government regulation that allows Eurobank to offer on eurodeposits higher interest rates than on the contributions made in the national currency, and allows banks to take from borrower’s higher interest for the use of Eurocurrency, than loans in national currency. In addition, transactions with foreign currency, banks are given much greater freedom of action.

7. At the same time, Eurocurrency market has drawbacks. Thus, when there is regulated banking system, the probability of loss of deposits in bank bankruptcy is negligible, while in non-regulated systems such as the Eurocurrency, the probability increases. Borrowing of company funds on the currency exchange market in the Eurocurrency can be risky. Signing a forward contract can incur risk, but there is no absolute guarantee.

8. Nowadays Eurocurrency market grows enormous proportions (its volume is about $760 trillion annually). A significant mobility of costs in this market due to the large scale of operations significantly affects the currency of the financial state of the world environment. The market covers all major international banks and world financial centers, and all convertible currencies.
Countries that have relatively large financial resources, compared with the possibility of profitable application inside the country, can increase its national income by allocation of loans to countries that have a higher rate of return on capital (interest, dividends). Country-importer of capital has an opportunity to increase its national income due to foreign investment obtained on more favorable, compared with domestic, lending conditions. In general, using international loans there is the maximization of global product due to the general increase in world production.

The essence of international loan value is that due to the loan there is a redistribution of capital among countries according to the needs and abilities of their more profitable use. Given the growth of international trade, supported by foreign direct investment, and governments of different countries receive foreign currency to stabilize the economy, covering external debt.

The effectiveness of the loan is achieved by:
- free movement of capital;
- the stability and predictability of the global economy development;
- the fulfillment by borrowers of their obligations, the full payment of their debts.

Each country is an importer and exporter of capital. As lenders and borrowers, i.e. subjects of international loan markets, there are commercial banks, corporations, financial intermediaries, non-bank financial institutions (insurance companies and pension funds), central banks and other public bodies, governments, regional intergovernmental organizations, international financial institutions. However, lending is usually carried out by the international banks, thanks to the broad field of their financial activities.

International banks are classified according to the share of international operations and profits as in total volume of agreements and revenue for the following groups:
- national banks with a small foreign subsidiary, which accounts for a small share of assets and income;
- banks, from 5 to 10 percent of their income are created by international operations;
- national banks, where there is a significant portion of interbank and centralization of capital, allows them to participate in the economic division of the global debt market;
- offshore banks, registered in offshore zones and used special tax and other incentives in the international loan transactions. Transactions of each TSE are not carried out without them.

The Bank of International Settlements includes specific activities of banks to the sphere of international lending operations, [1, p. 152]:
- loans and loans that banks offer to each other, both domestically and abroad;
- loans and loans, granted by non-bank institutions, both domestically and abroad;
- interbank deposit (Euro操作, operations on offshore banking markets).

The international operations of banks are characterized by the following features:
- lending operations include currency, loan, and regional risk; the implementation of the trading principle of profit maximization is valid for all types of loans;
- the main part of lending operations of international banks are loans to foreign banks, which are not branches of the bank. Direct bank loans tend to be concentrated in developing countries;
- international lending is mainly focused on providing short-term loans to foreign banks, which are not branches of the bank;
- geographical areas of the short-term lending are more diverse than areas of long-term loans.

10.1.3. The forms of international lending

International lending is carried out in various ways. They can be classified according to several features that characterize certain aspects of loan relations [1, p. 153].

According to sources, there is domestic and foreign lending in foreign trade. According to the subject of foreign trade agreements:
- commercial (trade) loans, which are directly linked to foreign trade. It is provided for the purchase of certain goods or payment for services and usually has "connected" character, i.e. strictly special purpose, fixed in the loan agreement;
- financial loan. It provides trade on any market that gives opportunities to choose trading partners. This type of loan is not used in the trade supply, but to the direct investment, construction investment objects, updating accounts in foreign currency, foreign debt repayment, maintaining exchange rate and so on. Loans are divided into loan, that exporters give importers, and by currency, issued by banks in the form of money.

According to the term, international loans are divided into short-term — up to 5 years (typically used in foreign trade, for the set of objects, for commercial insurance, speculative agreements), medium — from 1 year to 5 years (sometimes up to 7-8 years) and long-term — more than 5 years (used for investments in main instruments of production, financing major projects, scientific research, new technologies implementation, as well as international loans by international financial institutions, governments). According to the currency of loan, loans can be given in the currency of the borrower, country-currency, a credit country or international units of account (SDR, euro).

According to purpose, there are secured and blank loans. Products are served as a provision for loans, product manager and other commercial documents, securities, guarantees, Depository agreements, etc. Blank loans are given to the debtor under his obligation to repay it within a specified period, and the document of this loan is sold for-promise purpose, signed only by the debtor.

According to the technique of allocation of loan, they are classified as cash, which are entered in the account of the debtor and received at his disposal, the acceptance, used in the form of acceptance of draft by importer or bank; deposit certificates and other.

According to the type of lender, loans are divided into private, that are provided by firms, banks, brokers; government; mixed, involving both private companies and state, interstate loans of international and regional monetary and financial institutions.

As an important variety of international commercial loan is a corporata loan. It occurs when a firm-exporter of one country gives to the importer of another country deferred payment when selling goods and services. Under certain conditions, terms of corporata loan have become quite long (usually from two to seven years) and are determined by conjunction of world markets, commodities and services, interest supplier in maintaining foreign economic relations and the expansion of exports, etc. Corporate loan is usually registered by a promissory note or given by an open account.

A corporate loan, that expresses the relationship between the firm-exporter and firm-importer, is usually combined with a bank loan. As the long-term firm loan drains significant funds of exporter, who uses the bank loan or refinances his loan in the bank. Bank lending of the exporter and importer takes the form of loans on the security of goods, shipping documents, promissory notes and bills of exchange account. Sometimes banks give bank loans to a large exporting firm, i.e. without formal provision.

Bank loans have some advantages over firm ones. Give the opportunity freely use the funds for the purchase of goods to the borrower, provide extended loan terms, larger volumes of supplies due to the loan, and characterized by relatively lower cost.

Banks give besides the financial loans that allow under the most favorable conditions to purchase goods on any market, also export loans. Export loan — is the loan that is issued by the bank of the country-exporter to the bank of the country-importer for leading supply of goods. It is issued without the security and has "associated" character. The latter is a bank loan taken by the bank solely to purchase goods in the country-creditor.

The broker loan is the intermediate form between corporate and bank loan in some countries. As well as the commercial loan, it has to deal with commodity operations and simultaneously with cash loan because brokers usually take loan from banks.

The following alternative forms in foreign trade such international factoring, forfaiting and leasing are used in the practice of international bank lending:

Factoring — is an operation to sell foreign accounts before getting export goods to commercial banks or specialized companies by suppliers. Factoring can be carried out with a demand of regres and without it. Factoring with the right of regres means that non-compliance of terms of the agreement financial institution, which bought accounts, may indemnify company’s losses from the company that sold them. However, as a rule factoring of international agreements carried out with the right of regres.

The distinctive features of factoring: requirements of agreements accepted till 1 year, no restrictions considering the amount, it is usually used on the domestic market; potential right of regres of requirements for the buyer, using a wide range of currencies, additional guarantees are not always needed.

Factoring services usually provided by factoring companies, many of which are owned by banks. They are buying accounts from exporters at a discount. They can pay immediately in cash till 95% of the nominal value of the accounts of exporters. The rest is paid after the payment of bill to importers. The benefit to the importer is that he cannot deal with loan. Exporter avoids the threat of credit and currency risks. He should not expect the moment, when the importer will pay for the goods.

Forfaiting — is the purchase operation of bank-forfaiters for full terms and beforehand established conditions of bills and other debt and payment documents. According to the agreement of forfaiting importer, of course, provides a simple bill, which guarantees the bank on behalf of the importer. Exporter sells this promissory note to the bank-forfaiter at a discount. Bank-forfaiters assumes the risk of non-payment of debt without right of regres (turnover) of these documents to the forfaiter. Exporter may sell the purchased from exporting bills on the secondary market, which is called "a forfait" (which means to yield the right).

Distinctive features of forfaiting are:
- long-term notes are taken under the terms over 1 year;
- the minimum amount, which is used, is not less than $500 thousand;
- the average amount of contract - $1.2 million;
- it is used primarily in international operations;
- the absence of requirements of regres for export;
- the purchase of requirements only by FCC (freely convertible currency);
- obligatory bank surety.

For the exporter, forfaiting agreement is beneficial because it turns loan agreement into cash, it is not necessary to worry about the creditworthiness of the importer. Forfaiting frees the exporter from liability on the bill after the sale. Importer gets the goods on credit, without succumbing, as an exporter, to exchange-rate risks.

Forfaiting is often used in the implementation of medium-term lending of foreign trade by means of production, especially in Eastern Europe and the countries of Asia and Latin America, which are developing.

Factoring — is the operation of lending in the form of rental equipment, ships, planes, etc., for a period of 3 to 15 years. Rental serves as a form of loan and at the same time as a form of international trade, which creates conditions for the rapid development of new technologies. The leasing company (lessor) purchases...
There are the elements of the cost of loan: contractual and hidden. Contractual is the cost of the loan due to the agreement. They are divided into basic and advanced. The main elements are: the amount paid directly by the borrower to the lender: interest; costs of collateral commission. Additional elements of the cost of the loan include amounts, paid by the borrower to third parties (under warranty). In addition to the basic rate, there is bank commission: the negotiations, participation, management, the obligation to provide the borrower the necessary funds, agency commission.

The hidden elements of the cost of loan related costs associated with the allocation of loan, but not recorded in the agreement (high prices of goods under firm loans, compulsory deposits in certain amounts in respect to the loan, the bank's corresponding fees for collection of documents, etc.).

10.3. The Eurocurrency market

Eurocurrency market is an important source of borrowed funds. Banks provide short-term and long-term loans in Eurocurrencies. Using of eurocurrencies, as currencies of loans, is due to such advantages as large size, easy access, short mobilization, lower cost, because there is no national loan limit. The functioning of eurocurrencies promotes the formation of loan facility of greater efficiency and capacity on the international credit market.

International interest rates are applied for eurocurrencies, which are relatively independent compared with national rates. Eurocurrency interest rate, as a variable includes LIBOR – the London interbank offered rate on short-term inter-bank transactions in euro – and an increase to the basic rate that is the premium for banking services. Interbank interest rate of demand for short-term operations on the European market in London is called LIBID. As Eurocurrencies are not the subject of the local law and are not the subject of income tax, they can reduce the interest of their loans while maintaining of high profits.

Short-term eurocurrencies are usually given at a fixed rate for the whole term in full amount. This is the simplest form of the loan agreement. Medium- and long-term eurocurrencies that provide reproduction of the fixed capital, exports of machinery and equipment, implementation of industrial projects, take the form of rollover and syndicated loans.

The characteristic feature of the rollover eurocurrency is that the interest rate is not fixed for the whole term of the loan, and reviewed regularly (every 3 or 6 months) in accordance with a change in the basic rate (LIBOR rate). The main focus of rollover eurocurrencies include reusable rollover loans and rollover loan support (under conditions of "stand-by").

Rollover loan under conditions of "stand-by" is secured loan, i.e. at the condition of the loan agreement, loan is not actually available. The Bank takes commitments to provide eurocredit on the first demand of the borrower during the time of the agreement.

Rollover loans have no fixed size of the loan. It allows only a maximum limit within which the borrower is entitled to get loan in the required amounts at the beginning of each interim period of using it. There is fixed rate of interest and loan amount change in the loan agreement that is carried out every 3 or 6 months within a period of implementation.

Compulsory conditions of rollover loan agreements include: characteristics of partners; the amount and purpose of the loan, the procedure and the term of repayment; the cost of loan and guarantees of it.

Today, the most common type of international loans are syndicated eurocredits. The resources of Eurocurrency market are the sources of syndicated eurocurrencies. Typically, such loans are organized by large commercial banks, which are the head of consortiums (syndicates) and come to an agreement with the borrower about loan conditions.

There is the procedure of allocation of syndicated eurocredits:

1. The borrower finds a bank, which will lead allocation of syndicated eurocredit (bank manager) and submit major loan conditions (term, amount and currency of the loan) to its approval.
2. Bank manager forms the syndicate: inquire a certain number of banks to participate in the loan.
3. Appointed Banks – guidelines that establish the LIBOR rate (interest rate orientation).
4. Bank manager chooses bank agent that acts as a control on the loan. He receives the loan interest paid in accordance with the repayment schedule of the loan.

The total cost of syndicated eurocredit includes:

- interest payments (the interest rate is adjusted every 3 or 6 months based on changes in the interest rate orientation);
- tax payments to banks that are members of the syndicate;
- commission to banks that are members of the syndicate;
- commissions are paid at the beginning of the loan, making the loan package more appealing to creditors.

Commission fees are divided into:

a) commission for fees, when the borrower can determine the sequence of repayment the loan and can use cash after the conclusion of the agreement. These commissions are appointed on the part of the loan that has not yet returned;

b) commission for management, which is paid to bank manager as payment for arranging the loan;

c) commission for participation, which is paid on determined day or at the moment of full repayment of the debt. With the increasing number of members of the syndicate, the commission increases;

d) commission to bank agent as payment for services.

The total amount of commission varies from 0.30 to 1.25% of the nominal amount of the loan.
The main features of eurocredit are:
- the amount of loan—from 20-30 million to 1-2 billion of US dollars;
- terms—from 10 months to 12 years;
- interest rates—are reviewed regularly, calculated on the basis of the discount rate (LIBOR, SIBOR—Singapore bid proposals, the U.S. “prime rate”) plus the difference (spread), that uses floating interest rates as a result of the introduction of which the risk of changes in interest rates is transferred to the borrower;
- the commission for management, participation, loan servicing;
- usable currency—the U.S. dollar, British pound, Japanese yen, euro, Swiss franc, and others;
- access to funds is fast;
- the right to early repayment—under condition of payment of compensation;

Benefits of syndicated eurocredits lie in the fact that they make it possible to distribute loan risk among the members of the syndicate; banks can participate in lending, regardless of their size; the borrower gets a great loan due to the unification of resources of certain number of banks; the difference between interest rates on loans is much lower than in international banks; allocation of loans is carried out in any freely convertible currency, and it gives the borrower the ability to use these tools on his own, without limiting his economic decisions.

Disadvantages of syndicated eurocredits related primarily to the fact that they are given for a shorter period, compared to the national bank lending.

10.4. The international official assistance to developing countries—non-market mechanism of the redistribution of financial resources

One of the channels of global financial flows movement is the redistribution of national income through the budget in the form of official assistance to developing countries. The aim of the assistance is the elimination of underdevelopment. This redistribution of financial resources related to international non-market mechanism that contributes to macroeconomic stabilization of the economy and sustainable production growth in the countries that are directed to a market economy.

The International Official Development Assistance (ODA) to developing countries is mainly achieved in the form of preferential loans and Irrevocable subsidies, as well as in the form of commodity assistance.

There are the subjects of international assistance in the recipient country:
- governments;
- executive agencies, authorized by government;
- central and export-import banks;
- legal entities.

Recipient country receives the bulk of loans and subsidies irrespectively from institutionalized international financial institutions, multilateral funds, integration associations that act as foreign donors.

International official assistance to countries is classified in designed and out-of-designed.

**Projected assistance in development of country includes:**
- system designs (macroeconomic stabilization of the economy);
- financial stabilization of the economy;
- the structural changes in the economy;
- the reforming of economic relations;
- the implementation of administrative reforms;
- structural designs (structural changes in separate sectors of economy);
- loan rehabilitation; institutional development; state administration reforming; the reforming of legal system.

**Immaterial assistance designs:**
- investment designs: the development of production, industries and sectors of economy;
- technical assistance designs: forms of assistance additional qualified staff, job training, specialized courses in the recipient country; documentation, equipment and technology to provide technical assistance.

The designs have the following components: mutual obligations between the government of the recipient country and donor; the development program of certain sectors of the economy, the mechanism for its implementation and monitoring; grants, to improve effectiveness of the process of design preparation and implementation.

**Out-of-projected assistance in development of country includes:**
- commodity assistance: long-term preferential export loans for the purchase of imported goods; food as a gift for reside in the local currency; creation of special funds to support agriculture at the expense of profits derived from the use of export loans;
- grants to support the reformation actions of government; cover deficits of balance of payment; financing certain parts of some projects;
- in-kind tools of the ODA: discussion of strategy development of country in the short and medium term perspectives; general economic and branch of industry research work; the mobilization and co-ordination of official resources through the conducting sessions of donor countries and the participation in joint financing.

The international official development assistance is carried out on a bilateral (international) and multilateral basis, bilateral flows twice exceed the multilateral ones.

The donor countries give loans and irrevocable subsidies from the budget and strictly control their spending in case of the implementation of the ODA on the bilateral basis. Donors should commit funds in the amount of 0.7% of GNP to the ODA, which are fixed in a range of international documents. However, the major donor countries (USA, Japan, Germany) provide only in fewer amounts—0.25% - 0.35% (Table 10.1). So, the total amount of assistance in 2011 decreased compared to 2010 by 2.7%.

According to the basic programs of development, assistance increased by 9% over the past year. The overwhelming share of growth of the ODA fell to reduce debt to foreign creditors. For this component, the support from abroad increased by 3 times. Another component—humanitarian assistance—increased by 15.8% and reached $8.7 billion.

The ODA, which is provided by the EU as part of CAD, was increased by 28.3% ($35.7 billion). Most of it was aimed at reducing the debt of the recipient countries.

It was concluded a range of international agreements aimed at improving the efficiency of assistance over the last decade, with the active participation of the OECD.

Two momentous agreements—the Paris Declaration on Increasing Effectiveness of Foreign Assistance (2005) and the Accra Agenda for Action (2008)—were signed by more than 100 donors and recipients of the ODA. Five basic principles of international official development assistance are attached in these documents:
- the recipients should develop their own national development strategies;
- the donors should support national strategies, developed by the recipients of assistance;
- the donors should achieve the harmonization and co-ordination of their actions;
- the national development strategy should include clear objectives, and achievement of these objectives shall be monitored;
- the donors and recipients of assistance are jointly responsible for achieving of development goals.

In order to make the ODA to stimulate economic growth (not dependence on assistance), the recipient countries should act more actively by themselves. It aims to engage in the mobilization of domestic resources, attract foreign investment and develop small and medium businesses. It is needed to continue the reforming of the system of international trade and finance, to seek new forms and instruments of financing international development. Private foundations and non-profit organizations as new members of the ODA make significant contributions to the development. According to the OECD, in 2010, these organizations have spent for development $31 billion [23].
10.5. International debts

10.5.1. The causes of international debts

The practice of international lending clearly shows how the actual development of international loans does not come to an agreement about the conditions of the normal work of loan system such as stability and timely payment of debts.

Weighy evidence of this fact – in the global debt crisis.

The main reason for the periodic reiteration of the international debt crisis is the presence of strong motivation to abandon the payments on the debt of sovereign debtors. If the debtor-governments conclude that fulfillment of all payment obligations does not provide more net inflows of funds in the future, there is an incentive to give up from part or all payments on the debt, in order to avoid the outflow of resources. The existence of such an incentive to abandon the payments on the debt helps to explain the repeated refusal of payment of Latin American countries in the early XIX century, simultaneous mass refusal to pay during the financial crisis in 1929-1932, 1975-1986, 1997-1999, 2008-2009, when the amounts of debt service has grown to the size of the new capital inflows and many debtors demanded a review of the terms of payments.

The reason for termination of payments by sovereign debtors helps to explain some features of the behavior of financial creditors. One of them is the persistence in establishing higher interest on loans to foreign governments compared to the private and public borrowers in their own country. Requirements of higher interest rates are the way of getting in its way premium in case of refusal to pay the debts, until there is no crisis, creditors receive this premium, but in case of crisis they have big losses.

What can solve the problem of failure of payment? We believe that this cannot be a traditional sequel, but it links necessary to the lender with the implementation of requirement of “belt tightening” to gain the time of payments on debt. New loans must cover the amount of interest and main amount of debt at least. But even the new loans are so large, that their provision increases the total amount of debt, because the debtor may eventually refuse to pay independently of the term of new lending.

A reliable way to solve the problem of ownership of loans, given to sovereign debtors, is introduction of security or provision of payment on the debts of the debtor. In the loan agreements within the country, legally executed security is an important tool in managing payments on the debt. At the same time to strengthen the debtor creditworthiness, allowing him to get loans at the lower interest rate and more convenient temporary scheme. In the past countries, which paid debts on time, were those whose creditors were able to seize the debtor’s assets in case of non-observance of payment terms.

Despite the adoption of the above measures, the total world debt has increased by 2 times over the past 10 years, and in 2012 reached $69.08 trillion [47]. The external debt of some countries is illustrated in the Table 103.

The main part of the debt falls on developing countries. The problem of international debts of these countries is one of the central ones as in the theory as well as in practice of international financial policies.

A significant increase of debts of developing countries began in the middle of 70s of XX century. Let us consider its causes.

On the one hand – the growth of loan capital, which seeks for profitable use, began in connection with oil crisis in the late 1973. Developing countries have been involved in intensive process of international capital movement.

<table>
<thead>
<tr>
<th>Country</th>
<th>Total amount of external debt, billion of $</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU-27</td>
<td>10,090.00</td>
</tr>
<tr>
<td>USA</td>
<td>10,300.00</td>
</tr>
<tr>
<td>France</td>
<td>6,732.00</td>
</tr>
<tr>
<td>Germany</td>
<td>6,626.00</td>
</tr>
<tr>
<td>Japan</td>
<td>5,760.00</td>
</tr>
<tr>
<td>Italy</td>
<td>5,856.00</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5,610.00</td>
</tr>
<tr>
<td>Spain</td>
<td>5,261.00</td>
</tr>
<tr>
<td>Ireland</td>
<td>3,685.00</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>1,946.00</td>
</tr>
<tr>
<td>Belgium</td>
<td>1,040.00</td>
</tr>
<tr>
<td>Australia</td>
<td>7,535.00</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1,394.00</td>
</tr>
<tr>
<td>Canada</td>
<td>1,801.00</td>
</tr>
<tr>
<td>Total</td>
<td>69,080.00</td>
</tr>
</tbody>
</table>

The share of external debt is usually made in a foreign currency.

For the analysis of external debt, country's ability to service external debt, the World Bank uses a number of relative indicators:

- the ratio of the total amount of external debt to exports of goods and services;
- the ratio of the total amount of external debt to GDP;
- the ratio of debt service payments to exports of goods and services;
- the ratio of international (official) reserves to the total amount of external debt;
- the share of short-term debt in the total amount of external debt;
- the share of debt to international organizations in the total amount of external debt;
- the share of concessive debt in the total amount of external debt.

It is believed that the upper limit of the optimality of external debt should be:

a) the ratio of the total amount of external debt to exports of goods and services not more than 20 - 25% (in calculating of this indicators we usually take into account public and publicly guaranteed debt);

b) the ratio of payments on debt service to exports of goods and services is not more than 15 - 20% (In calculating of this indicators we usually take into account public and publicly guaranteed debt).


10.5.2. The concept of external debt and its restructuring

External debt is the amount of financial obligations of a country, owed to foreign creditors for unpaid foreign loans and interest.

Long-term debts are the most important. They are classified by type of borrower:

- the external public (official) debt, which is the amount of obligations of central and local state bodies to external creditors for unpaid loans and interest;

- the external private (private) debt, which is the amount of obligations of non-credit institutions to external creditors for unpaid loans and interest.

- the state guaranteed debt, i.e. an obligation of private firms, banks, companies, where the guarantor of payment is the country, private non-state debt, i.e. a debt of private borrowers that is not guaranteed by a country. It occurs when a borrower receives bank and other loans by means of purchasing debt securities in the international stock market.

External debt service payments are usually made in a foreign currency.
CHAPTER 11
INTERNATIONAL SECURITIES MARKET

The important segment of world financial market is an international securities market (ISM). Its role in recent years has increased considerably. With the rapid economic rise of many industrialized countries, traditional sources of funding are not fully meeting the needs of large corporations in the capital. Therefore, these companies are not limited by the borders of the national banking system and, relying on a high credit rating, they attract cheap financial resources by issuing securities. Growing demand from issuers, increase of supply as a result of the integration of national markets, competition, as a result of openness and globalization of the country leads to a reduction of the role of the banking sector as a mechanism for the redistribution of financial resources at the national and international levels and to simultaneous strengthening of investing and lending activities in the international capital markets.

The issue of securities gives the possibility: to raise a loan for a long period (for a few decades, bonds, for example), to invest the instruments of a loan of unlimited use of financial resources (shares), i.e. investment in the instruments of property (title of ownership), to reduce a financial risk, i.e. investment in the instruments of trade in the financial risk (financial derivative).

Thus, the international securities market unites the part of the global debt market (namely, the international debt securities market, which is mainly presented by the international bonds market), the international market of legal titles (property rights) and the international market of financial derivatives.

There are following instruments of the loan: bonds, bills of exchange, deposit certificates. The instruments of property include all types of shares and depositary receipts. There are also so-called hybrid instruments, securities, which have features of both bonds and shares (for example, preferential shares and convertible bonds) - obligations with the features of securities and shares.

Market of loan instruments deals with a loan capital, and market of property instruments - with parts (by shares) of property within a corporate capital.

The stock market deals with long-term borrowing instruments and instruments of property derivatives.

At the international capital markets trading in securities denominated in foreign currencies is conducted.

The Bank for International Settlements distinguishes such types of security issues in the international market:

- the security issue by nonresidents in national or foreign currency in the international financial market of the country;
- the security issue by residents in foreign currency;
- the security issue in national currency, which are intended for a sale to foreign investors [16, p.175]

The international securities market is divided into two structural segments: the foreign securities market. It is a financial market of the states, in which the transactions with financial assets of nonresidents (foreign securities) are conducted;
- securities Euromarket. It is a market, in which the securities expressed in Eurocurrencies are guaranteed and sold.

The definition of eurocurrency is given in the Council Directive 90/286/EEC of the European Commission, according to which eurocurrencies are being in circulation in more than one country and sold.

1) pass underwriting and are placed through mediation by a syndicate, at least two participants of which are incorporated in different countries;
2) are offered in considerable volumes in one or more countries, except the country of registration of the issuer, in which the issuance was made;
3) can be initially purchased (including the subscription way) only through mediation by the credit organization or other financial institution.

The functioning of ISM is conditioned by the demand, supply, intermediaries, regulatory and self-regulatory system. The demand for securities is determined by the welfare of the nation. The higher is standard of living, the greater are the savings of the population and the possibility of purchasing securities. The supply depends on the demand. It is higher, if market mechanism of sources delivery of long-term loans and financing are more developed. For the development of the securities market specialists of investment business and the system of training such specialists are needed. Finally, intermediary organizations - brokers and investment dealers, firms, stock exchanges and regulators of investment business are required.

The securities market - a major source of investment resources for governments, corporations and banks.

11.1.1. Investment capital, its suppliers and consumers

The term "investment" has several meanings. The most common is the definition of investment as use of money to generate income or to accumulate capital. All property and intangible values that are contained in business and other activities to make a profit or achieve social impact are investments.

Even with this definition it is clear that this is not just about money, but about money, which is a form of monetary circulation of capital, i.e. money invested in capital. Investment capital can be personal (retained earnings, depreciation) and borrowed, the source of which is temporarily free someone else's money. But free money is not an investment. They are converted into investments in the hands of those who spend them on purchase of elements of production that brings income, i.e. converts into real assets. Real assets - are economic resources of the company.