III. OPENED ECONOMY

1. **The Balance of Payments**
2. **The Exchange Rate**
3. **The Currency Market**
4. **The International Monetary System**

OPENED ECONOMY –TERMS AND CONCEPTS

1) **Microeconomy** – refers to individuals, private companies, better use of resources and competition.
   - internal market
   - external market:
     - international microeconomy
     - foreign trade
     - flow of capital
     - flow of labour

2) **Macroeconomy** – deals with the economy in general
   - economic growth (rate of growth of GDP)
   - employment and unemployment
   - Balance of Trade (imports and exports)
   - The Balance of the Current Account
   - The Balance of Payments
   - Scope:
     - find solutions to increase economic growth (investments etc.)
     - use of the possibilities of an economy to grow

3) **GNP (PIB) –** all the products and services produced, sold and consumed in a country in one year.
   - includes only the final products and services
   - main destinations:
     - the consumption of population (**C**)
     - the consumption of the government (army, health, education)(**G**)
     - investments (**I**) (population and governments)
     - the Balance of Current Account – The Balance of Trade (Exports – Imports)**.**

There are two types of economies:

a) **<u>Closed economies</u>**: limits its activity to the internal market.
   GNP = C + G + I
   I = S (savings)

b) **<u>Opened economies</u>**: GNP = C + G + I + (Exp – Imp)
   I > S (Investments can be bigger than internal savings)

1. THE BALANCE OF PAYMENTS

Payment = to give and receive money.

	Receive	Payment
I. THE CURRENT ACCOUNT	+	-
1. Balance of Foreign Trade (Exp-Imp)	+	-
- Exports - Imports	X	 X
2. Balance of Incomes/ Revenues	+	-
- money circulating from transfers of salaries and dividends	X	X
3. Balance of Unilateral Transfers	+	-
- donations and aids	X	X
II. THE CAPITAL ACCOUNT BALANCE	+	-
- Credits - Loans - Foreign Investments		
III. INTERNATIONAL RESERVES	+	-
TOTAL	=	=

Example:

	Receive	Payment
I. THE CURRENT ACCOUNT		**-7**
1. Balance of Foreign Trade (Exp-Imp)		**-10**
- Exports - Imports	**90**	 **100**
2. Balance of Incomes/ Revenues	**+2**	
- money circulating from transfers of salaries and dividends	**4**	**2**
3. Balance of Unilateral Transfers	**+1**	
- donations and aids	**1**	
II. THE CAPITAL ACCOUNT BALANCE	**+6.5**	
- Credits - Loans - Foreign Investments	**1** **5** **0.5**	
III. INTERNATIONAL RESERVES = 8 (7.5)	**0.5**	
TOTAL	=	=

Indicators:

a) Openness of an economy = $\frac{Export}{GDP}$

b) Relation between exports and imports = $\frac{Export}{import}$

c) External debt of a country = total of imports contracted or guaranteed by the state, coming either from other countries or organizations or from the private capital market.

d) Yearly service of external debt = what a country has to pay in one year.

e) International reserves = must have a minimum level equal to 6 months of imports.

2. THE RATE OF EXCHANGE

a) Definition: - The Exchange Rate is the price of one currency (national currency) expressed in other (foreign) currency

- The Exchange Rate = the price of money (on the internal market, the price of money = The Interest Rate)
- Devaluation = depreciation – happens when national currency becomes weaker than an external currency.
- Reevaluation = appreciation - happens when national currency becomes stronger than an external currency.
- The Rate of Exchange depends on demand and offer.
- "The Rate of Exchange is the most synthetic price" and it reflects the relations between the economies.

b) Theories: - "Purchasing Power Parity" – basket of products

- the rate of exchange depends on the level of prices
- "Rate of Interest" – when a country has a low interest rate, this country represents no interest for the foreign investors. A high rate of interest attracts foreign investors.

c) Macropolicy - Money – Rate of Interest – Rate of Exchange (a strong currency means having a low quantity of money and maintaining a reasonable level of the rate of interest)

- Production – Export – Rate of Exchange (devaluation stimulates production and exports).
- Currency Interventions (the intervention if the National Bank buying or selling money in order to manipulate the exchange rate)

3. THE CURRENCY MARKET

a) The place: - the currency market is the system of electronic connections between the currency departments of banks all over the world (in real time)

- London

b) The structure: - a bank has 2 departments: a department dealing with national currency and a department dealing with foreign currencies.

- clients:
  - tourists (it is called "import of tourism" when a Romanian visits France)
  - exporters and importers
  - investors (investing money in production, in services etc.)
  - governments
- there are 2 types of actors in the currency departments of a bank:
  - **dealers** – they are employees of the bank (they work in the bank for the bank)
  - **brokers** – they are intermediaries (special persons or companies who makes the connections between a person willing to exchange money and a bank)

c) **Types of operations: -** Spot (the transaction takes place now)
- Forward (the transaction is negotiated today but the exchange of money takes place in the future)
- Speculative (buying or selling on a speculative basis)

d) **Factors affecting:** - Technology
- Balance of Payments
- Expectations

4. THE INTERNATIONAL MONETARY SYSTEM

a) Internal – External Equilibrium, interference rules

b) Gold Standard: - the 1st stage of International Monetary System
- the money was made of gold or silver
- the rate of exchange was fixed, depending on the weight of the coin
- there were two forms:
  - Specie Gold Standard – money existed in the form of gold or silver coins.
  - Bullion Gold Standard – in time, because of the circulation, the gold coins lost their weight and there appeared "Paper Money". This money was covered in gold.

c) Bretton Woods – the 2nd stage of International Monetary System
- fixed rates of exchange
- 1947-1972 system – Rate
  - Dollar (main point of the system)
  - Gold
  - Convertibility
- The price of gold was established at 35$ per uncie (afterwards at 38 an even 42)
- There was an obligation to ensure the convertibility = the possibility to change any type of money into any other type free, without restrictions.

d) Floating Rate of Exchange - The 3rd stage of International Monetary System
- Demand – Offer
- there are two systems of floating – **Free Floating**
  - **Managed Floating** (e.g. Romania: the rate of exchange is free but BNR interferes on the market)
- the system is based on 3 currencies: $ - € - ¥
- the volatility of exchange rates is very high.