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# FOREIGN ECONOMIC ACTIVITY OF ENTERPRISES

TEXTBOOK



LODZ UNIVERSITY OF TECHNOLOGY

LODZ 2018

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## PREFACE

The development of market relations, which is accompanied by an increase in the openness of the country's economy, the emergence of a powerful non-state sector, and the commodity content of domestic markets, inevitably leads to intensification of foreign economic relations between domestic business entities and foreign partners. The foreign economic activity of the state in its evolutionary development has undergone several stages, which, using the terminology of economic science, can be characterized as: protectionism, liberalization, transnationalization and integration.

The protectionist policy is inherent in the early stage of development of foreign economic relations. For instance, since the mid-1990s, Ukraine has moved to a policy of gradual liberalization of foreign economic relations, which appeared in lowering the import duty, abolishing the export duty on most commodity positions and legislative protection of foreign investments. Since the late 1990s, transnational capital has been actively penetrating Ukraine. The most massive transnational investments were involved in the food industry and trade. A similar trend appeared in the early 90's in the countries of Central and Eastern Europe.

The current stage of development of foreign trade is characterized by a number of transformational changes due to deepening integration into the World Trade Organization (the WTO), which requires further reform of the state customs policy, investment and quality policies.

Each of these stages, having its own peculiarities of legislative regulation of foreign economic activity, was characterized by its quantitative and qualitative parameters, the most striking among them are the volumes and structure of foreign trade. As the state of economic development changes, the volume and structure of foreign trade is changing.

Forecasting the increase of competition in the domestic and foreign markets as a consequence of state's accession to the WTO and the simultaneous need to eliminate existing commodity imbalances in the structure of exports with an increase in the share of products with a high proportion of skilled labour require the construction of such a model of foreign economic relations that would be based on innovative component of economic development, scientific, technological and investment cooperation,

formation of competitive advantages of national goods on internal and external markets.

The implementation of these priorities is possible only with the general interest of all subjects of relations: the state, enterprises, population and with the organic combination of information, labour, material and financial resources accumulated to achieve the stated goals.

Knowledge, as an information resource, in the conditions of the information economy is the most important component of ensuring the effectiveness of any activity. Foreign-economic activity of transport enterprises has distinctive differences in processes and mechanisms of organization, planning, coordination and control, and therefore requires integrated knowledge for its implementation. In other words, the necessary knowledge would combine both the basic procedures of economy, finance and management, and special procedures of international cooperation.

The dependence of foreign economic activity on foreign trade policies of the countries participating in export-import operations and the norms of international regulation requires an integrated, systematic approach to the disclosure of the essence, procedures, mechanisms of the operations themselves, and to the study of the impact of the institutional environment and the environment of counterparties.

In the proposed textbook the methodical bases of organization and planning of foreign economic activity of transport enterprises with disclosure of its specific features, considering international norms and traditions of cooperation, are presented. Relying on the disclosure of legal possibilities of realization of types of foreign economic activity, the essence of the procedures of their organization, the features of contractual activities in the organization of trade cooperation with foreign counterparties and the main content of the stages related to the performance of contractual obligations are revealed. The authors emphasized specific details of the sequence of actions in the organization of foreign trade operations and their implementation, which will ensure logical consistency and systematic presentation of the material and promote full understanding the material.

The textbook aims to give the reader theoretical knowledge and practical skills in organizing foreign trade activities by transport enterprises.

# 1. CURRENT TRENDS OF FOREIGN ECONOMIC ACTIVITY (FEA) REGULATION



## KEY TERMS AND CONCEPTS

✧ <i>Foreign economic activity</i>	✧ <i>Methods of regulation of FEA</i>
✧ <i>Foreign economic policy of the state</i>	✧ <i>Institutions that promote FEA</i>
✧ <i>Subjects of regulation</i>	✧ <i>Protection of the domestic manufacturer</i>
✧ <i>Objects of regulation</i>	✧ <i>Bodies of state regulation of FEA</i>
✧ <i>Free trade</i>	✧ <i>Tools for regulating FEA</i>
✧ <i>Protectionism</i>	✧ <i>Strategy of development of FEA of the state</i>

**Foreign economic activity** is a process of organization and development of economic ties between residents of different countries.



In world practice management as a practical activity, science and academic disciplines exists over 100 years old. During this time, it became widespread, especially in countries with developed market economy. International Management and Management of foreign economic activity (FEA) occurred much later, at about 60 years of the twentieth century, influenced by the rapid development of international business and transnational corporations (TNCs), the deepening of the international division of labour, the development of international economic integration.

Management of foreign economic activity of enterprise largely depends on the conditions that will be created in the country for development of its activities in external sphere, depends on the government's role in regulating and supporting the development of FEA at the level of a state.

In all countries, without exception, especially in countries with transition economies where economic relations are unstable, government intervention in the development of FEA is an objective necessity. This is mainly connected with the aim to protect national interests in the carrying out FEA, more complete use of foreign economic activity as a factor of economic growth.

In conditions of "closed" economy, providing economics management, including FEA, based on government's monopoly and carried out mainly by administrative methods, the direct manufacturer was not interested in the development of export activities. Direct links between producers and consumers were absent. There was no clear concept of foreign economic activity, which would reflect its objectives, priorities and methods to achieve them.

In market conditions or transition to them, the state impact on the economy, including foreign economic activity, is changing radically. This influence takes the form of state regulation, which means creating the appropriate conditions favourable to the effective development of the economy as a whole and its parts in particular.

Thus, state regulation of foreign economic activity of the enterprise in the transition to a market economy consists in the creation of necessary conditions and promotion the development of the relations of the enterprise with foreign partners.

It should be noted that the term "regulation" of the economy, including FEA is mainly used in the CIS countries. In Western countries, and documents the GATT/WTO in relation to foreign trade, the term "reglamentation" is used. We will continue to use both them.

Government regulation is a system of legislative, executive and the controlling character measures, designed to improve foreign economic activities in the interests of the national economy.

Government regulation of FEA is carried out through the development and implementation of state foreign economic policy.

In modern conditions foreign policy represents a system of measures aimed at the most favourable development of economic, scientific, technical, industrial relations with foreign countries, on purpose to decide strategic tasks of country's socio-economic development.

Foreign policy is a component part of state's domestic economic policy. Certainly, the decision of general tasks (objectives) of foreign policy in each country has its own specific characteristics. The main components of foreign policy of Ukraine are:

- foreign trade policy;
- investment policy;
- scientific and technical cooperation policy;
- currency-financial policy;
- policy of labour force migration, etc.

*Each of the foreign policy directions decides the problems considering the stage of country's development and modern trends of world economy development.*

Regulation of FEA is carried out to:

- provide the economy balance and equilibrium of the country's domestic market;
- stimulate progressive market structural changes in the economy
- create favourable conditions for economic development of the state in the system of international labour division.

Government (state) regulation should ensure that:

- protection of the economic interests of the state and legal interests of FEA entities;
- creation of equal opportunities for FEA entities with the aim to develop all types of business activity, regardless of ownership;
- development of competition and the elimination of monopoly.

There are two types of foreign trade policy:

- 1) free trade;
- 2) protectionism.

The policy of free trade is minimal government intervention in foreign trade activities, unlimited access on the domestic markets of foreign goods.

Protectionism involves government intervention in foreign trade activities, the introduction of various restrictions for foreign goods to support national producer.

Despite the advantages of free trade policy, all states in varying degrees, use protectionism. In reality, in pure form, none of these approaches is used but the variants in varying combinations.

*Bodies of state regulation of foreign economic activity.* The scope and efficiency of foreign economic activities strongly depends on the organization, its regulation and management as at the level of the state or region, as at the enterprise level.

The system of bodies for regulation of foreign economic activity has some common features in countries around the world.

First, in each country in regulating of foreign economic activity takes part, in the first place, the highest legislative body. For example in the U.S. – the Congress, in France – the National Assembly, in Poland and Japan – Parliament. In Ukraine, such body is Verkhovna Rada (The Supreme Council of Ukraine).

Regardless of the name, these bodies perform the following functions:

- adopt the laws that regulate foreign economic activities;
- ratify the relevant agreement;
- assign funds for the efficient development of foreign trade.

Second, each country has the highest executive authority that:

- issues orders based on the adopted laws concerning the economic activity development;
- controls the execution of these laws;
- controls the rationality of using the allocated funds for the development of foreign economic activity.

Thirdly, the greatest impact on the development and regulation of foreign economic activity is carried out by ministries, which directly dealing with economic relations with foreign countries and questions of state foreign policy implementation.



#### **Issues for self-control**

1. Objectives, subjects of regulation of foreign economic activity.
2. Principles of regulation of foreign economic activity.
3. Tools for regulation of foreign economic activity.

#### **Materials of practical classes**

1. Stages of development of the state foreign economic policy.
2. State regulation of foreign economic activity: the essence, principles and tools.
3. Functions of bodies of state regulation of foreign economic activity.
4. Non-governmental organizational structures and their role in the regulation of foreign economic activity.

#### **Questions for self-study**

1. Systematization of methods of regulation of foreign economic activity.
2. Subjects and objects of regulation.
3. Functions of state regulators of foreign economic activity.
4. The WTO and its role in regulation of foreign trade of the member countries of the organization.

## 2. FEATURES OF CUSTOMS REGULATION OF FOREIGN ECONOMIC OPERATIONS



### KEY TERMS AND CONCEPTS

✧ <i>Customs policy</i>	✧ <i>Licensed import</i>
✧ <i>Duty</i>	✧ <i>Customs</i>
✧ <i>Customs tariff</i>	✧ <i>Country of origin of the goods</i>
✧ <i>Customs territory</i>	✧ <i>Customs value</i>
✧ <i>Customs border</i>	✧ <i>Contract</i>
✧ <i>Customs payments</i>	✧ <i>Licensing system</i>
✧ <i>License</i>	✧ <i>Quota system</i>
✧ <i>Quota</i>	✧ <i>Non-tariff barrier</i>
✧ <i>Export quota</i>	✧ <i>Non-tariff regulation</i>
✧ <i>Import quota</i>	✧ <i>Export restrictions</i>



## 2.1. Modern customs regulation and peculiarities of tariff regulation

Customs policy is a system of principles and activities of the state in the area of providing their economic interests and security via customs and tariff and non-tariff measures of regulating the foreign trade.

Customs policy aims to protect national interests and economic security by supporting a peaceful and mutually beneficial international cooperation with other countries, in compliance international law regulations and generally recognized principles of such cooperation.

The law rules of the customs regulation regulate procedural matters of export-import operations, determine the customs regimes and govern the conduction of customs procedures when crossing the state border, specify the procedural standards in cases of violation of customs regulations and so on. The essence of the customs control is shown in Fig. 2.1 [78].

Customs regulation is the relationship between the state and subjects of FEA that arise when crossing the state borders of goods, services, capital and workforce. The components of the customs regulation are presented in Fig. 2.2 [78].

Customs regulation is regulation of issues related to the establishment of taxes and customs duties, customs procedures, organization of customs control bodies activity. In practice of foreign economic activity of the world there are two levels of customs regulations:

**1) international**, which provides the customs regulation through the adoption and enforcement of decisions of specialized international organizations such as the World Trade Organization (WTO). These organizations carry out customs regulations by establishing the basic principles of international customs regulations and fixing rules and regulations of performance of relevant operations in countries that are part of their composition. Today WTO regulates about 90% of global foreign trade turnover.

**2) national**, based on the relevant laws and other legislative acts of national legislation.

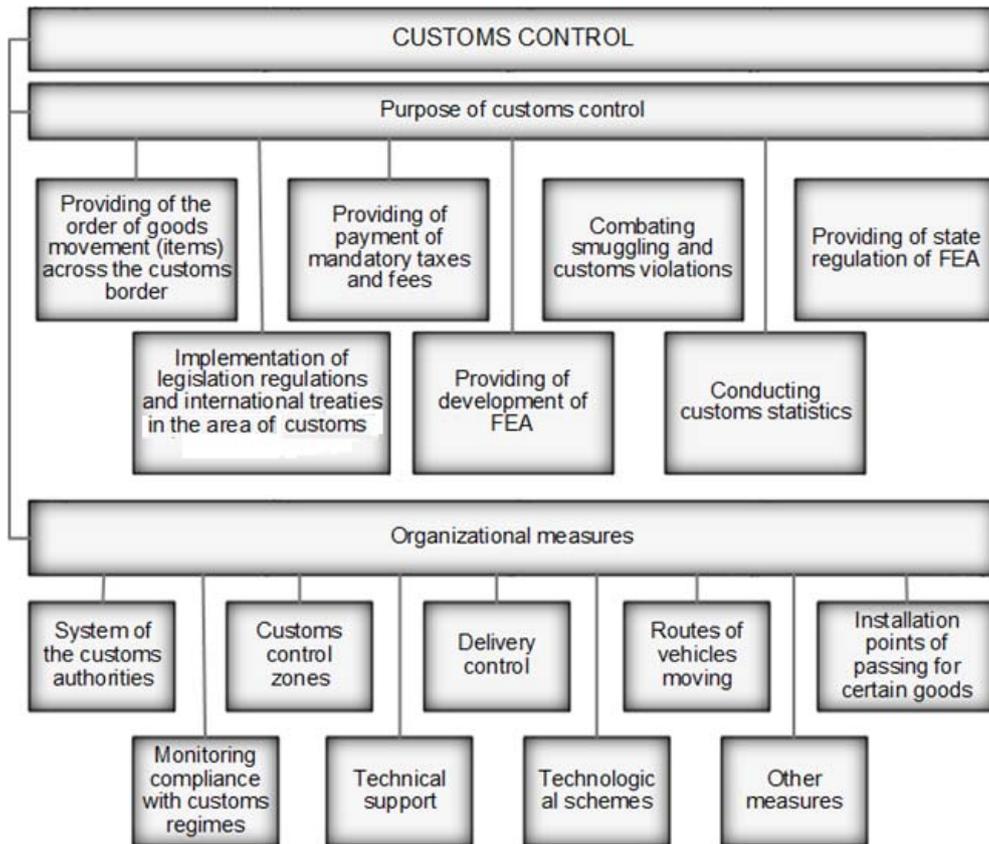


Fig. 2.1. Scheme of customs control organization

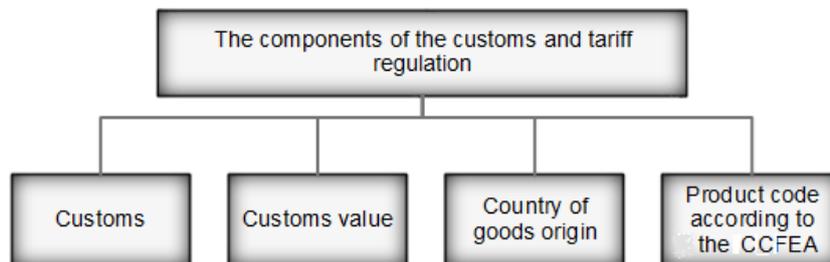


Fig. 2.2. The components of the customs regulation

Those principles underlying the customs regulations actually regulate the implementation of state customs policy in life and must be considered in the practical use of customs tools.

*Customs regulation* is based on the *following principles*:

- the principle of exclusive jurisdiction of the state to its customs territory;
- the principle of the exclusive competence of the customs authorities of the state on implementation of customs regulation;
- the principle of legality;
- the principle of a single order of goods and vehicles movement across the customs border;
- the principle of consistency;
- the principle of efficiency;
- the principle of observance of the rights and lawful interests of individuals and legal entities;
- the principle of openness and transparency.

The state territory occupied with land, territorial sea, internal waters and airspace covered by the exclusive jurisdiction of the state, constitute its *single customs territory*. And the borders of customs territory are the customs border of the state. In this case, it coincides with state border, except to the borders of territory of special customs zones, which are the customs border of the state.

In order to implement customs policy, the state customs bodies execute the following main objectives:

- 1) the execution and monitoring of compliance with the legislation of the state on customs;
- 2) protection of the economic interests of the state;
- 3) enforcement of obligations under international treaties of the state on customs matters concluded in accordance with legislation;
- 4) promotion of the protection of intellectual property of participants of foreign economic relations and other legal and natural persons;

- 5) application in accordance with the law of tariff and non-tariff regulation in moving goods across the customs border of the state;
- 6) implementing of customs control and customs clearance of goods and vehicles crossing the customs border of the state, improving the forms and methods of implementation;
- 7) monitoring compliance with the rules of the movement of currency values across the customs border of the state;
- 8) implementation, in cooperation with other competent public authorities, of measures to protect the interests of consumers of goods and compliance with the participants of foreign economic relations of state interest in the foreign market;
- 9) creating favourable conditions for commodity circulation and passengers flow through the customs border of the state;
- 10) combating smuggling and violations of customs rules;
- 11) development of international cooperation in the field of customs;
- 12) keeping of customs statistics;
- 13) keeping of national commodity classification for foreign economic activities;
- 14) implementation of the verification (to establish authenticity) certificates of origin of goods from the state [19].

For subjects of foreign economic activity, the cooperation with customs is especially important, which is the customs authority that directly provides the performance of legislation on customs affairs, collecting taxes and duties and other tasks entrusted to it. Customs operates within the territory defined by the specially authorized central body of executive power on customs practice. The forms of customs control are shown in Fig. 2.3.

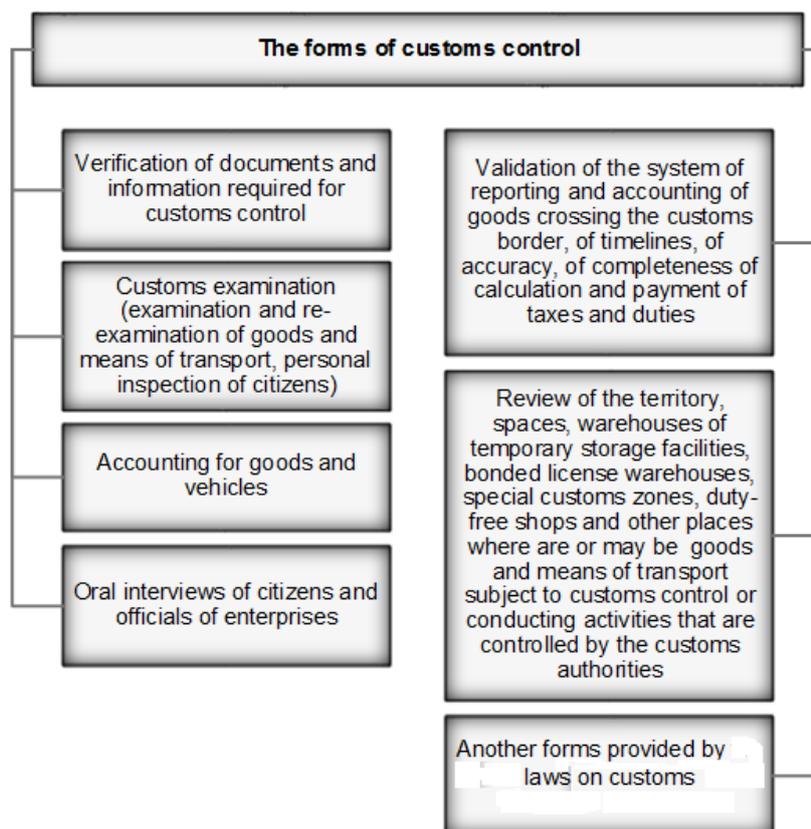


Fig. 2.3. The forms of customs control

An obligatory condition for the implementation of active foreign economic policy is the availability and efficient functioning of the mechanism of customs and tariff regulation. This allows customs authorities successfully implement the task of ensuring economic security and to protect the economic interests of the state.

Actual tasks of customs and tariff and non-tariff regulation arising from the overall economic situation of internal and external conditions for its development.

Allowing protect domestic producers and perform a number of international obligations (customs and tariff regulation is established by international agreements and conventions that outline the principles, conditions and rules of customs and tariff regulation), means of the state regulation of foreign trade activities require certain

restrictions in the activities of enterprises-subjects foreign economic activity in the performance of export-import operations.

According to the International Convention on the Harmonized System of Commodity Description and Coding from 17.05.2002 № 466/2002 states recognize global standards in the field, joined them and put them on the basis of national Commodity Classification for Foreign economic activities.

By this classification customs tariff is determined – namely import duty levied on goods imported into the state. The customs tariff is one of the most common components of the regulation of foreign economic activity in the world. Using it, most countries have successfully solved various problems of state regulation of foreign economic activity.

Customs tariff includes not only detailed list of goods subjected to tax duty, but duty rates, the method of its calculation, premiums or discounts to the basic customs duty rates, list of goods prohibited for import, export or transit through the territory of the state. Tariff rates are set by the government of the state through adoption of appropriate laws.

Customs tariff, while a systematized collection of customs duties and is the same for any and all economic agents, with the exception of a number of cases stipulated by international treaties or laws of the state.

When moving goods across the customs border of the state, are charged a specific indirect tax – customs or duty. Duty may be import (which is charged on goods imported into the country) and export (which is charged on goods exported from the country). Customs is always included in the price of goods and paid by their end users.

However, when goods cross the customs border, customs duty is paid by the importer of its working cash. As they are so distracted from circulation, it can fairly significantly affect the financial position of the importer-subject of foreign economic activity.

Customs tariff and rate, as shown in Fig. 2.4 simultaneously can perform several different functions that are quite closely related to each other.

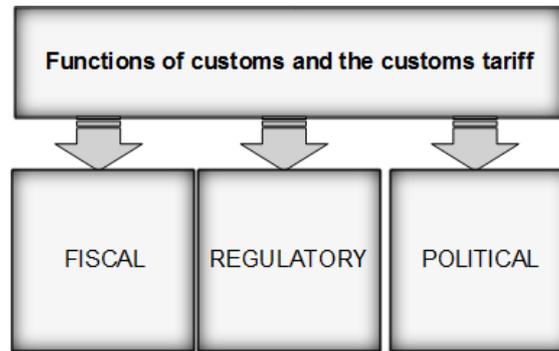


Fig. 2.4. The main functions of customs and the customs tariff

Fiscal function (the filling the state budget) is to:

- 1) create a barrier, which increases the price of goods and thus changes its competitive ability in the market;
- 2) filling the state budget;
- 3) encouraging the development of individual national companies or entire industries, mostly young (from serious competition with foreign producers to allow domestic producers to get stronger);
- 4) protection against dumping, which could be used by foreign producers to capture the market of another country;
- 5) stimulating the growth of employment.

The political function is to:

- 1) protection from competition of foreign goods (making conditions worse for competition of foreign goods on their own market);
- 2) ensure the defence ability of the state (in this case, the protective duty is intended to strengthen the national economy industry, specializing in the production of strategically important goods);
- 3) ensuring the integration of the country into the global market (facilitating access of national products to the world market);
- 4) the creation of appropriate conditions for the structural transformation of national economy to reduce dependence on foreign markets;
- 5) the possibility of putting pressure on competitors.

Regulatory function is to:

- 1) maintain an appropriate mix of public currency revenues and expenses;
- 2) stimulate certain goods movement flows and slowing promotion of others (it may refer either to specific groups of products or goods flow from specific countries);
- 3) influence the domestic pricing.

Despite a wide variety of functions of customs, major of them are filling the state budget (especially with regard to import duties) and protect its market against competition from foreign producers.

Thus, the fiscal can be achieved by large-scale use of low rates of duty on imports of consumer goods. On one hand, it encourages importers to import "white" (legal) imports rather than seeking opportunities to implement circuits using import "other colours and shades", on the other – to bring in a number of different products.

Otherwise, custom taxation can be used to relatively small group of products with high import duty, which also allows you to maintain customs revenues to the budget at a high level.

The protective function of the customs tariff is not only in cases of direct competition of domestic goods with foreign goods, but also, if necessary, in reducing foreign exchange costs in the unfortunate situation of the balance of payments (artificial increase in prices of imported goods in the absence of domestic analogues reduces the level of their consumption).

Implementation of the customs tariff increases revenues and protects national market. Thus, the use of low customs duties increases revenues for the state budget and the use of high rates strengthens protection of its own market.

Since customs regulations is an organic combination of the procedures of the application of the customs tariff, commodity classification and methods of determining the country of origin and the establishment of the customs value, the successful execution of their duties by the customs control is achieved by using all of its most important components.

To explore customs (duty) as an element of state regulation of foreign economic activity, it's classification should be conducted. For that purpose, different criteria and

approaches can be used, given its origins, impact, principles of limitations, methods of calculation and methods of application of customs rates, time of application, directions of movement of goods subject to customs duty.

Thus, customs duty simultaneously performs both essential functions.

Implementation of the customs tariff increases revenues and protects national market. Thus, the use of low customs duties increased revenues for the state budget and the use of high rates strengthens protection of its own market.

Given the impact of customs duty on the price of export or import of goods, the provision of domestic producers the possibility of obtaining additional revenue through higher prices for their products should be used differentiated approach to setting the customs for each individual product with its price on the domestic and international markets.

Due to the use by the various countries own competitive advantages in foreign trade and their specialization in the manufacture of certain types of finished or semi-finished products, their foreign trade policies diversify approaches to different products or their groups in matters of justification and setting the duties.

The custom duties can be established:

- higher than the difference between the prices at the national and international market (in this case, it protects the internal market making the access for foreign goods heavier).
- based on the difference between domestic and international prices (in this case, it fills the state budget and equalizing competitive conditions for goods with domestic production and imported).
- lower than the difference between domestic and world prices (in this case stimulates imports and customs rate based either very low or zero).

Since the size of customs duty is a quantitative index, it does not allow one clearly estimate the customs tariff as an element of the state regulation of foreign economic activity. In this regard, by the effect on foreign trade situation in the country, the customs should be distinguished as real and nominal.

If nominal duty gives an idea of the level of customs taxation of goods in the country in general, real customs shows the real condition of the state taxation. The real duty is determined considering the global and domestic prices and other factors that affect its installation.

Nominal customs can only have a positive rate. The real customs may have both positive and negative rate (when the customs tariff on imported components or semi-finished products exceeds customs tariff on finished products). Consequently, at the formation of the customs tariff rates, it is necessary to consider the interests of domestic consumers and producers.

To protect domestic producers and if there is a possibility of replacing imported products with domestic, import customs tariff rate on finished products should be set higher than the import customs tariff rate on components. And to protect domestic producers of semi-finished goods and components, with stimulating the market competition among producers of final goods, the rate of import customs tariff on finished products should be set lower than the import customs tariff rate on components. In this way, by providing incentives for the import of raw materials, semi-finished products and components are stimulated manufacturers of finished goods - exporters. Thus, a containment or encourage imports occurs, depending on the level of their processing.

According to the direction of movement of goods there can be divided into export and import customs.

**Export duty** is paid when exporting the goods outside the customs territory of the country and is installed on a limited number of products. It is settled primarily to restrict the export of certain goods outside the country by increasing their value after export from the country. This type of customs is relevant to living animals, scrap metal, oil seeds and leather.

**Import duty** is paid for goods imported into the customs territory of the country. As one of the methods of protectionism, import duties apply in almost all states, though it is not a universal tool for protectionism and to some extent reduces the level of welfare in trade countries.

For instance, in Ukraine there is a differentiated approach to charging customs on the following criteria:

1) origin from countries or economic unions that have the most favoured nation treatment in Ukraine (in this case international economic activity subjects in other countries or alliances have certain benefits to pay customs duties, except of those matters when specified duties and privileges as to their payment set out in within preferential treatment) apply preferential import duty rates stipulated by customs tariff of Ukraine;

2) the origin from the states, which are also with Ukraine part of a customs union or form a joint special customs zone (in this case, when you install a special customs preferential regime a preferential import duty rate is applicable);

3) for the rest of the products installed full import duty rates.

According to the accrual method, the following types of customs are used: ad valorem, specific and combined.

***Ad valorem duty*** is the main type of duty that is calculated as a percentage of the customs value of goods subject to customs duty. This type of customs is applied to those goods which are in the same product group, but have different characteristics. On the one hand, the ad valorem duty has always supported equal degree of protection of the domestic market, regardless of price change for goods. It always increases the cost of imported goods on a constant percentage of its price. On the other hand, anticipating the need for conduction of customs valuation of goods for the purpose of calculation and imposition of its customs, there is a subjective factor of customs control, which, considering the human factor is a cause of abuse and various violations of the customs officers.

***Specific duty*** is charged in the prescribed amount of money per unit of goods subject to customs duties. This applies to standardized products, but a fixed amount of this customs depends significantly on fluctuations in world prices. When at low level specific customs well protects domestic market, but at rising prices, the level of protection with help of this type of customs falls. At the same time, it doesn't give an

ability to manipulate their own definition of size and, therefore, does not create the temptation to abuse by the customs employees their official status.

**Combined duty** combines both previous kinds of customs taxation of goods. However, it performs protective and fiscal functions (protecting domestic producers and filling the state budget). The use of specific and combined customs prevents conscious understatement by subjects of foreign economic activities of the customs value of goods and evasion of customs duties.

In some cases, when crossing the customs border of the state, regardless of the other types of duties, they can be subject specific types of customs: anti-dumping, countervailing and special.

**The anti-dumping customs** applies when at the customs territory of the state goods are imported at the time of such importation at prices that are significantly lower than their competitive prices in the country of export, provided threatening damage to domestic producers competing with imported goods. This type of customs is also used when exporting goods from the state at prices that are much lower than the prices for these or similar products of other exporters in creating a threat of harm to the public interest.

The antidumping customs rates do not exceed the difference between the competitive prices in the countries of export and declared import price at the customs territory of the state or the difference between the price of goods exported from the state and the average price of similar goods or other domestic exporters.

**Special duty** is used as a protective when at the customs territory of the state the amount of imported goods is so high (or they are imported on some specific conditions), that there is a threat of injury to domestic producers of such or similar product.

Special duty is used as a powerful preventive measure against violators of national interests in foreign economic activity and with aim to combat unfair competition. It can also be used as a means of combating discriminatory steps other

states in cases of violation of rights and legitimate interests of domestic subjects of economic foreign agents.

The rates of special customs are determined for each individual case.

**Countervailing duty** is associated with the use of subsidies in the production or exportation of goods and is used when importing goods cause a threat of injury to domestic producers of the same or similar products or when at exporting goods a threat to the public interest is appeared.

Rate of the countervailing duty does not exceed the size of the product subsidies. According to the period of validity duty may be permanent and seasonal.

**Permanent duty** remains unchanged for the duration of its use. The vast majority of all customs duties belong to the permanent. This important fact enables businesses to efficiently plan their foreign economic activity.

To address a number of operational tasks on separate item temporarily, no more than four months, there may be established a seasonal duty. It is clearly protectionist in nature and can be considered as an exception to certain preferential customs regimes.

According to its origin, the duty may be autonomous or conventional. Without assuming any obligation to other countries, the state independently establishes and changes, depending on their needs and interests, independent customs. This duty is applied to goods regardless of their origin. However, it has a strong fiscal function. At the same time, independent customs may be a tool to achieve certain goals in customs and trade policies of the state even more than a source of fiscal revenue. To achieve mutual interests (through concessions in matters of appointment of independent duties on certain products or groups of products, in exchange for certain concessions from trading partners) rate of autonomous duty and the procedure for its application may vary, turning it into a contract (conventional) duty.

**Conventional duty** is agreed and it is established as a result of creation of a customs union or agreements with other countries. Consequently, it can't be changed unilaterally. Using conventional duties promotes international trade liberalization by

reducing trade barriers. The validity of such customs is long and ends when the transactions are terminated that caused its implementation.

Depending on the type of rating duties may be constant or variable.

In this case the regular duties may be understood as the duties in which rates are set by the government and not subject to change depending on various circumstances.

*Variable duty* is one in which the customs duty may be modified by changing the level of public subsidy and prices in the domestic or international market. Variable duty, usually is used by the States when world prices for certain groups or types of goods significantly change.

Thus, the prices of imported goods and the level of prices at the domestic market, which directly affect the results of financial and economic activity of enterprises, affect import duties rates.

## **2.2. Non-tariff regulation. The mechanism of implementation of quotas and licenses on export and import of goods**

Another essential element of customs and tariff regulation is the country of origin. It is determined to be able to apply the correct tariff and non-tariff measures to regulate imports of goods into the customs territory of the state and their export from this territory, and to ensure accounting of goods in foreign trade statistics [36].

The country of origin is determined in accordance with the principles of international practice.

However, under the country of origin everyone understands not only individual countries but groups of countries, customs unions, region or part of the country, if there is a need to allocate them to determine the origin. There is established three main options: recycling, the percentage composition, the list of goods for which the country of origin is considered to be, one in which it is made in full.

The goods wholly obtained in the country are:

- 1) minerals extracted in its territory or within its economic zone;
- 2) plant products grown and collected on its territory;
- 3) live animals born and raised in this country;
- 4) products derived from animals reared in this country;
- 5) products of hunting, fishing and sea fishing;
- 6) products of sea fishing extracted and (or) produced in the world oceans in ships or vessels of that country leased (chartered) by it.
- 7) recyclables and waste resulting from production and other operations performed in the country;
- 8) high-tech products obtained in the open space on the spacecraft belonging to that country or rented it;
- 9) goods produced in that country solely from products referred to above [93].

Processing or processing in the country considered sufficient when the goods that cross the customs border of the state are classified in tariff heading other than raw materials or products used to make them (and origin from other countries), or if the change in the cost of goods as a result of processing, the value added of not less than 50%. If for a specific product or country, the criterion of sufficient processing speed is not specified, then the rule applies under which the product is considered to be subjected to sufficient processing, if this was a change of classification code of the goods under the Harmonized Description and Coding System of goods on the level one of the first four digits.

When goods are produced under interstate cooperation, and then by their sequential processing of these countries are considered as one.

The main document that proves necessary information about the country of origin, is the certificate of origin. By the issuance of this document Chamber of Commerce confirms the country of manufacture of the goods. Belonging of product to any country can significantly influence the levying taxes and fees of the product.

To confirm the origin of the goods, the customs authorities may require a certificate of origin. When exporting goods where the certificate is required and this

is reflected in the rules of the country of importation or provided for by international agreements of the state. When importing goods certificate must be submitted in the following cases:

a) for goods that were produced in countries for which the state gives preference according to the Customs Tariff;

b) for goods imported from the country, that is regulated by quotas or other measures of foreign economic activities control;

c) if required by international agreements signed by the state in the established order, and domestic legislation in the field of environmental protection, public health, consumer protection, public order, public security and other vital interests of the state;

d) in cases when, there is no information about the origin of goods in the documents submitted to customs clearance and the customs authorities have reasonable grounds for believing that declared information about the origin of goods is false.

The certificate of origin shall clearly indicate that the specified product comes from the country and should include:

- written request of the exporting country of goods origin;
- written certificate of the competent authority of the country-exporter that has issued a certificate stating that the above information in it is valid.

The certificate of goods origin shall be submitted together with the customs declaration, the customs value declaration and other documents submitted for customs clearance.

If the origin of the goods is not defined correctly, they are issued by customs at the full rate. But if, within one year from the customs clearance, subject of foreign economic activity will provide the customs authority properly issued certificate of goods origin, then that product may be renewed MFN or preferential treatment.

In determining the country of origin, the origin of energy, machinery, equipment and tools used to produce it aren't considered. Thus, the features of origin of the goods exported from the territory of special (free) economic zones located in the territory of the state shall be established by law.

In the absence of a certificate of origin or additional information about the origin of the goods or the inability to clearly establish the country of origin, it is passed through the customs border of the state only after the payment of all fees at full rate.

Thus, proof of origin of goods affects the size of the duty and can either completely dismiss it or may have some impact on the use of certain non-tariff measures (quantitative restrictions in export-import operations in the state).

Modern customs and tariff regulation in any country was not created instantly. Together with the national economy and the instruments of state regulation of foreign trade, they have passed its evolutionary path.

*The customs value of goods crossing the border*

Customs value is an important part of the tariff regulation of commodities. Exercising customs control and customs clearance of goods and transport, this method of regulation is used in order to:

- impose import or export duties;
- conduct customs and foreign economic statistics;
- apply non-tariff regulatory measures (quoting, licensing, etc.).

In the vast majority of countries customs fees represent a percentage of the value of imported/exported goods. At the same time, value of the goods, which can be affected by various circumstances that accompany the delivery of the product, is extremely important for buyer. It is clear that in case the seller transfer goods directly to the buyer in his stock facilities in his country, the cost will be less than the value of the goods that the seller has delivered to the country of the buyer at his own expense. Although product is the same, but its price may vary significantly, depending on the conditions of transfer from the seller to the buyer. Hence, there is the need to equalize the rights of the seller and buyer both on customs valuation regardless of the delivery terms. This, in turn, requires a unified approach to the valuation of goods for customs purposes in different countries.

This approach should provide a unified customs valuation of goods supplied under different conditions of supply, despite the fact that the seller or the buyer actually bears the cost of the delivery of goods and pays customs duties.

In this regard, the way in which the customs valuation will be carried out is very important for each subject of foreign economic activity. Because the result of customs valuation will be the conclusion about economic feasibility of the transaction, a profit from it and other.

It is no exaggeration to say that the customs valuation is one of the most important issues of bilateral trade between countries.

This approach should provide a unified customs valuation of goods supplied under different conditions of supply, despite the fact that the seller or the buyer actually bears the cost of the delivery of goods and payment of customs duties.

In this regard, to ensure fair, equal and transparent customs valuation of goods under different conditions of supply, at the UN Conference adopted common rules for customs valuation and introduced the specified rate – the customs value. It is set as the price that actually paid or is to be paid at the time of product crossing the customs border of the country.

To determine the customs value the united criteria were worked out, namely: the moment of crossing the customs border and the transaction price (i.e. the price indicated in the invoice). Herewith, the size of the customs value of identical goods will be the same even if they come under different conditions of supply. Methods for determining the customs value and consistency of their use are presented in Fig. 2.5 and 2.6 [7].

The customs value of goods is a declared by the declarant or determined by customs authority value of goods crossing the customs border of the state and calculated at the time of crossing the customs border of the country.

Calculation of customs value is carried out primarily on the basis of the transaction price, i.e. the invoice value of the goods. Invoice (or contract) price – the price of goods, which is due in the contract and invoice.

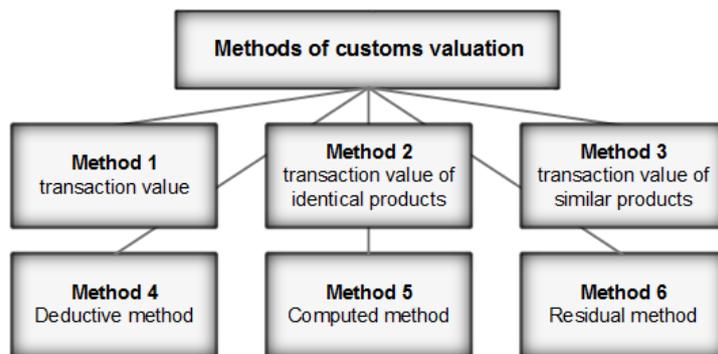


Fig. 2.5. Methods for determining the customs value

Further calculation of customs value shall be based on the terms of delivery of the goods in accordance with the interpretation of international commercial terms INCOTERMS, based on the fact what costs are included by seller to invoice and when they are made: before crossing the customs border or after.

In calculating the customs value of expenditures, that costs which are made before crossing of goods the customs border (if they are not included in the invoice) are added to the invoice value. This could include payment for the loading of the goods on the vehicle, paid export customs, insurance costs, etc.

The same costs that are made after the goods crossing the customs border deducted (if included in the invoice).

If you cannot determine the customs value on the basis of the submitted documents (no invoice, etc.), the customs authorities shall determine its own based on the prices of identical or similar goods, operating in major exporting countries of these products.

The customs value of goods and other items that cross the customs border of the state, in most cases, is the basis for the customs tax.

If country produces and sells a considerable range of goods is produced, imported and exported by various countries. In order to regulate the production and flow of international trade, it is necessary to distinguish the products between

themselves. In this regard, it was decided to create a systematic list of commodities and assign them numeric codes.

If each national industry has produced and exported (imported) a limited number of products (for example, only petroleum and petroleum products), there would be no need to create any special range of products. The sequence of application of the methods of customs valuation present on the Fig. 2.6.

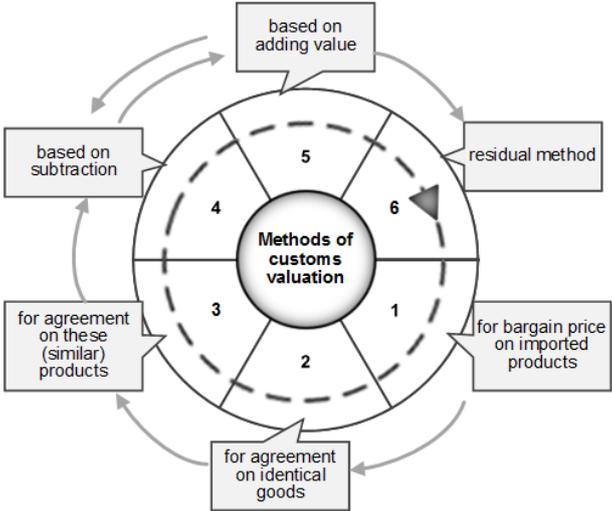


Fig. 2.6. Methods of customs valuation

Since there is a need for exporting and importing thousands of different types of products, without systematizing data from all of these products, it is difficult to distribute them, as descriptions of various commodities may overlap each other (for example, potatoes can be attributed to vegetables and foodstuffs). Only certain systematization allows you to avoid the likely difficulties in the classification of certain goods.

When the state introduces the number of means for regulation of foreign economic activities, such as licensing or duty rating, they do it with all their products

and without clear systematization it is not easy. To be able to distinguish different products, they should be systematized and classified.

This systematic list of commodities is Commodity Classification for Foreign Economic Activities (hereinafter CCFEA), where each product has its specific location. In product nomenclature all products are systematized in sections, sections are divided into groups, and groups – into products.

At the declaration of goods for customs clearance, it is important to fill in field 31 and 33 cargo customs declarations. In column 31 it is indicated the commercial and proprietary name of the product, its features, which include range, model numbers, sizes, types, standards, completeness, and other information about the product that make it possible to clearly classify it according to the code specified in item 33 cargo customs declaration.

As an example, in the Customs Tariff of Ukraine customs rates are given in accordance with the codes of products. Non-tariff restrictions mainly apply to the goods specified in the form of codes or headings.

Group structure in CCFEA includes the name of the section, code and the name of the group, code and name of goods position, code of the product, name of product, preferential, reduced and full rates of customs, and abbreviated designation of additional units of its measurement.

The elements of CCFEA structure are the system of coding and the classification system.

Coding is a presentation of the product as a digital sign. Code of the product in CCFEA consists of ten digits and is formed as follows:

- code group – 2 signs.
- code position – 4 signs.
- code subposition – 6 signs.
- code under subposition – 10 signs.

Structure of ten commodity code according to CCFEA is shown in Fig. 2.7 [7].

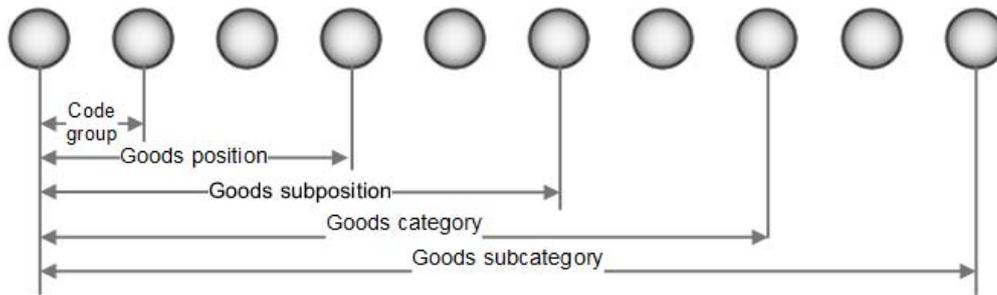


Fig. 2.7. Structure of the product code according to the nomenclature

So, in CCFEA all products grouped at several levels of information value. They are started from the level of the most general description of product categories and are ended by levels describe a particular product.

The customs value of exported goods is determined on the basis of the price that was actually paid or to be paid for the goods at the time crossing customs border of the state.

The customs value includes the actual costs that had not been included before. These costs are:

- payment for handling, shipping and insurance to the point of crossing the customs border of the state;
- commissions and brokerage fees;
- license and other fees for the use of intellectual property, which the buyer must directly or indirectly implement as a result of the sale or export of the estimated products.

The customs value of the goods exported from the state under a contract other than a contract of sale is determined based on the documented confirmed prices.

In case of price limitations to the export of certain goods (indicative price, limit price levels and prices, that are set as a result of anti-dumping investigations, etc.), the customs value of the exported from the country goods is determined considering application of these limitations.

It should be emphasized that the basis of the customs value calculation is the transaction value, which is actually paid or to be paid for exports goods if the price was not affected by:

- restrictions relating to the rights of exporter on the estimated goods;
- dependence of the transaction value and the trade itself on the conditions that cannot be considered;
- information provided by the declarant of the goods is not confirmed by the documents or is not reliable;
- if the exporter and importer are interdependent.

The customs value of the goods and the method of its determination are declared by the declarant to the customs authority at the time of the border crossing by the presentation of the customs value declaration.

Declarations are filled in the official language with using the computer.

In the foreign trade of today is used more than 600 document types. This manufacturing, payment and transport documents describing the product, containing information about its origin, quantity, quality, price and so on. However, preparation of various documents requires a lot of time and costs. Requirements related to the customs processing of the documents impede the border crossing, delaying the passage of goods and, because of it, increase the value of foreign trade operations. The way to reduce the costs is to use conventional international standards developed by the International Organization for Standardization. In addition, there is a need to adapt to the rules established in the importing country. In recent years, steps were taken to unify goods-production documents. In particular, a single package developed by the EU. It includes a certificate of origin, declaration and notification to import, a certificate of preferences, message about sending, shipping invoice, and instructions for completing the documents.

Cargo Customs Declaration – a written statement which includes information about products and other objects and vehicles, the purpose of their movement across the customs border or information about changes on customs regime for these products

as well as information required for customs control and customs clearance, keeping customs statistics, calculation of customs duties.

It is made as a prescribed form, namely, CD-2, CD-3, CD-8.

Cargo Customs Declaration does not apply to goods with customs value up to 100 euros (excluding goods subject to export control and import goods for which excise duty is set).

Customs registration card – confirming of registration (accreditation) of the subject of foreign economic activity at the customs authorities of the state. Required when making any transactions with the customs authorities.

**Customs value declaration** – a statement of the customs authority in the prescribed form that consist information on the customs value of goods crossing the customs border or in relation to which customs regime is changed.

**Previous Declaration** – a document that contains information about the goods imported to the country (for any purposes other than transit). Filled in the form of unified administrative document form CD-2 (CD-3).

It is not a Customs Cargo Declaration previous declaration is used exclusively as an instrument of control over the delivery of goods to the customs office of destination.

**Consignment note (International Automobile note, CMR)** is a document that accompanies the vehicle. Indicates a contract for the carriage of goods.

**Railway consignment note (SMGS)** is main transportation document with fixed established form, pursuantly issued and granted to railway by sender with cargo. Consignment note is a form of compulsory written bilateral agreement on shipping, which is concluded between sender and railway in favour of a third party – the consignee. It is also the contract of pledge for insurance, proper freight fees payment and other charges for transportation. Railway consignment note is accompanying cargo transportation all the way to the destination station.

**Aviation cargo waybill (Air Waybill)** is a document indicating the contract of carriage of goods and other objects by air, terms of carriage and acceptance of goods and other items for transportation.

**Bill of Lading** – the document that regulate the relationship between the carrier and the consignee of cargo, indicates acceptance of the shipment by the carrier, details of which are given in the bill of lading and is one of the documents confirming the contract of sea carriage.

The bill of lading includes:

- name of the vessel, if the goods are accepted for carriage on a specified vessel;
- name of the carrier;
- place of acceptance or loading of cargo;
- name of the sender;
- destination of the goods or, in case of charter, destination or direction of the vessel;
- name of the consignee (straight bill of lading);
- endorsement (order bill of lading);
- bearer (bill of lading to bearer);
- description of the cargo, its labelling, the number of seats or the number and/or measure units (mass, volume), and if necessary – the data on the external appearance, condition and special properties of the cargo;
- freight and other carrier charges or links that freight should be paid according to the terms set in the voyage charter or other document or mark that freight is fully paid;
- time and place of issue of the bill of lading;
- the number of stacked copies;
- captain or another representative of the carrier signature.

The carrier should issue to the sender at his wish a multiple instance of the bill of lading of the same meaning. By the way, each of them contains number of stacked copies of consignment. After issuing a load on one of the instances of the bill of lading, the remaining copies lapse.

Bill of lading is transferred according to the following rules:

- a straight bill of lading may be transferred by endorsement or registered in another form in accordance with the rules established for the delegation of debt;
- order bill of lading can be transmitted by full or blank endorsement;
- bill of lading to bearer may be transferred by mere delivery.

Load releases in the port of destination on:

- a straight bill of lading to the consignee indicated in the bill of lading, or the person to whom the bill of lading has been transferred for a nominal endorsement or in other form in compliance with the rules established for delegation of the debt;
- order bill of lading – to the sender or the recipient, depending on the drawn bill of lading either "shipper's order" or "consignee order", and in the case of a bill of lading endorsement – to the person named in the latest of a series of continuous endorsement or bearer of the bill of lading with the last blank endorsement;
- bill of lading to bearer – bearer of the bill of lading.

**CARNET TIR** is a document that indicates the transport of goods and other items under the terms of the TIR Convention, 1975.

It can be applied for the goods transportation using the road transport. The presence of the TIR Carnet confirming approval of the vehicle for the carriage of goods under Customs seal and validity of the financial guarantee.

It gives reason to customs authorities to put a claim to the national guaranteeing association (AsIAC) if goods are not shipped to the customs office of destination.

*Certificate on admission of the vehicle for transportation.* In the carriage of goods by road transport carriers – residents of the state are allowed to conduct the carriage under customs seal provided that they have:

- licenses of state authorities to conduct international transport carriages by road (except for shipments to CIS countries);

- and the certificate of approval of road vehicles for the carriage of goods with customs seals issued by the customs authorities of the state.

In case of road transportation using the TIR Carnet availability of the certificate is required.

*Cargo Customs Declaration type "31 PS"* is a document that is used to control multiple crossing the customs border by water vehicles that belong to the residents of the country.

Each cross-border movement of the vessels through the customs border is subject to submission of the fourth copy of the declaration through the border checkpoint of the state. After completion of border control, the instance of declaration returned to the applicant for safekeeping.

Cargo Customs Declaration type "31 VTZ " is a document that is used to control for multiple moving through customs border water vehicles belonging to residents.

Each movement of water transport across the customs border is subject to submission at the checkpoint border of the state of the fourth copy of the declaration. After completion of border control, the instance of declaration returned to the applicant for safekeeping.

*Documents proving the cost of delivery* of the goods used in commercial practice for preparation of appropriate agreements and declarants use them to determine the customs value of goods.

As these documents may be considered:

- document defining the relationship of the parties in the agreement for shipment services from the place of departure to the destination;
- invoice of the shipment agreement contractor, which contains details of the parties, the amount and terms of payment, and the subject of payment;
- banking payment documents proving that payment for the delivery of services in accordance with the invoice.

***Invoice*** is a document that accompanies goods and other items moved across the customs border to indicate their value and allows them to be identified. This document is used for conducting reciprocal payments between agreement contractors, and it is

the basic document by which the declarant determine the customs value of goods crossing the customs border.

**Proforma Invoice** is a commercial document that contains information about the product's price but is not used for making payments for goods (barter, consignment, order supplies, raw material, finished products, exhibitions, fairs, etc.). It is the basic document by which the declarant determines the customs value of goods crossing the customs border.

**Foreign economic agreement (contract)** – materially issued agreement between two or more subjects of foreign economic activity and their foreign counterparts, unless otherwise provided by law or an international treaty of the state, and aims to establish, change or cease their mutual rights and obligations in foreign economic activity. For foreign economic activity the contract is filling in writing form.

**License** – duly prepared right on exports (imports) of certain goods within the prescribed period. It is issued by the state regulative body and submitted to customs authorities at the time import declaration of goods subject to licensing.

**Veterinary health certificate** of the country of origin must necessarily contain information about the specific recipient of goods in the state and is one of the conditions for the importation of goods subject to veterinary inspection on the territory of the country. Veterinary certificate certified with numbered seal and personally signed by a specialist of state veterinary control and imprint stamp "Upload and customs clearance at the border state veterinary control".

**Veterinary certificate** – a document issued by the specialists of structural units of regional services of the state veterinary control the local places of clearance after the veterinary – sanitary examination and is one of the conditions for the customs clearance of goods under control. Form of the veterinary certificate (F1, F2, F3) depends on the type of controlled goods. The procedure for issuing veterinary certificates and list of controlled goods, divided by type of veterinary certificate is appropriately approved.

**Phytosanitary certificate** is the basis for entry into the customs territory of the country and the customs clearance of regulated articles. Phytosanitary certificate is issued by a state authority of the exporting country with the quarantine and protection

of plants. Importation of regulated materials from countries that don't have public bodies on quarantine and plant protection, is allowed without phytosanitary certificate with previous permission of state head quarantine, which established specific requirements for their importation and use.

*Quarantine import permit* is the basis for entry into the customs territory of the state and the customs clearance of under quarantine materials and objects. Quarantine import permit is issued by the State Inspectorate for Plant Quarantine. Shipping across the state border is allowed only through a particular point(s) of admission indicated in the quarantine permission. The term of the permit no more than six months. Payment processing is carried out by a quarantine permit rate.

Depending on the type of product and the conditions of admission, one should present to customs:

- approval for the import of products that may contain ozone-depleting substances;
- permission (license) to import environmentally hazardous goods or wastes;
- permission to import goods that were in use in accordance with the Regulations on the Control of Transboundary Movements of Waste utilization / Disposal;
- permission to manufacture, storage, transport, use, destruction and disposal of toxic substances, including toxic industrial waste, biotechnology products and other biological substances;
- conclusions on compliance with applicable laws, rules and rules on nuclear and radiation safety in exports (import) of radioactive materials – for transportation through the customs border ionizing radiation sources;
- approval of executive authority in the field of environmental protection when importing scrap metal;
- permit the transport of radioactive materials.

Import of medical supplies, medical equipment and immunological drugs used in medical practice is permitted in the presence authorization document of the State Service for Drugs and medical devices.

The reason for importation may be the following documents:

1. When importing the medical products, medical equipment:
  - proof of state registration for registered products in the country;
  - one-time permission for unregistered products in the country;
  - conclusion about the possibility of application in medical practice in the country for unregistered products.
2. When importing immunological preparations:
  - proof of state registration for registered products in the country;
  - one-time permission for unregistered products in the country.

The reason for the customs clearance of the drugs imports using the VAT benefits is confirmation of state registration for products registered in the country and the availability of goods in inter-agency database of medicines registered in the country.

Enterprises, with the one of the types of which is a medical practice must additionally present during customs clearance license for medical practice and a copy of the license, certified in the prescribed manner.

*Single (individual) license* is applied to each foreign economic operation of a subject of foreign economic activity to whom the special sanctions are used.

*Certificate of origin* is a special document that is used to confirm the country of origin. The certificate is issued by the competent authorities of the exporting country and is used as one of the grounds for the application of the preferential rate of the customs duty (if it may be applied to the country of origin). Providing the certificate of origin to customs office is the best option for the declarant. This document is considered as the basic customs document that clearly proves that the mentioned product originated from a particular country. Certificate of Origin is provided with cargo customs declaration when declaring goods.

The origin state can also be defined on the basis of other documents (according to the data specified in the invoice, proforma invoice, waybill, packing list, shipping specifications, certificates of compliance, quality, veterinary, etc., export customs declaration, exporter written statement (shipper) and others that accompany the

product. In such cases, it is recommended to direct exporter (shipper) on the necessity for specifying in a "commercial" or other documents information about the country of origin of each particular product.

The prerequisite in such cases is the matching of data specified in the shipping documents with actual data set by Customs during customs inspection.

In case of the absence in the product accompany documents information on the country of origin, it is allowed to establish the country of origin on the basis of information (marks, labels, stickers) placed directly on the product or related to it (passports, technical documentation, conclusions, customs examination and other competent authorities, etc.). This condition may be applicable only in the case of customs examination supported with the act of customs inspections in a due course. If the product contains other information about the country of origin than those specified in the documents that accompany goods, the country of origin should be confirmed by a certificate.

If the product or the product accompanying documents contain other information about the country of origin than those specified in certificate, the country of origin of goods is recognized on the basis of the data of certificate. In such cases a written explanation of the certificate issued body or exporter (manufacturer) of the product must be submitted to the customs explaining the reasons for such discrepancies in the information about the origin. If this explanation is not presented, the country of origin is determined based on the product labelling. In some cases, in accordance with the formalities provided for by the law certificate of origin is required in any case.

### **2.3. Non-tariff regulation**

For certain types of goods quantitative and value limits are established on their cross-border movements – so-called regime of licensing and quotas.

Export (import) quota is a limited number of certain categories of goods (quantitative limitation) defined in physical and value units, which is permitted to be

exported from the territory of the country (import into the territory of the country) within the prescribed period.

There are the following types of export (import) quota:

- global – quotas on goods that are installed without specifying certain countries where this product is exported or imported from;
- group – quotas on goods, applied for a list of certain countries of export or import of the product;
- individual – quotas on goods that indicate some specific countries of export or import of the product;
- anti-dumping;
- countervailing;
- special.

For each type of product can be installed only one type of quota.

Quoting is realized by issuing individual licenses, moreover total volume of exports (imports) for such licenses shall not exceed the amount of the quota.

The decision to introduce licensing regimes and export (import) quotas is taken by the appropriate state body with annual suggestions for the goods (works, services) that are subject to licensing, terms of this regime and its publication in the official public media.

***Export (import) license*** is a permission to export/import goods within a specified time limit.

There are the following types of export (import) licenses:

- general is an open permit to export and import certain products (products group) with a particular country (several countries) within the prescribed period of the licensing regime;
- individual or single – a nominal one-time permit is issued for each export and import specific subject FEA for the period of such transaction;
- open individual – a permission to export and import operations within a specified period (not less than 30 days) determining the total amount of goods.

The licensing and quotas for export and import take effect only after 60 days from the date of official publication.

Cross-border movement is carried out exclusively through the customs office specified in the license.

A copy of the license obtained by the subject of FEA attached to the customs declaration and is the basis for customs crossing permission of goods falling under the licensing and quota system.

There may be the following non-tariff measures in addition to the mentioned above:

- contracts registration;
- authorization of the ministries and agencies with the necessary authority to permit certain products;
- standards and requirements for commodities;
- quality characteristics of goods;
- health and safety standards, hygiene requirements;
- environmental protection requirements;
- increasing requirements for packaging and labelling.

Methods of non-tariff regulation are presented in Fig. 2.8 [19].

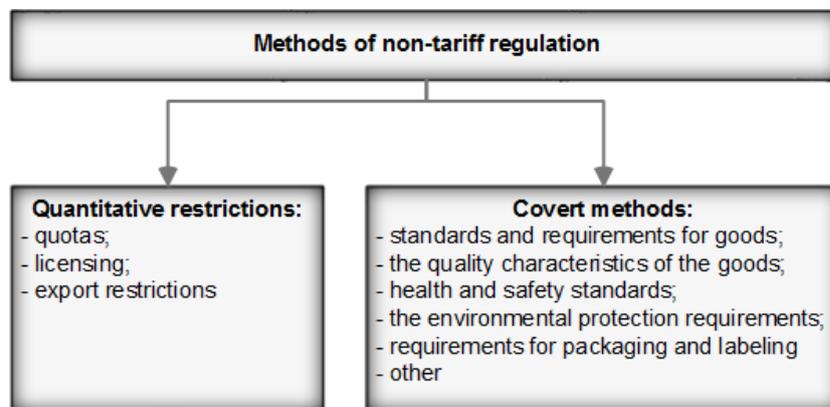


Fig. 2.8. Methods of non-tariff regulation

Among all non-tariff barriers, the most popular are import quotas or quantitative restrictions of foreign products volumes that are allowed to import into the country annually. The state issues a limited number of licenses allowing the importation and prohibits the unlicensed importation.

If the licensed import amount is less than the demand in the domestic market, the quota doesn't only reduce the volume of imports, but also leads to an increase in domestic prices above the world ones for which license holders buy goods abroad.

In this situation, the import quotas are similar to tariff restrictions.

As an example of such quotas can serve an agreement between Ukraine and the European Union on Coal and Steel Community in 1995. According to this agreement, the supply of rolled metal from Ukraine to the EU may not exceed 190,000 tons. In addition, quotas are set for certain positions (flat steel, beams, thick sheet).

Licensing is the most common instrument of imports (sometimes exports) regulation. License – is a permission to import or export different products and services.

Subjects of licensing:

- products, works and services of national importance;
- export or import depending on the country;
- products of the enterprises engaged in unfair competition or causing losses to the state through their actions.

For example, in Ukraine, the licensing and quota system for the first time was applied to exports of goods in 1992 (75 items). Then in 1993, the regime extended to 32 items. In early 1994 the regime of quotas and export licensing extended to 31 heading. Licensing of 17 items. Regime of quotas and licensing for import of goods – 7 position (groups), licensing for import of goods – 4 items. At the end of 1994 quotas and licensing regime for export of goods was used to 5 product groups (grain, coal, waste and scrap of precious metals, ferrous metals, cast iron). In 2005, quotas and licensing regime for export of goods remained at the level of the year 2004. Licensing regime for imports of goods distributed into 4 product groups (slag, chemical pesticides, pharmaceutical products, veterinary products, fertilizers, cosmetics and personal care products).

The list of goods that are subject to export quotas and licensing include: ores and concentrates of precious metals, precious and semi-precious stones, precious metals, waste and scrap of precious metals and deprecated metals. In this case, the export quota of ores and concentrates of precious metals is 1 ton, processed or unprocessed diamonds, but unmounted and not rounded – 200 thousand carats of precious stones (other than diamonds) and semi-precious – 20 thousand pounds; precious and semi-precious stones synthetic or regenerated – 180 kg. Silver (including plated with gold or platinum) unwrought or in powder – 2,700 kg; gold (including galvanized platinum) unwrought, semi-manufactured or in powder – 180 kg, platinum – unwrought, semi-manufactured or as powder – 300 kg; wastes and scrap of precious metals and deprecated metals – 50 thousand kg; coins (with precious metals only) – 450 kg, amber – 50 kg, amber products – 1000 kg, cooking and cutlery, containing at least one product covered with precious metals – 1,500 kg.

*Implementation of quotas and licenses for export and import of goods*

The effectiveness of licensing and quoting system and its impact on the national economy depends on the procedure of granting the right to perform the export or import of the goods, that is the quotas and licenses granting.

In terms of transitive economy, the state has to determine the order of licensing and quotas, based on the position of the subject.

Licenses distribution is held:

1. According to the system of a clear advantage.
2. By «cost method».
3. Competitive auction.

According to the system of a clear advantage state licenses certain companies without prior applications or negotiations. Most of these licenses are provided to the most reputable companies (or direct producers) in an amount corresponding to their share in the total value of exports of the products of the country. An example of this type of distribution is the distribution of petroleum import licenses in America in 1959-1973 years when import licenses, that brought billions in profits annually by raising domestic prices, were distributed free of charge among oil companies on the basis of their share in oil imports before 1959. This practice had a political goal, which was to compensate the reduction of permitted imports to companies oriented on foreign

oil. It reduced the danger of lobbying pressure towards elimination of import quotas, which were primarily supported by U.S. firms that compete in the domestic market with imported oil. In this example, the redistribution of income has been made in favour of the oil companies, which generally did not give any benefit to the country. In Ukraine, this system is used in the allocation of licenses for the export of goods.

By providing license by the "cost method", the state makes applicants compete on non-price basis. For example, "sooner you came – sooner you got". It leads to the fact that licenses get the economic agents, that are "closer" to the licensing structures. Others spend time in queues for processing different paperwork and etc.

Another example is the licensing of the industrial raw materials import depending on the amount of production capacity. It leads to resources losses due to excessive investment in equipment, which is usually not used, but is only available to get more licenses. Hence, it requires support of applicants claims, resulting in significant time and money loses to establish contacts with government decision makers and to bribe them.

Most fair and efficient way is the competitive quotas auction. Auctions can be open and closed. All interested economic operators may participate in a public auction. In Ukraine, the auctioning of export quotas is made on a stock exchange weekly.

So far in the trade community there are three ways to obtain quotas or licenses for exports of goods: receipt of the public procurement or state contract in which the quota and licenses are issued free of charge; you can get the export quota and license at the Ministry having payed full export duty and you can buy quotas at auctions and get a license free of charge.



### **Issues for self-control**

1. Justify the importance of the certificate of origin of goods.
2. Describe customs control and customs clearance when implementing foreign trade.

3. What information includes permission of the environmental control bodies?
4. Describe the means of regulating foreign economic activity.
5. Name the main tasks of non-tariff regulation.
6. What are the hidden methods of non-tariff regulation?

#### **Materials of practical classes**

1. Instruments of customs and tariff regulation of foreign economic activity.
2. Customs tariff in the system of customs regulation.
3. Functions of the customs tariff.
4. List and features of documents used in foreign economic activity
5. Determination of the complete package of documents when transporting goods by different modes of transport.
6. Characteristics of the system of non-tariff regulation.
7. Purpose of application and tools of non-tariff regulation.

#### **Questions for independent work**

1. Methods of determining the customs value of goods.
2. Types and rates of duty.
3. Customs clearance of goods at the crossing of the border.
4. What information is indicated in the cargo customs declaration?
5. Analyse the "fullness" of the documentation.
6. Analyse the main reasons for the state's use of the export licensing system.
7. What causes influenced the active use of non-tariff barriers in the second half of the XX century?

### 3. NEGOTIATION PROCESS IN FEA



#### KEY TERMS AND CONCEPTS

✧ <i>Foreign trade operation</i>	✧ <i>Business negotiations</i>
✧ <i>Contractor</i>	✧ <i>Functions of business negotiations</i>
✧ <i>Basic delivery terms</i>	✧ <i>Force majeure circumstances</i>
✧ <i>Criteria for the classification of firms</i>	✧ <i>Business protocol</i>
✧ <i>Sanctions</i>	✧ <i>Dossier on the firm</i>
✧ <i>Contractors</i>	✧ <i>Contradictions in the negotiation process</i>
✧ <i>Reclamations</i>	✧ <i>Arbitration Court</i>
✧ <i>Preamble to the contract</i>	✧ <i>Stages of business negotiations</i>
✧ <i>The price of the contract</i>	✧ <i>Strategies of business negotiations</i>



### **3.1. Business negotiations and their peculiarities in the process of foreign economic activity implementation**

In the process of foreign trade transaction counterparties enter into business negotiations with partners, potential customers and suppliers, transportation, insurance companies and others.

The success of any negotiations depends on the art of conducting, the ability to predict the situation, especially the mentality of business partners, the correct choice of strategy and tactics of business communication.

The ultimate goal of business negotiation is a common activity. To achieve the result, it is important to assess the psychological characteristics of the business partner, choose the strategy, tactics and method of business communication.

Meetings and negotiation with business partners are the basis of business protocol. Protocol is a set of behavioural rules, norms and traditions in formal and informal meetings. There is a clear system of organization and planning meetings and negotiations.

You should arrange a business meeting for 1-2 weeks prior to the date of its implementation, if the partners are on different continents meeting dates may be announced in 3-4 weeks. The venue of the meeting can be a place in the exporting country, the importing or third side country place.

Business meeting should be planned according to the program of the meeting. Business communication of partners can be of formal and informal character.

The meeting program usually includes: the procedure of the meeting, a personal membership and participation of the press representatives, presenting flowers, greeting speech, hotel accommodation, business part, cultural program (visiting places of historical and cultural tour of the country), informal receptions, etc.

Protocols of the meeting shall contain the following main agreements:

- subject of the business meeting;
- place of the meeting;

- time of the meeting;
- participants;
- materials for discussion and final meeting materials.

Functions of business negotiations:

- Informational. Typical for negotiations that are preliminary. In the process of conducting preliminary negotiations, the parties exchange with views and information, develop options for future cooperation and so on. Preliminary negotiations may be one of the stages of preparation for the conclusion of foreign trade contract but may not have their continuation in collaboration between the participants.
- Agreement achieving. A feature that is implemented in an environment where partners have the necessary information, sufficiently well-defined positions of the parties, potential conflicts were not analysed that may arise during the execution of the contract and their coordination mechanism is not developed.
- Regulation, supervision and coordination. The functions are implemented where necessary to further monitor the implementation of joint decisions.

In the course of foreign economic contract execution, the possibility of contradictions and conflicts between partners cannot be excluded, the reason may be such factors as psychological characteristics of partners (different values, attitudes, perceptions, habits, etc.) and bad coherence in the arrangements during some moments of the transfer obligation originated from one partner to another.

In business communication different possible positions of the parties, which are determined by the business development strategy of each party and their views on ways of resolving conflicts are possible.

There are two main approaches to resolving conflicts:

- 1) partnership;
- 2) confrontation.

Partnership approach is based on finding a mutually beneficial solution.

Confrontational approach to business communication very often leads to the fact that the parties forget about the benefits of co-decision, attempting to demonstrate their strength and advantages. One way to resolve conflicts is bargaining, in which the partners are trying to get maximum benefits with minimal concessions. Confrontational approach is characterized by the use of different methods of pressure, including blackmail and threats, distortion of information.

Confrontational approach is based on subjective assessments of partners and personal traits of each of the partners. Very often the decision is made under the influence of perseverance, the dominance of one of the partners.

Any communication involves three major steps:

- preparation;
- negotiations;
- analysis of results and implementation of the agreements.

The most important stage of business communication is preliminary preparation, as it is the first step on the way to make and implement foreign trade contracts. At this stage people with whom it is necessary to conduct business negotiations and matters that must be solved are defined. The list of business partners is determined on the basis of previously collected information about the company and its leader, financial condition, reputation, activities, company partners, prospects and intentions and so on. The more complete information you collect, the easier it is to plan the future negotiation tactics, efficiently balancing with partner and confrontational tactics and approaches to their implementation.

Through the collection of information about his future counterpart, each partner should prepare information about himself, giving it to his partner in small doses. The more accurate and comprehensive is your own information, the less chance that the partner receives distorted information from other sources.

Information about their activities should cover the main aspects of the company, preferably with opening most important achievements, major developments, results of cooperation with major contractors, cooperation guarantees, the reliability of the

company. Information should be positive and must convince partner about seriousness of the intentions of entering into business negotiations and reliability with respect to fulfilment of contractual obligations.

Programme of business communication preparation includes:

- analysis of the problem;
- formulation of goals, objectives and positions in business communication;
- identification of possible solutions to the problem;
- preparation of proposals and arguments in favour of these proposals;
- drafting the necessary documents and materials.

The negotiation process can be divided into three stages:

- mutual clarification of interests, perspectives, concepts and positions;
- discussion, debate, arguments, and provide reasons for their proposals;
- coordination of positions and making arrangements.

Presented steps can be implemented at different times, and several steps may be performed simultaneously.

Mutual clarification of interests, viewpoints, concepts, attitudes is very important in view of the need to understand the essence of the same category, partners will operate with during business negotiations, the content of the agreement and the outcome of its implementation. This stage acquires particular importance in the condition when the partners are residents of different countries and speak only the languages of their countries. The success of negotiations in such a situation is determined by the professional and cultural level of the interpreter fluent in the same language of both partners and acknowledged with the nuances of the language, neglect of which can lead to future misunderstandings.

Under discussion parties seek to consider their own interests. It doesn't exclude the potential for the greatest number of misunderstandings and conflicts. Partners should have the means and methods to resolve the misunderstandings and avoid conflicts. The most common way of resolving the misunderstandings is negotiations transfer to an informal environment.

At the stage of coordination, the most effective way is to agree on common fundamental issues, and then discussing the details.

### **3.2. Strategy of business negotiations and methods they may be conducted**

In practice business negotiations three strategic approaches are used:

Hard is characterized by a partner's commitment, uncompromising positions, rigid solutions. Partners, defending their own interests, resort to tactics, the results of the use of which is a maximum result with minimal concessions to the partner.

Soft, which is based on the principles of kindness, gentleness. Partners, revealing their position and point of view on the subject of negotiations, give part of their self-interest to avoid confrontation. This strategy eliminates the possibility of the use of pressure, threats and blackmail. Using this strategy can delay the negotiation process, reduce the profitability of its results on the size of the concessions, grant agreements vague and obscure features.

Principle, based on a rational and wise use of the ratio of the two previous strategies. The main goal of using this strategy is to achieve the desired result. Tactics, by means of which the strategic goals are realized, include a set of methods from partnerships to confrontation.

Depending on the approaches, used in the negotiation process and the chosen strategy, different tactics can be applied:

Opening position provides that a party clearly defines its objectives and interests, revealing their views and positions.

Closing Position provides that partners do not reveal their explicit intentions regarding future agreements, provide incomplete or incorrect information in pursuit of certain unilateral advantage of the situation.

Emphasis on the community position emphasizes the same vision of the goals and interests of the partners in the process of negotiations. Highlighting differences between the parties may focus on different visions of the process and its outcome.

Backtracking a method that is used by a partner, motivated by a desire to shift the negotiation in the absence of the necessary information to complete them, the need for additional support for the final decision, the weakness of his position, the reluctance to continue the negotiations because of their continued futility and more. When using this tactic partner primarily raises proposal to postpone the discussion, switches to discuss another issue, delaying negotiations with excessive details, constantly involves in a negotiation process information, that is not related to negotiation.

Waiting - a tactical approach that provides that one party tries to predict partner's intentions without disclosing his own position.

The method of "salami" – the gradual disclosure of their intentions with extremely small amounts of information.

"Overpriced own capabilities" – giving the exaggerated form to the own abilities of the company. It is used when negotiating with low-skilled partners or representatives of the companies, whose image is much lower.

"The nomination of requirements at the last minute" – a technique designed for adopting amendments to the already formulated and agreed terms with less time-and labour costs. The basis of this tactic is the belief that the latest requirements will be accepted without much discussion in the hope of saving already reached agreement.

"Bundling" – method, using which favourable and unfavourable to partner decisions are taken in a package at a time.

"Bluff" – method, based on pre-submission of false and exaggerated information to influence the position of partner.

"Understatement" – method, by which the partner does not disclose its position with reference to the confidentiality of commercial information.

"Conscious negative evaluation of the partner's positions" is used in case of the partner's position rejection and is demonstrated in the public announcement of his attitude. In some cases, this technique in conjunction with other methods can be used as a part of psychological attack, as a means of pressure on the partner. When using this technique partner resorts to saying: "how could you", "it is in the public," and so on.

The practice of conducting business negotiations is not limited only by the mentioned tactics. Depending on the particular subject of negotiation, opponent's mental characteristics, the degree of preparedness for negotiations, the amount of information on partners, guarantees of obligations fulfilment to each other there can be also used special tactics, such as an open demonstration of their benefits, blackmail and more.

Tactics can be used separately or in combination depending on the stage of the negotiation process, the impact of previous tactics.

One of the most important tasks of any negotiations is to convince a partner in the proposal feasibility. The offer should be compelling, economically, technologically, organizationally justified, sound and it should have distinct advantages of its implementation for both partners. It will be adopted and implemented by the future partner only with the presence of such features. The decision of negotiations can be made by partners using different methods, the most common of which are:

Persuasion. Can be used in the position of mutual agreement on the fundamental issues of the agreement. Further disclosure of the benefits, the provision of additional information enhances the confidence of partners in the decisions correctness. It corresponds to the most efficient method of business communication, as it provides unity of positions of partners on the negotiations results.

Suasion – can be applied in case of in different positions of the partners concerning the result of negotiations. This method may be implemented using the tactics based on the provision of concessions, compromises, additional benefits.

Coercion – achieved through the use of pressure, threats, blackmail.

In the process of business communication different forms of persuasions are used: interpreting speech, dialogue, explanatory memorandum, business letters, articles, brochures and more.

The conviction must have a clear logical structure of the content and include the following elements:

- precise formulation of the main ideas;

- proof of the importance and usefulness of the proposals and their benefits to partners;
- proof of the reality and attainability of proposals;
- justification of expenses and means for implementation of the proposals;
- summary – formulation of main idea.

During business communication you have to deal with different cultures and countries. Differences in styles are defined not only by national characteristics, but also by traditions of the states.

Americans during business negotiations tends to excessive detailing of the implementation process of foreign trade transactions. The only ground for decision is the law and their own experience, that's why members of the American delegation relatively independent, self-confident, persistent. The American position is marked with high professionalism, partnership approach to business negotiations, friendliness of tactics and methods of negotiation. At the same time, members of the American delegation differ from others because of their persistence and vigour during business negotiations. They are characterized with mostly informal way of negotiation.

The French are a nation of individualists. The negotiations seek to preserve the independence and significantly alter the behaviour, considering the status of the partner. They are characterized as using indirect expression, ease of causing disputes, straightness in the utterance of disagreement directly at the negotiating table. Before the topic for business discussion matters, the French want to know more about the subject of negotiations and the parties of negotiating.

French are expressive as verbally and nonverbally. The negotiation process is long, unstructured, often interrupted with verbal confrontation. Management decisions are long.

Italians are very sensitive to such concepts as respect and honour and that's why the negotiations with them are mostly conducted in accordance with their established rules and traditions.

Italians prefer negotiations in a personal meeting. They use such means of communication as telephone, fax or e-mail less. They are not punctual during negotiations, extremely emotional, which can transform a business discussion in noisy verbal battles. Italians' talk style can be different: cheerfulness, enthusiastic, emotional.

The Japanese value punctuality and discipline, preferring to establish rapport early before the business meetings. The Japanese are happy to make concessions in the case of partners are also willing to make concessions. During negotiations, the Japanese behave with restraint and formally. Special attention is paid to the personal meeting and acquaintance. In business communication they often use indirect subtle expression. Threats in negotiations with the Japanese are ineffective. Japanese try to avoid debates and clashes position in the formal negotiations. Most Japanese companies make decisions by consensus.

The Germans are willing to enter into business negotiations soon after they met. Before the discussion of business issues, they do not need to establish close personal relationship with a partner. Germans are very punctual, discreet, do not show their emotions openly. Unlike the Italians and Hispanics, Germans do not gesticulate actively, their faces do not express emotions and they don't interrupt each other in negotiations. Germans' preparations for negotiating is very thorough, they never recede from their positions, do not respond to moral suasion and pressure. They usually enter with a desire into those negotiations, where they believe in the possibility of finding a solution. They carefully work out their position and like to discuss the issue consistently, rather than all at once.

The British are considered to be quite formal, reserved, able to keep calm in stressful situations. They are less concerned about the preparation for negotiations and believe that the best solution can be found in the negotiations depending on the position of partner. They are quite flexible and respond positively to the initiative of the opposite side. Before proceeding to discuss business issues directly, the British like to talk with their new partners.



### **Questions for self-control**

1. What is the function of organization and planning of business negotiations?
2. What functions do business negotiations?
3. What are the reasons for the contradiction in the process of business negotiations?
4. What approaches to the solution of controversy are used by participants in business negotiations?
5. Name the stages and reveal the essence of each stage of business negotiations.
6. What are the strategies of business negotiations most often used in foreign economic activity and what is the difference between them?
7. What tactics are used by partners to achieve selected strategic goals?
8. What is the difference between the methods of business negotiations?
9. How do national peculiarities of business partners affect the strategy and tactics of business negotiations?

### **Issues of practical classes**

1. Organization and planning of business negotiations.
2. Stages of business communication.
3. Strategy, tactics and methods of business negotiations.
4. Influence of national peculiarities of business partners on the choice of strategy and tactics of business negotiations.

### **Issues for self-study**

1. Give examples of trade practices of two different countries.
2. Analyse the expediency of collecting information about competitors before signing an agreement.

## 4. INTERNATIONAL TRADE AGREEMENTS AND CONTRACTS AS AN INSTRUMENT FOR IMPLEMENTATION OF FOREIGN TRADE OPERATIONS



### KEY TERMS AND CONCEPTS

✧ <i>Foreign trade operation</i>	✧ <i>Degree of solidity</i>
✧ <i>Contractor</i>	✧ <i>Currency of payment</i>
✧ <i>Basic delivery terms</i>	✧ <i>Force majeure circumstances</i>
✧ <i>Criteria for the classification of firms</i>	✧ <i>World prices and discounts</i>
✧ <i>Sanctions</i>	✧ <i>Dossier on the firm</i>
✧ <i>Contractors</i>	✧ <i>Company map</i>
✧ <i>Reclamations</i>	✧ <i>Arbitration Court</i>
✧ <i>Preamble to the contract</i>	✧ <i>The quality of the goods</i>
✧ <i>The price of the contract</i>	✧ <i>Contract currency</i>



#### 4.1. Foreign trade operations and the procedure for their concluding

Essence and types of foreign economic operations

The exchange of material goods and services takes place through transactions of a commercial nature, i.e. on the paid basis.

Foreign economic operation is a set of actions of contractors from different countries (foreign partner) to implement the trade exchange and actions that ensure this exchange.

The classification of foreign economic operations on certain grounds. Modern scientists mainly distinguish the following types of foreign operations [35; 69; 75; 84]:

1. According to the object of the agreement:

a) trade with goods (import-export, re-export, re-import, counter-trade);

b) trade with services:

– basic, are not directly related to the sale of goods (financial, rental or leasing, engineering, international tourism, consulting, sale and purchase of information);

– additional or supporting, serving international trade (international settlements, insurance of goods, transportation of goods, freight forwarding services, customs operations, storage of goods, repair and maintenance);

c) trade with scientific and technical products (transfer of know-how, exchange of resident scientific and technical work, license operation);

2. According to the methods of the implementation:

a) international transactions, with direct connections between the manufacturer and the end user;

b) international transactions, with indirect links (through intermediaries);

3. According to a method of the goods sales:

a) traditional trade;

b) international cooperation;

c) countertrade;

d) exchange trading;

e) operation at international auctions, tenders, trade shows, fairs.

Let's consider the operation of counter-trade.

Countertrade operations involve reciprocal obligations of the exporter to the importer to purchase goods or services for the full value of goods exported, or a part of the cost.

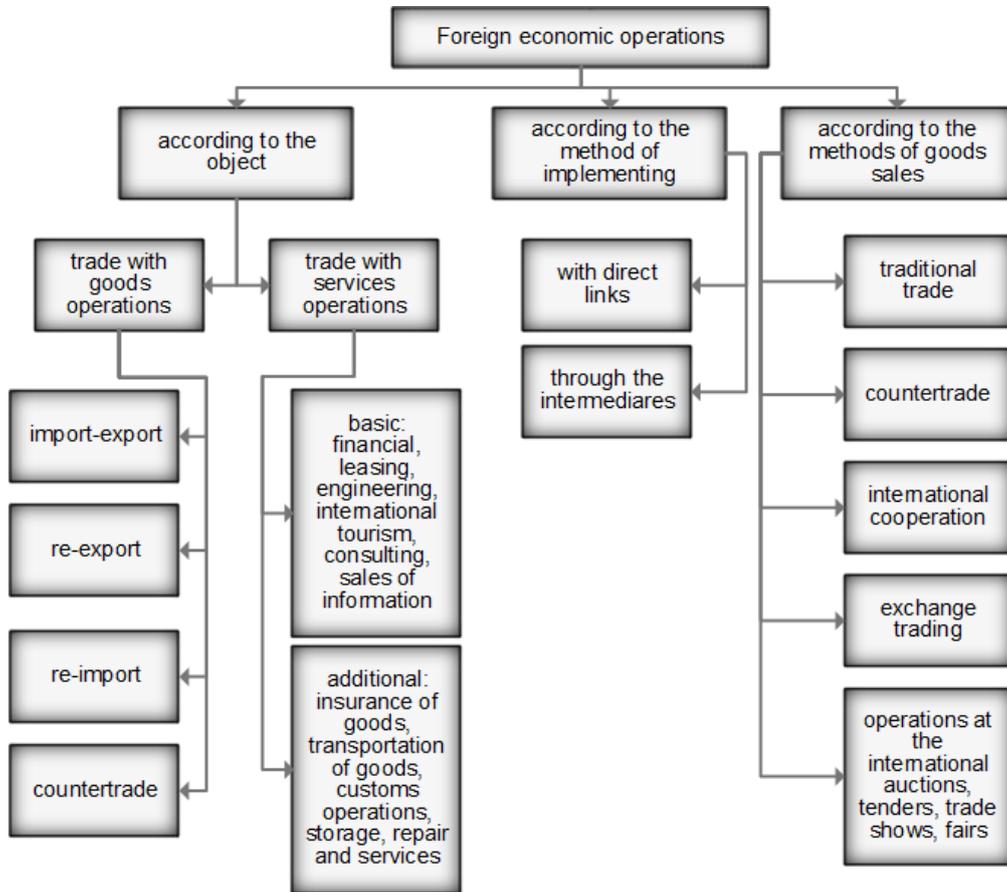


Fig. 4.1. Schematic classification of foreign operations

Often countertrade transactions through barter are carried out between countries in which there is underdeveloped banking system and there is no national currency.

The forms of counter-trade and barter include compensation agreement.

The main methods of counter-trade are the following:

- barter – transaction with the exchange of goods without commercial value of the goods which is not mediated by the funds;
- counter purchase – barter transactions, considering the real value of the goods, in which the balance of the transaction was not paid, and entered into the account partner. Counter purchase is made with, usually two or three inter-related contracts;
- compensation arrangement – barter transactions based on the real value of the goods on which the transaction balance is paid in hard currency;
- clearance – offset counter-claims and liabilities for trade agreements;
- tolling operations – barter transactions for which the cost of supplied raw materials, is paid with products produced from it;
- operation of industrial cooperation – exchange of commodities for which countertrade is associated with supply-side area, creating a specific counter delivery;
- supplies to compensation – barter transactions for which the manufacturer performing a large order, gets some component from the customer;
- repurchase of counter products – barter transactions by which the supply of new products is carried out at the same time with the repurchase of outdated (trade-in).

Implementation of barter operations is governed by special legal act. It establishes the procedure for exercising barter in the field of foreign trade, the responsibility for violations of its rules and defines the authorities and functions of public bodies while monitoring the conduct of such operations.

Estimation of goods for barter contract is held to create the conditions for the equivalence of exchange, as well as customs records, determining insurance premiums, claims assessment, the application of sanctions.

The condition of equivalent exchange for barter contract is the exchange of goods (works, services) at prices determined by the subjects of foreign economic

activity of the state on the basis of agreement on the basis of supply and demand and other factors that act in the relevant markets at the conclusion of barter agreements.

Barter contract states the total value of imported goods and the total value of goods (works, services) exported under this contract, with the obligatory expression of foreign currency referred to the first classification group rates by the Central Bank.

Timing for barter operations is set "goods imported under a barter agreement, being imported into the customs territory of the country within the time specified in this contract, but not later 90 calendar days from the date of customs clearance (date of cargo customs declaration for export) of goods actually exported under barter contract, in case of exports under barter contract works and services - from the date of signing or other document certifying the works or services."

Barter trading undermines the soundness of the currency, and that's why they are unwanted. In order to increase foreign currency revenues in the country, monetary stabilization of the national currency and financial recovery of the whole banking system a barter transaction may be prohibited to conduct in the field of foreign economic activity of certain goods (works, services).

The disadvantages of barter are:

- possible unilateralism in a barter transaction;
- binding partners with coincidence of needs for barter transaction;
- difficulties in negotiating the price and number of bilateral trade flows;
- preparation and implementation of barter requires significant expenditure of time.

Another form of counter-trade is an international compensation agreement.

International Compensation Agreement is a foreign trade agreement according to which the buyer pays for the goods or services the cost of other supplies of goods or services and, if necessary, the difference is paid with extra money.

Generally, compensation agreements are long-term in nature.

Often compensation agreements are used in the construction of large projects.

During the setting of international compensation agreements parties shall exchange lists of goods for the mutual supply, indicating the price and quantity of the goods.

There are two types of international compensation agreements:

- commercial transaction compensation;
- industrial compensation agreement («buy-back»), which includes the supply, particularly on credit terms, by foreign partners means of production and their further payment with the counter delivery products or with the revenue from the sale of this product.

Although commercial compensation agreements are inherently very similar to barter, they largely differ.

Differences among the commercial agreements of compensation from barter transactions are the following:

- compensation agreements suppose potential part of the commercial payment in cash, while barter operations suppose equivalent exchange in natural form without money payment;
- in commercial compensation agreements exporter may sublicense his imports counter duties on transaction to a third party through such operations as "switch", barter transactions are conducted directly between the two parties.
- in compensation agreements both commercial partners charge their deliveries in terms of money.

In turn, the industrial compensation agreements include:

- transactions in which the calculation is made on equipment supplied in kind;
- agreements with individual monetary and financial payments for equipment and supplies counter commodities.

In international practice "offset" and "switch" transaction are often used.

Operations such as "offset" means mutual repayment. With this agreement (also called "gentlemen's agreements") the exporter's reciprocal obligations are not legally

issued. According to it the exporter orally agrees to buy the importing goods at the cost of the part of the export delivery.

Basically, the "offset" operation is used in international economic relations between developed countries with high culture agreements of such type.

Often one of the parties in the "gentleman's agreement" is a multinational corporation. Operation "offset" are associated with powerful costly government programs for the procurement of equipment for nuclear power plants, military, aircraft, etc.

Operation "switch" is a set of counter-trade transactions that involves the transfer of obligations to a third party, usually a specialized trading company. They are purely financial re-export operations. The purpose of these agreements is to release the exporter of the obligation to sale the products they don't need in terms of the counter purchases. Also, the "switch" operations allow to balance the trade between the two countries, which signed clearing agreements.

An important part of counter-trade is tolling operations.

Customer-owned raw materials (semi-finished goods) – a raw material (semi-products) of the counterpart partner imported (exported) to another country for processing, handling, assembly or installation with the subsequent return in the form of finished goods to the country of the owner.

Finished product is meant to be the final product of the processing, mentioned in the contract.

Participants in these transactions are:

- performer, conducting tolling manufacturing;
- customer, who provides material for conversion.

Ownership on the goods for commission on each stage of processing, as well as produced from it finished product belongs to the customer.

Raw material of the customer is the main component and its value is not less than 20% of the total cost of the finished product. In this case, the preliminary delivers of the goods made on commission.

Payment for the work carried out by the Executive is made with:

- part of the raw material;

- part of the finished product;
- cash;
- in mixed form.

Industrial cooperation operations also refer to counter-trade and can be divided into:

- simple and complex compensation operations;
- industrial cooperation;
- franchising.

In simple compensation agreement one country, using technologies, equipment and services in another country, creates or upgrades on its territory certain industrial facility. Production of this industrial facility will be a mean of payment with the country that has provided everything you need to create it.

Complex or global compensation agreements are tripartite agreements.

Complex compensation agreement is referred to large-scale multi-million long-term (5 to 10 years) operations.

Such agreements can be used by equipment exporter who does not want to use compensation in full production and transfers it to a third party, which compensates the exporter cost of the equipment, and the loan through the sale of products.

Very often, a third party is elected through holding international tenders.

In practice the benefits of industrial cooperation are widely used by trading partners, which is implemented as:

- contracting cooperation;
- contract specialization;
- joint ventures.

Contracting cooperation involves performing specific work contractor on behalf of the customer indicating the scope, duration, and other commercial terms.

In contract specialization parts and stages of production programs are separated. It also involves a redistribution of capital.

There are technological and detailed contracting production specialization.

When creating complex products, it is common to organize co-production in the form of consortia.

Consortium is a temporary union of engineering, manufacturing, marketing, insurance companies and banks to implement capital-intensive project based on a general agreement and is jointly and several responsible to its customers.

An example of such a consortium was the International Consortium "Medium Transport Aircraft" (Ukraine – the Russian Federation), established in 1996. It was founded by ASTC Antonov Aircraft Manufacturers serial aircraft designers and manufacturers of engines and equipment. This consortium formed and carried out joint research and development, production and business activities, provided long-term cooperation and pooling of finance, material and other resources to meet the challenges of certification, production, sales, after-sales service and leasing of AN-70.

International franchise is a complex of mutually beneficial arrangement whereby a large well-known company sells the right to use its brand, technology to another firm.

There are two main types of franchising: franchise production and trade in services.

Commodity franchise is a simple transfer of goods for sale under the brand name of a particular company. It is mainly realized through large supermarkets.

Production franchise is the transfer of techniques for manufacturing specific product along with the right to use a trademark but not copyright to a client firm.

Manufacturing franchising use world famous companies such as Coca-Cola, McDonald's and others.

#### *Export-import transactions*

Implementation of foreign payments of any country that has been involved in international trade, is directly related to import and export operations.

Export transactions – the sale and export of goods abroad with the transfer of ownership to their foreign partners.

Import operations – the purchase and transportation of goods for sale on the domestic market of the importing country or industrial consumption by the importer.

The main methods of export-import operations are:

- direct (direct link: manufacturer – the final consumer without intermediaries);
- indirect (sale of goods through intermediaries – agents, representatives, brokers, dealers, agent, consignee, distributor).

The direct method is used in the standard equipment sales through foreign subsidiaries, products of national enterprises, expensive and big equipment, raw materials under long-term contracts.

The indirect method is used in the sale of consumer goods, standard industrial equipment on remote and underserved markets.

Advantages and disadvantages of direct and indirect methods of export-import operations are presented in Table 4.1.

Table 4.1

Advantages and disadvantages of direct and indirect methods  
of export-import operations

	<b>Advantages</b>	<b>Disadvantages</b>
<b>Direct method</b>	<ul style="list-style-type: none"> <li>– close communication with buyers;</li> <li>– high industrial mobility;</li> <li>– good knowledge of the market conditions.</li> </ul>	<ul style="list-style-type: none"> <li>– own wide wholesale network is necessary;</li> <li>– own foreign subsidiaries are necessary.</li> </ul>
<b>Indirect method</b>	<ul style="list-style-type: none"> <li>– presence of the already created network for sales of goods and services;</li> <li>– high trading experience;</li> <li>– availability of link with counterparties;</li> <li>– good knowledge of the market conditions.</li> </ul>	<ul style="list-style-type: none"> <li>– direct links between the producer and consumer are absent;</li> <li>– higher overhead.</li> </ul>

At present, most of the export operations are agreements on cooperation and internal delivery within multinational corporations.

Companies, engaged in international activities, need to:

- form their own strategy of export/import;
- organize their international activities.

To arrange export transactions companies, create export departments, built on the industrial or regional basis, or export subsidiary.

To organize import operations permanent missions and purchasing offices in major shopping malls are established, where the products are manufactured or sold according to the interests of importer.

Export-import transactions are made on the basis of contracts of sale.

Export-import transactions are considered to be realized when the product has passed the customs border of the country counterparty after the relevant customs procedures.

#### *Re-export and re-import operations*

Re-export operation – export of goods, previously imported into the country, which have not undergone any processing.

Goods of foreign origin, which are located in the country of re-exporter for no more than two years are considered to be re-exported.

Re-export permits operation of labelling and packaging, if their value does not exceed 50% of the export contract.

Re-export is performed in the following cases:

- resale;
- if the company wants to reduce customs duties;
- when the market of products was defined incorrectly;
- if the trade relations between the exporter and the importer countries are not set.

In conducting the re-export operations usually create two contracts. Under the first contract re-exporter buys the goods, for another contract – sells this product.

In most cases, re-exported are goods that are sold at the international commodity exchanges and auctions.

Using the re-export operations, the company might benefit by using the difference in prices for the same product in different markets.

Re-import operation – reverse importation from abroad of goods of national production, which have not been subjected to processing.

Re-import operations include:

- reverse import of goods that were not sold at auction;
- return of goods that were rejected by buyers;
- return of goods from consignment stores.

In international practice, re-export is considered to be unsuccessful exports, which have no commercial basis.

#### **4.2. International contract of sale of goods**

International contract (or international agreement) is an agreement on the commercial exchange of value between multiple contractors, and, as a result of this exchange, each participant will receive a personal benefit from the object that is exchanged or sold.

In practice, various standard forms of contracts are widely used in international trade. They were developed by major exporters and importers in the late XIX century. Preparation of any contract, including contract of sale is a very laborious task that requires high costs, efforts and time. So, business people have long sought to somehow unify, standardize and make them typical. By some estimates the world market today uses more than 10 million of typical contracts.

A typical contract is a document designed in accordance with the rules, that contains a number of standardized conditions adopted in the practice of international trade, i.e. like agreed in advance, typical conditions. The second part of a typical contract contains the articles that require approval. These articles contain information on contract price of the product, its quality, delivery time, payment terms and so on.

Typical contracts on the world market can be used in various forms. The most common form is a standard contract, which outlines and has properly formulated articles that contain the general conditions of sale. In those articles that require coordination, there is a place for clarification. After preliminary agreement individual terms are added to the agreement, and it is ready for signing. Sometimes all items are subject to revision.

The second form of typical contracts differs with articles, that contain the general conditions, are printed on the reverse side of the contract or other pages, and articles that require coordination are printed on the face of the contract. There is a default option contract in which the general conditions of sale are not set. They are agreed in advance and are referred to on the reverse side of the contract and 3-4 articles that require coordination (i.e., the amount, price, terms, and sometimes the quality of delivery) are printed on the face of the page.

The use of standard contracts can be done in two ways:

- unconditional accession of one of the parties to the terms of the final form of a typical contract that the other side offered;
- use the default contract as a model that can be changed according to the specific transaction.

The most common standard contract is developed by one of the parties before the agreement, it is taken as a model and on its basis by matching every article, every contract term developed by individual contract that is signed by the parties.

Typical contract form is mainly developed by major exporters of this product, associations of industrialists and entrepreneurs, associations, unions, chambers of commerce, the Exchange Committee. For example, typical contracts for industrial raw materials are developed by business alliances. The most common in the trade in grain, oil, sugar, non-ferrous metals, cotton, natural rubber, etc. are standard contracts developed by the Exchange Committee. Industrial associations usually develop several variants of standard contracts for each type of goods. The difference between these options is usually in the method of determining the price (FOB, CIF, etc.), methods of the goods delivery (whole or in small shipments), which could affect the packing of goods, provided insurance and more.

Standard forms of contracts are binding the parties only with their consent. Of course, the content of such agreements is based on the law and practice of the country-developer. It should be considered by national businessmen contracted with foreign partners.

The main content of the international contract is the qualitative and quantitative parameters that characterize commodity supply and determine the financial obligations of the buyer to the seller that he has to perform. However, the fulfilment of mutual obligations suggests that the many technical conditions existing written and unwritten, mandatory and optional (additional) parameters and rules of conduct for contractors who are also reflected in the contract.

The required contract includes terms, without which appropriate contractual document has no meaning and content necessary for the parties to have legal grounds due to the economic and industrial activities (definition of the parties, quantity, quality, delivery of goods, the price to be paid etc.).

Additional conditions are required for execution of the contract, they define a procedure surrender/acceptance of the product, its packaging, order of the termination of the contract due to force majeure circumstances, the nature of dispute resolution and more. These additional conditions in certain circumstances are required, but in any case, what is more detailed and clearer description of the terms of the contract, the mutual obligations of counterparties, nature and timing of their actions, the more reason to expect that the contract is executed, and the interests of its members satisfaction.

Thus, the contract itself must have a rigid structure, must be thought as a single document and articulate the rights and obligations of the parties. Thus, concluding it there should be considered that there were traditions about the sequence and nature of the "content" of individual structural units of the contract.

Mandatory contract clauses are as following:

- The preamble of the contract. The preamble states the full names of the parties – participants of foreign economic operations, to which they are officially registered, showing the country abbreviation definitions parties as contractors ("Seller", "Buyer", "Customer", "Supplier", etc.), those whose name is placed in foreign economic agreement (contract), and the names of the documents governing contractors in the contract (contract) (constituent documents, etc.).

- The subject of the contract. This section defines the exact goods (works, services) that one of the partners is obliged to produce (deliver, provide) to another, indicating the exact name, grade, class or final result of the work performed.

In the case of barter contract or contract for tolling manufacturing is the exact name (brand, sort) of counter deliveries (or the name of the product, which is the ultimate purpose of tolling) is defined. If the goods (works, services) require more detailed specifications or range of goods (works, services) is quite large, it is stated in the application (specification) which is an integral part of the agreement (contract).

To barter contract is attached application (specification), which is balanced by the total value of exports and imports of goods (works, services).

The annex to the agreement (contract) for tolling manufacturing includes corresponding flow chart of such processing. Flow chart should reflect:

- all the main stages of raw materials processing and the process of converting raw materials into finished products;
- quantitative indicators at each stage of processing of the justification process losses of raw materials;
- executants' loss of processing at each stage of processing.

- Quantity. Defined in this section, depending on the range, the unit of measure of goods for this type of goods (in tones, kilograms, units, etc.), its total quantity and quality characteristics.

The text of the agreement (contract) for works (services) determines the specific scope of works (services) and a timetable. In case of sale of goods on the matter considering the weight of the tare weight: Net weight means the weight of the goods unpacked and gross weight – including it, and in the latter case, the cost of packaging is actually equal to the weight of packaging (where packaging weight is relatively low, i.e. 1-2%, or if the value of container is comparable to the cost of the goods.

Quality of goods – definition of aggregate characteristics and properties, which determine its ability to meet certain consumer (individual, household or industrial) needs of the buyer. Quality is defined by using one or more of the following assessments:

- standards that are developed and approved by governmental bodies and specialized agencies – trade and industry associations, unions, leading manufacturers, scientific, technical, environmental associations, etc.;
- technical specifications which are applied in the absence of relevant standards and in cases where the specifics of production and/or use of products requiring regulation of its characteristics, technical staff, descriptions, and the contracts may provide for methods of control of relevant characteristics (e.g., in relation to the supply of aircraft, ships, complex industrial equipment);
- specifications, which are usually annexed to contracts and fixed parameters of an individual product;
- description which reflects the individual characteristics of how goods may vary within the basic tribal characteristics;
- example which is generally accepted and/or agreed to the standard by the parties, additionally the comparison method is determined;
- content of substances according to the chemical, technological composition of the product, minimally acceptable amount of useful and the maximum permissible number of undesirable substances or impurities (e.g. metal ores) are installed;
- rate of release of the finished product, according to which a percentage or absolute terms of the amount of the final product is set, which can be obtained from raw or intermediate substances (e.g. oils from seeds);
- preliminary review, where in due time buyer has the opportunity to inspect the consignment and the seller guarantees that the goods were sufficiently represented (usually used in the sale at auction and warehouses);
- fair average quality when the contract provides that the contract goods at the time of supply meets traditional notions about the quality (especially in relation to the supply of grain);
- “tel quel” approach, which involves the sale of goods" as it is " at the time of conclusion of the contract, and the buyer agrees to accept the goods,

regardless of how it will change the quality properties to the moment of delivery, the only term is that it should correspond with the fixed in the contract type or breed (especially regarding unharvested crop).

- Basic terms of delivery. In this section the type of transport and basic conditions of supply are indicated. In accordance with international rules of interpretation of commercial terms of the current edition, which define the responsibilities of contractors to deliver the goods and establish time allocation of risk from one party to another, as well as a specific delivery term of the goods (separate shipments).

In the case of work (services) contract, this section identifies conditions and terms of work (services) performance.

Often this item can be not as an independent section, but as the subject of the contract. Incoterms 2010 rules are applied only in respect of the export-import operations, i.e., only in international practice, while reference to a particular type of contract basis is often used in the internal practice.

- Product price. This section defines the measurement unit price of the goods and the total value of the goods or the value of the works (services) supplied under the agreement (contract), unless the price of goods is calculated by the formula, and the currency of the contract. If under the agreement (contract) supplied goods of different quality and variety, price is set separately for each unit, class, grade, and itemized agreement (contract) set its total price. In this case, the price indices may be specified in the annexes (specifications), to which reference is made in the text of the agreement (contract).

When calculating the price agreement (contract) with the formula, it should be stated the estimated value of the contract at the date of its conclusion.

The processing agreement (contract) should also specify the mortgage value, price and total value of the finished product, the total cost of processing.

In barter contract the total value of exported goods (works, services) is reported and the total value of imported goods (works, services) under the agreement (contract) with the obligatory expression of foreign currency, referred by the Central Bank to the first group of Foreign Currencies Classifier.

The price can be set depending on the nature of the goods and the practice that has developed in the course of trade in the commodity. The requirement for the presence in the body of the agreement the supply price is obligatory under national law, otherwise the contract is null and void. In determining the final price of the goods an important factor is price basis, which gives information whether the shipping costs is included to the price of commodities. Basis for the price depends on the chosen basis of contract, which, for example, may be added with the cost of internal transportation and other expenses. Currency of price (currency in which the product price is expressed) may be different from the payment currency, therefore, exchange rate fluctuations is an important factor for contractors in the profitability of the transaction.

- Terms of payment. This section specifies the currency of payment, method, procedure and terms of financial arrangements and guarantees to fulfil the mutual payment obligations.

Depending on the terms of payment chosen by the parties the text of the agreement (contract) shall include:

- conditions of the bank transfer (advance payment) and/or after shipment or conditions of the documentary letter of credit or collection (with warranty);
- conditions of warranty if it is present or where it is needed (type of guarantee: on demand, conventional), conditions and terms of the warranty, the ability to change the agreement (contract) with no change guarantees.

- Packaging and marking. This section contains information on the product packaging (boxes, bags, containers, etc.), labelling (name of the seller and buyer agreement (contract), destination, size, special conditions of storage and transportation, etc.), if necessary also provided its return.

Packing of goods, as well as its marking is the responsibility of the seller, and the terms of international trade impose strict requirements on the process. The main task of marking is to inform about the participants of sales transaction, country of manufacture of the goods and the place of his destination, contract number, as well as technical requirements for transportation – net weight and gross of each cargo unit, dimensions and instructions for special care, limitations etc. Marking is usually placed

on the two opposing sides and top for greater information content and quality of reception and delivery of goods.

Thus, it must be subject to specific comments in the contract. Usually in most cases, packaging becomes the property of the buyer with the product since its value is considered in the price of goods. However, there are possible exceptions to this rule, and the contract price does not include packaging or fixed obligation of the buyer to return it to the seller. Modern packaging considered to be a type of container that provides the best preservation of the cargo and makes it possible to use different modes of transport. Other types of packaging are boxes, bags, tubs, trays (sometimes followed by packing in the film).

- Delivery acceptance of the goods – the procedure of transfer of goods, accompanied by appropriate formal actions and documents and does not necessarily reflect the transfer of the rights in goods from the seller to the buyer. The contract establishes the place of physical delivery, for which the chosen basis of the contract is bind to a specific location (e.g., FAS – Port Illichiv'sk).

This section identifies the time and location of the actual transfer of goods and shipping documents.

Delivery acceptance of the goods is carried by the number – according to shipping documents, quality – according to the documents certifying the quality of the product.

- Sanctions and reclamation for breach of the contract – the position of the nature and extent of compensation and penalties for violation of terms, the supply of defective products, incomplete and quantitatively incomplete delivery, as well as violations of other provisions of the contract. These provisions are the basis for the submission of claims (reclamation sheets) – claims which refer to the non-fulfilment or improper fulfilment of contractual obligations.

This section establishes the procedure for the application of penalties, restitution and submission of claims in connection with the failure or improper performance of one of the contractors of their obligations.

In this case, should be clearly defined penalties size (as a percentage of the value of short-delivered goods (works, services) or the amount of unpaid costs, terms of payment of fines – when they start and their duration, size limit), the terms for which the claim can be filed, the rights and obligations of the parties to the agreement (contract) and, at the same time, methods of claims settlement.

- Arbitration. This section identifies the conditions and procedure for dispute resolution in the courts as to the interpretation, failure and/or improper performance of the contract with the indication of the name of the court or the court of clear criteria for any of the parties depending on the subject and nature of the dispute and agreed by the parties the choice of substantive and procedural law to be applied by the court and the rules of procedure of the court settlement.

Advantages of arbitration before litigation lies in simplicity of procedure, the speed of the case, lower costs, better guarantees the confidentiality of business and technical information, the choice of arbitrators (judges), and the choice of the hearing language.

An important institution that promotes arbitration process is the Chamber of Commerce, which has in its composition the International Commercial Arbitration Court. Consequently, domestic participants of export-import operations are recommended to specify in their international contracts that commercial disputes which may arise during the execution of the contracts should be reviewed by the arbitration authority using the existing legislation in the sphere of external relations.

Internationally important role plays the International Court of Arbitration of the International Chamber of Commerce (Paris), International Court of Arbitration (headquartered in Hamburg), Arbitration Committee at Lloyd's (London) and others, including sectoral and regional judicial and arbitral bodies.

- The circumstances of insuperable force (force majeure). This section contains information about cases in which the terms of the agreement (contract) cannot be executed by the parties (natural disasters, acts of war, embargo, intervention by the authorities, etc.). In this case, the parties exempt from obligations for the duration of the circumstances or may refuse to perform the agreement (contract) in part or in whole,

without additional financial responsibility. Validity of force majeure is confirmed by the Chamber of Commerce of the country.

So, when a situation arises in which the performance of the contract is impossible or impractical, contractor may decide to stop the contract execution fully or partially (i.e. delay for a certain period of time). Thus, the risk of force majeure should be carefully considered in the contract, because it can help avoid disputes, arbitration and investigations of law enforcement and customs of the country's fulfilment of the contract.

The circumstances of force majeure may be temporary and long-term (permanent). In the first case, the period of performance of contractual obligations is removed for the duration of such circumstances, and the second – the contract is cancelled. And may be indicated the maximum time, after which the contract may be terminated, and, depending on the duration of storage of goods, cancellation the contract can last for days and weeks (food, flowers) or months (technical equipment). To ensure unbiased peer review parties may indicate the organization (institution) that issues certificates on the duration of the force majeure.

- Address, email and payment details of the parties. At this point the contract recognized legal addresses of the parties, specify billing information and banks that cater to contractors.

Some contracts specify the product warranty and after-sales service – these are the conditions under which the seller can commit on the quality of the delivered goods and to support its functional qualities over a guarantee time. During this period technical assistance may be provided or may be reimbursed or compensated for losses. In practice this means elimination of defects, repair of machinery, equipment, reducing the contract price or refund the amount of the contract.

However, warranty concerns contain a list of conditions under which the seller is not responsible for the goods in the event of improper use or storage, human error, that it serves others.



### **Issues for self-control**

1. Name the types and list of preparatory works when signing the contract.
2. What information about a potential counteragent need to be collected before signing an agreement?
3. What do you need to know about competitors' activities in a potential market segment?
4. The concept of foreign trade agreement.
5. Differences between typical and individual contracts.

### **Questions of practical classes**

1. How are trade practices considered when signing agreements?
2. Where is the required information about the activities and trading practices of potential counterparties going to be collected?

### **Issues for self-study**

1. Consider the international and national rules for regulating the form, order of the conclusion and execution of foreign trade contracts.
2. Analyse the expediency of collecting information about competitors before signing an agreement.

## 5. TRANSPORT SUPPORT OF FOREIGN ECONOMIC ACTIVITIES OF ENTERPRISES



### KEY TERMS AND CONCEPTS

✧ <i>Transportation support</i>	✧ <i>Bulk cargoes</i>
✧ <i>Basic delivery terms</i>	✧ <i>INCOTERMS</i>
✧ <i>Transport system</i>	✧ <i>Special handling loads</i>
✧ <i>Linear shipping</i>	✧ <i>Charter agreement</i>
✧ <i>Transport service</i>	✧ <i>The cost of transportation</i>
✧ <i>Tramp shipping</i>	✧ <i>Seasonal traffic</i>
✧ <i>A beneficial effect</i>	✧ <i>Transportation operations</i>
✧ <i>Lines of destinations</i>	✧ <i>Mixed transportation</i>
✧ <i>General cargoes</i>	✧ <i>Shipping terms of delivery</i>
✧ <i>Bill of Lading</i>	✧ <i>CMR international transport bill</i>



## 5.1. International transport operations

Foreign economic activity of the enterprises closely related to transport maintenance, which is an important part of the process of delivery of the goods from the place of production to the place of consumption. In fact, it is identical to the trade and is based on the concept of logistics. However, transport should be considered as a separate aspect of commodities turnover that has its own specific. Transport provision means a series of elements that are closely related and constitute a single transportation system that integrates operations associated with the production and circulation of products. The product of the transport is the process of moving goods from producer to consumer. This is the essence of transport services.

*Transportation, like all services have their own peculiarities.*

1. Transportation does not produce a new commodity or a product, but thanks to their movement from one place to another, provided a continuing process of production and circulation, there is a final consumption of produced goods. The transport created value is movement of goods and products from place of production to the place of consumption.

2. Effect of transport services is reflected in the following useful effect that can't occur, maintain and realize in isolation from transport. However, production of transport services is inseparable from their consumption. Transportation services meet the needs at the time of its manifestation, the creation of such services matches with their consumption.

3. Transportation has a special place in international trade. On the one hand, it is a necessary condition for the international division of labour, foreign trade, and on the other hand – the transport industry acts on the global markets as the exporters of their products, partially, transportation services.

4. Transportation services performed in the field of foreign economic activities are exposed to all the factors which characterize the development of a market economy. First of all, it is fluctuation in oil prices, demand and supply, and, consequently, transportation volumes, the exchange rate, the degree of state intervention in the

foreign economic activity, the state of political and economic relations of different countries and many others.

Transport plays an important role in the development of foreign economic activity. Its proper functioning ensures fulfilment of obligations by the parties of trade agreements and the commercial effect of foreign trade agreements. Violation of the transport process often leads to exporters and importers financial losses, influence the competitiveness of domestic goods on the world market.

Transport provision of foreign economic activity is objectively necessary. Often, it is difficult to the goods owner to navigate in the transport environment that requires professional knowledge of the legislation of some countries, international conventions (treaties), technical and operational characteristics of vehicles, congestion and points handlers, their work conditions, intermediary services and others. Therefore, if it is necessary to ship cargo abroad, first of all, it is recommended to establish close contacts with transport companies and organizations that are engaged in international transport. Thus, it is important to choose the type of vehicle that you would like to send goods abroad. It should be kept in mind that in today's world there are six types of transport: *sea, rail, road, river, air and pipeline*. Types of transport are divided into water (sea, river), land (rail, road, pipeline) and air. Each has its own specifics.

Planning the shipment and type of transport, it is important consider a number of circumstances.

*First*, the type of cargo. Transported goods are divided into general, mass and with a special regime. General includes various goods (packaged or not). According to the size, they are divided into regular, lengthy (over 3 m) and oversized. By weight – light and heavy (with masses greater than 5 tons per cargo unit).

*Massive loads* represent a structural mass that is transported in large quantities in bulk. They are liquid (oil and oil products, gases, animal and vegetable oils, alcohols, etc.) bulk (ore, concentrates, fertilizer, etc.), other bulky goods (grain, sugar, raw, etc.) and the wood.

*Special regime* goods are stored and transported according to the special rules (dangerous goods, perishable, etc.).

Selecting the means of transport, it must be considered that in some cases the opportunity of transport mode is unavailable. For example, perishable goods should be transported by air. However, air travel is not allowed during transportation of flammable and explosive goods.

The main part of transportation by sea includes the bulk transportation of liquid and bulk cargoes (petroleum and petroleum products, iron ore, coal, grain, etc.). Maritime transport is widely used for the carriage of general cargo.

*Second*, the time factor. It is well known fact that the fastest way is cargo delivery by air. However, because it is expensive, it is used only when necessary to deliver the goods for a minimum period of time (food, perishables, flowers, etc.).

*Thirdly*, the cost of transportation. Of course, each customer would like the cost of transportation consist a small percentage of the value of the goods. However, there are times when there is no choice and you must pay a high price for shipping cargo. When there is a choice, the price will be lower. For example, small and medium-volume consignments can be delivered by air and by land for about the same price.

*Fourth*, the safety of transportation. It is better to transport fragile and precious equipment by air. Goods that have a high risk of theft (parts of cars, office equipment, pharmaceutical products, etc.) tend to be delivered by sea, mostly in containers, even if it may be more expensive.

It is important to consider the mentioned circumstances choosing a mode of transport. However, the mode of transportation is largely dependent on priorities of the commodity owner. If he is interested in the speed of delivery, he chooses between air and road. If the goal is the minimum cost, there is a choice between water and pipeline transportation (to some commodities).

It should be noted that in Ukraine the volume of international traffic is constantly increasing. However, at present, the transport does not provide needs of owners of cargo in transportation. This is due to lack of vehicles, poor quality and largely worn material and technical base, inadequate preparation of goods for shipment, transport organizations lack of responsibility for damage to goods in transit, in storage. The potential of the transport sector in transport services export is not fully used.

Let's consider the meaning of certain transport operations in foreign trade activity. These operations are determined by the nature of international transport and classified according to the number of features:

- the subject of transport operations (divided into cargo and passenger);
- mode of transport (water, air, ground and mixed);
- type of product (with general cargo, mass, liquid, gaseous);
- periodicity (regular and irregular);
- border cross (shifting and not shifting transportation);
- transport-technological systems (container, ferry, etc.);
- type of connection (direct and indirect transportation).

In the context of the time there are three groups of transport operations:

- 1) prior to foreign trade agreement;
- 2) occur during its implementation;
- 3) operations after closing.

The first section includes activities such as foreign trade transportation planning, analysis of transport market conjuncture, rates and conditions of goods carriage, transport factors in determining the price of goods, transport and basic conditions of supply in the contract of sale.

The second group of operations includes activities such as preparing goods for transportation, contract of carriage, processing of relevant transport and shipping documents, insurance, certificate of cargo insurance, preparation and execution of cargo customs declaration, payments to carriers, customs formalities handling, sanitary operations, required documents preparation and more.

The third group includes operations related to the settlement of disputes between the consignee and purchaser, if any, claims to penalties, addressing them in due course.

Transport operations can be carried out in different places: at the point, on the way to the cargo handler at points on the border crossing points and the recipient of the goods. They can take place both within the country and abroad.

## 5.2. Organization of international transportation by main types of transport

Considering the issues of transportation, it is important for participants of foreign trade agreement to clarify the main transport and basic conditions of supply and the issues of the goods delivery quality and management.

Economic efficiency of foreign economic activity, as already noted, is largely dependent on properly selected basic terms of goods delivery. The contract of sale has a special section – transport conditions of delivery. It stipulates the obligations of the parties on the movement of goods. This section usually includes: order the carriage of goods, conditions and duration of loading and unloading, size, payment and calculation of freight charges, proforma charter party, bill of lading type and other services.

In each case the content of transport agreement depends on the type of vehicle, the nature of the goods, agreement type, the basis place of supply, as well as the international treaties, agreements, conventions and traditions of the country.

The basis of the transport conditions is the basic terms of delivery. Establishing the basic terms of delivery in the contract of sale, the parties define their duties, among which is the issue of transport movement of contract objects, as follows:

- who carries transportation costs for the delivery of goods;
- who provides the vehicles for the carriage of goods;
- load position relative to the vehicle;
- who provides customs procedures for export and import;
- who provides the goods loading and unloading;
- where the transfer of ownership of the goods from the seller to the buyer takes place;
- when does the risk transfer from the seller to the buyer in case of death, injury or damage to the goods and as shared responsibility.

Now, as have been noted, "INCOTERMS 2010" is valid and it presents 11 basic conditions of delivery [76]. The seller undertakes minimum duty according to the EXW (ex-works) term. Under this condition the seller needs only to prepare the goods for shipment: pack and label the packaging. All other duties on the goods movement from the place of production to point of consumption are held by the buyer.

Maximum responsibilities for goods delivery is taken on the seller for the supply of basic conditions DAP (delivered at place/point) and DDP (Delivered Duty Paid). All other commercial terms require the allocation of responsibilities for the transport of goods between seller and buyer.

In carrying out the delivery of goods from the seller to the buyer, there is an essential question how the shipping will be arranged (which rules) and what contractual documents should be issued.

**Sea freight.** The international maritime transport covers a significant amount of the world trade turnover – about 60%. Massive bulk cargoes are the main part of the international maritime transportation. They are: crude oil, petroleum products, iron ore, coal, grain, etc. Also, general cargo is distinguished, that is finished industrial products and semi-products. There are two patterns in international shipping: regularly, as a liner shipping, and irregular in form tramp shipping.

Liner shipping is a form of transport services, which provides regular services for the announced schedule between defined ports. Freight shipping line flow consists mainly of general (packaged individually) loads. Small quantities of goods are carried by line ships, mostly they are finished and semi-finished products.

Maritime connections between certain ports called line. The following types of lines:

- unilateral – characterized by the fact that the vessels of only one country or shipping company operate the line;
- bilateral, were vessels of the two countries (in agreement) or two shipping companies operate;
- conference, which employ the vessel of two or more companies from the same or from different countries.

The main purpose of the conference lines (conference agreements) is to set the same rates and conditions of carriage for all participants in traffic. According to the Convention on a Code of Conduct for Liner Conferences that was developed in the United Nations in 1974, the conference is considered to be a group consisting of two or more carriers that provide international transportation line in a certain direction

and have a general agreement on tariff rates, the rights and duties conference members and other conditions.

The main document in maritime transport is a bill of lading. This document is issued by the ship owner (Captain) at shipper certification of acceptance for carriage by sea.

Bill of lading serves three main functions:

- 1) confirms the freight is accepted for carriage;
- 2) acts as the shipping document, it gives the right to receive the goods as to whom he was discharged;
- 3) acts as the evidence of the contract of carriage of goods by sea, by which the carrier undertakes to deliver the goods to the specified destination.

The bill of lading contains information about the name of the vessel, its owner, the tonnage of the vessel, port of loading and unloading freight, the sum and place of payment, the number of published copies, including the original and so on. In the bill of lading fields, as it is the shipowner's receipt for the goods, we may find their description. Bill of lading is signed by shipping agent or captain.

Bill of lading can be of the following types: nominal (indicating consignee), bill of lading to bearer and order bill of lading (published by "order of the sender" or "at the order of recipient"). Bill of lading also divided into direct, that is without transshipment, and transit, which involves handling cargo on the way.

It is usually issued three original copies and multiple copies of bills of lading, but only one of the originals can serve as the shipping document.

Tramp shipping is a form of shipping, in which ships performs irregular maritime traffic. They do not have a clear schedule and the ship owner direct them to that point, where is demand for tonnage and proposals for transportation.

Tramp shipping deals with the transport of certain types of bulk cargo (timber, coal, ore, grain, oil, petroleum products, cement, fertilizer, etc.), though, if necessary, can transport general cargo, packaged or unpackaged (equipment, chemicals, hardware, automobiles, cars, agricultural machinery, etc.).

The contract for the carriage of goods in tramp shipping is signed in the form of charter. Charter plays a central role in the regulation of contractual relations between

the parties in tramp shipping. This Bill of Lading is the document that complements it.

The main points of the charter contract are:

- time and place of signing the charter;
- the full name of the parties;
- name and description of the vessel;
- location of the vessel at the time of conclusion of the contract;
- type of cargo and the way his carriage;
- conditions of loading and unloading, including demurrage (fine for simple vessels over time) and dispatch (compensation paid to the carrier by the charterer for faster loading compared to established norms);
- order of payment of freight and others.

In maritime navigation practice, typical freight contracts, known as pro forma charter, are widely used. Based on them, the charter for the carriage of specific goods in a specific direction are concluded.

Depending on the freight agreements the following types of charter are distinguished: voyage (single-trip charter), time charter, demise charter, bareboat charter.

Fee for shipping, which is paid by the owner of the cargo (freighter) to the carrier (ship owner) is calculated depending on market conditions for transport and set directly by the ship owner.

Due to the specific features of maritime transport its advantages are following:

- low transport services cost;
- indispensability and lack of alternatives (for example, for island countries – Japan, the United Kingdom);
- large capacity;
- possibility of container traffic.

Relatively negative features are:

- low speed of transportation;
- difficulty in overloading from one transport to another;
- limited traffic due to seasonality and possible increment weather.

***Rail transportations.*** International railway transportation is carried out through bilateral and multilateral international agreements and international consignment note.

Rail consignment note serves as the acknowledgment of cargo for transportation, shipping documents and the contract of carriage.

Important role in the regulation of international rail transport play an international agreement. They also determine the form of the consignment note.

In practice, international trade is widely used form of bill, developed by the International Convention concerning International Carriage by Rail – ERM, which since 1984 is called COTIF (Agreement on international transportation). COTIF participants are 33 countries. They are mainly European countries and a number of countries in Asia and Northern Africa.

Text of the invoice for COTIF is printed on standard forms, usually in two languages. Stamped with the stamp of the carrier, is accompanying the goods, and the duplicate remains in the shipper. To the note such shipping documents as shipping specification, quality certificate, packing list and others are attached.

Among the former socialist countries of Europe and Asia was signed multilateral convention on international railway agreement (IRA). With some additions it is used at present. Its members – the CIS countries, former socialist countries of Asia (China, Mongolia, North Korea, Vietnam), Bulgaria, Poland, Hungary, the Czech Republic, Slovakia, Romania, who denounced the Agreement, however, are willing to use its provisions.

The main purpose of IRA is establishing common conveyance documents to all railways – Parties of the Agreement. The agreement consists of 8 sections, which are governed by the full range of issues of transport process: the contract of carriage, the order of receipt of goods before shipment, invoice, deduction of freight charges, etc. IRA is complemented by a number of tariffs, rules and regulations.

Conclusion of International Carriage of Goods according to IRA is issued with a uniform waybill consisting of 5 pages.

1. The original bill – accompanies the goods to the destination station and issued to the recipient along with the 5th page.

2. Railway memorandum bill – accompany the goods to the destination and remains in the destination.

3. Invoice duplicate is given to the sender after the conclusion of the contract of carriage.

4. Sheet of cargo delivery – accompanied by a dispatch to the destination station and remains in that paragraph.

5. Sheet – notification on arrival of cargo – accompanying dispatch to the destination station and issued to the recipient along with the original invoice and the goods. Also, filled with extra copies of the required amount of road information (for road departure, transit ways and customs authorities).

Consignor simultaneously with the delivery of goods to transportation for each departure, issue departure station invoice and its duplicate.

They perform different functions. Railway bill, after affixing stamp station is evidence of the contract of carriage and a major transportation document. Its duplicate is proof of the contract of carriage and a receipt in the railway for cargo transportation. Railway bill and its duplicate is filled by the shipper. Railway bill must be completed in compliance with all IRA rules.

In addition to the above, in Ukraine there are other important agreements on international rail traffic.

There are following advantages of rail transport:

- flexibility of delivery, sometimes even to the enterprise warehouses, providing the railways availability;
- the use of various types and form of transportation (for example, one railroad train can consist tanks (cisterns), freight wagons, special wagons for transportation of new cars);
- relative efficiency compared with other types of transport.

Disadvantages of railway transport are:

- the need to trans-ship on other types of transport;
- the expensive cost of a developed infrastructure.

**Truck transportations.** Basic conditions of international road transport governed by the Convention on the Contract for the International Carriage of Goods by Road, signed in Geneva in 1956.

The contract of carriage is performed in the form of CMR waybill. The full title is "International Consignment Note", however, in-work it is known as CMR.

Its functions are:

- 1) the contract of carriage;
- 2) the shipping document;
- 3) receipt of the carrier.

Road consignment note is issued in triplicate. It should indicate the date of shipment, the name of the cargo to be carried, the name and address of the carrier, the name of the recipient, delivery time and amount of penalty for delay in delivery, the cost of transportation. The consignment note shall be signed by the carrier and shipper. In addition to CMR such shipping documents such as packing list, shipping specifications, quality certificate and others are also moved with the cargo.

The advantages of road transport include:

- branching of roads that allows to deliver goods directly to the destination;
- possibility to transport perishable foods (like dairy products) with trucks refrigerators;

The disadvantages of road transport are:

- the condition of the road surface;
- breaking the instructions and rules of safety by the drivers.

**Air transportation.** Air freight are processed by air waybill. It serves as:

- 1) agreement on air transport;
- 2) the shipping document;
- 3) receipt of acceptance of goods;
- 4) custom declaration.

The air waybill issued by the shipper in triplicate and handed over to the carrier along with the goods. The first instance is marked "for the carrier", signed by the shipper, the second – "for the recipient", signed by the shipper and the carrier and is sent with the freight, and the third copy, marked "for the shipper" is signed by the

carrier and returned to the consignor after the goods is accepted. Besides air waybill, the freight requires shipping documents.

The rapid development of air transport is consistent with the trend of globalization countries. The development of air transport in Ukraine, as well as the world in general, affecting the same factors that determine the trends for all other modes of transport and international economic activity in general.

Major *drawback* is the high cost of air transportation and a lack of flexibility.



#### **Issues for self-control**

1. Characteristics of international, foreign trade and domestic transportations.
2. Differences between international, foreign trade and domestic traffic.
3. Classification of international transport operations.
4. Types of linear transport.
5. The cost of transportation of goods in different ways of organization of transportation.

#### **Issues of practical classes**

1. Characteristics of types of transport.
2. Legal regulation of transport operations (national and international aspect).
3. Organization of international transportation of goods by sea mode of transport.
4. Organization of international cargo transportation by air transport.
5. Organization of international transportation of goods by automobile transport.
6. Documentary registration of transport operations.

#### **Issues for independent work**

1. Consider the organization and conditions of international combined transportations of cargoes.
2. Describe the organization of transportation of international transit cargoes.

## 6. PRICE POLICY AND MECHANISM OF CALCULATIONS IN THE EXTERNAL MARKET



### KEY TERMS AND CONCEPTS

✧ <i>International contract</i>	✧ <i>Foreign Trade Contract</i>
✧ <i>Contract terms</i>	✧ <i>Offer price</i>
✧ <i>World prices</i>	✧ <i>Prices of auctions</i>
✧ <i>Prices with subsequent fixation</i>	✧ <i>Documentary collection</i>
✧ <i>Market prices</i>	✧ <i>Fixed prices</i>
✧ <i>Collection of payments</i>	✧ <i>Contract currency</i>
✧ <i>Reference prices</i>	✧ <i>Flexible prices</i>
✧ <i>Simple collection</i>	✧ <i>Currency of payment</i>



## 6.1. International Contract Price

Pricing of the international contract is the major specification in signing this document. The contract price is affected by numerous and diverse factors. These factors can be classified as:

- *objective* (properties of consumer goods, general supply and demand);
- *subjective* (experience and knowledge of commercial contractors, availability of the technical means to implement the agreement and ability to organize support during customs clearance, etc.);
- *long* (those that characterize the stable value and economic relations);
- *conjunctural* (associated with currency fluctuations, current changes in production and consumption, changing the ratio of basic market forces);
- *economic* (relating to purely market laws and current events);
- *non-economic* (natural disasters, armed conflicts and man-made disasters).

Pricing of the contract is not an easy mechanism, because the price should reflect the operating results and be flexible tool in competing in international markets at the same time.

In particular, the price functions are following:

- includes direct and indirect costs of producing goods;
- reflects the usefulness of the product (this is especially noticeable when setting prices for new, technologically leading products);
- provides income to the seller;
- reflects market conditions and forms them using the product price fluctuations.

According to the economic factors, peculiarities of the production, the nature of the product itself, the available information about prices and reasonable methods of concluding specific contracts, using different methods of determining prices.

In determining the contract price is important to know about the prices of similar foreign operations that take place in international trade. It uses a variety of objective data and a variety of prices.

*World prices* – prices of the most influential market companies. Depending on the goods, this are the prices used by the countries (exporter or importer), exchanges and auctions, leading companies.

*Market prices* – prices at which trade is conducted on a specific national or regional market. They have a key role in the marketing strategy and deciding about entering a particular market, segment conquest, selecting the pricing policy of the firm.

However, the concept of the "world price" and "market price" is somewhat abstract, and, in fact, their real meaning is appeared in a variety of systems and sources of pricing.

These sources are primarily *published prices* – reference prices, stock quotes, auction prices, bid prices of large firms, average export and import prices.

*Reference prices* are prices for similar goods that are used in international trade and in domestic markets at the wholesale trade of various countries. Reference prices can reflect the parameters of recent transactions, given that the main source of reference prices are newsletters, catalogues, magazines, specialized newspapers, catalogues and more.

*Stock quotes* is the sale price of goods, reflect supply and demand for the commodity on markets, and mostly they reflect the real price parameters of the contracts. Stock quotes are critical in determining the price of a homogeneous mass products that are traded on exchanges.

*Prices of auctions* record the conditions of non-standard products sale. This type of pricing in international trade is applied to certain groups of goods (wool, fur, tea, etc.). Price auction can be set in the process of bidding higher prices (this is more common rule) and with a decrease in prices that occurs after the announcement of the highest expected price.

*Offer prices* of large firms have a nominal value, as they are the seller's price. Basically, they refer to high-tech products that are the subject of a complex production.

*Average export and import prices* are calculated using statistical data on international trade, which took place over a period (usually a year). The relevant data are the Ministry of Economy of Ukraine, State Statistics Committee of Ukraine. For

accurate and reliable information, sometimes specialists use alternative statistical framework, where appropriate calculations are carried out with some independent think tanks.

Besides of officially published prices *preliminary agreements prices* can still be used that are available to contractors. However, this information is not always reliable, and sometimes is deliberately concealed by the commercial transactions parties.

On the basis of prices examination and depending on the nature of the goods, conditions of contract, and market conditions the method of prices fixing may vary and differ. There are forms of prices, depending on the date of final determination: fixed prices, driven by pricing, followed by fixation and prices slide.

1. *Fixed prices* are established at the time of signing the contract and do not change during the contract execution. This pricing model is the most appropriate in carrying out urgent deliveries (about 2 weeks) and applies where the period of performance of contractual obligations does not exceed 2 or 3 weeks.

2. *Flexible prices* are established when the object of contract is the products with long production and are tentatively determined at the time of signing the contract but may vary depending on the dynamics of market prices for the goods.

3. *Price with the subsequent fixation* are also established when the object of the contract is the products with long production and depend not only on the market prices dynamics, but the quality of the final products (for example, metals or chemicals on the basis of useful and unwanted additives) and actual production costs, which are not always easy to predict previously.

4. *Sliding prices* are used when a contract deals with not only products with long production period, but with the composite pricing. That is, initially, the contract states the basic price and its structure: its content of various kinds of components and costs (costs of raw materials and energy, depreciation, labour, overhead costs, profit). Thus, it is the dynamics of the components (for example, changes in prices of raw materials, energy or labour) that determines the "slip" of the final price, which will be specified in the contract.

The final price of the contract is a compromise of quotations and preferences of buyers and sellers. The desire to include all the above components in the seller's price and increase their profits, and the desire of the buyer to purchase goods at the lowest price, created a diversified system of price discounts.

The size and nature of the discount depends on the type of product (for example, product use after a short period requires immediate sell – it mainly applies to fruits and vegetables, and other products), market conditions, characteristics of the relationship between the seller and the buyer (for regular customers or buyers of large quantities of goods preferential approaches may be applied), type of payment and other factors. Overall, there are about 20 species of discounts. Moreover, the condition of granting discounts to one of the contractors may be included in the text of the contract.

The most common discounts in commercial practice in the world are the following.

*Simple (or general)* is typical price discount concessions of the seller during the negotiation process, which depends on the market situation and the nature of the goods. Discounts on complex products can be 1/5-1/3 the price of goods, while discounts on raw materials – 3-7%.

*Progressive (wholesale) discounts* are provided to customers in case of an increase in demand and consignments size, and they can proportionally increase with the increasing amounts of contractual delivery. In world practice, the value of these discounts can be 10-15%.

*Seasonal sales* are seasonal and available when consumption of goods is not typical or mass for a given season. The usage of seasonal discounts is typical for such goods of mass demand for clothing, footwear, and for mass production of similar items and seasonal use, such as fertilizers.

*Special discounts* are applied for VIP buyers and may vary depending on the nature of the relationship between contractors and type of operations. For example, the seller may be interested in specific orders of buyers (probably by offering the special discounts to the seller in case of signing the contract). Besides, special discounts are

applied on sample shipments sales or if the product is entirely new, or if the manufacturer is trying to gain a foothold in a new for him market segment.

*Dealer discounts* (the difference between the retail price and the contract price) are provided to regular intermediaries, agents, dealers. Their income is formed by these discounts. This type of discount is applied in the sales of standard equipment, office equipment, vehicles. The size ranges from 10-20% (sometimes around 30%) of the retail price.

*Bonus discounts* (or discounts from sales turnover) are provided to regular agents and wholesalers for a large number of products in accordance with the specified annual turnover. Discounts for commodity are 5-7%, and for certain types of equipment and products machine engineering are 5-25%.

*Allowance for cash.* Such discounts are applied for cash payments, if the payments under the contract have been performed before a specified period (for example, if the reference price provides credit payment, and the buyer pays the money immediately). In fact, the value of "cash discount" is determined by the lending credit to a national market.

*Closed discounts* are applied for internal-trade (in internal trade in integration associations) as well as the implementation of supply, according to some intergovernmental agreements.

## **6.2. Terms of payments and payments for export-import operations**

Terms of payment contracts is a complex concept, whose content corresponds to the nature of the payment obligations, the terms of payment and guarantees partners.

Terms of payment contracts require definition:

- methods of payment;
- means of payment;
- forms of payment.

*Method of payment* vary depending on the time of payment for goods and their actual delivery. Payments can be made in so-called *cash way*, *advance payment (prepayment)* and *credits* (using the services of banks and is bound in time to act of physical goods transfer).

*Cash payment* is made before or after the transmission of documents by the seller to the buyer (including the period of processing the payment document by accounting departments and banking institutions). Actual payment takes place prior to its conversion for use by the consumer.

*Advanced payment* is the payment made by the purchaser according the contractual obligations before the moment of documents transmission and the product itself. Advanced payment may play a positive role in the organization of supply, because it is actually a credit for the seller and provides him with the necessary financial means and material resources (if it is not carried out in cash but as a commodities). In addition, for the seller it is a guarantee against losses in a situation where the buyer refuses to products which are the subject of the contract.

It is important to consider that the benefits for the seller determine the need for the buyer in appropriate record in the contract guarantees on reversible advance payment and possible compensation.

*Credit payment* provides the primary supply of goods by merchants, according to the different commercial interests with the following buyer's financial obligations. Thus, this form of payment is also called supplier's credit or commercial credit. According to the time of realization of the importer's financial obligations, after getting the credit (the actual implementation of supply), this form of payment can be considered a short-term (up to 1 year), medium (1 to 5 years) and long term (over 5 years).

This form of payments spread due to competition among producing equipment firms, in order to encourage potential buyers and is also used in the situations in which the payment making may be difficult or even impossible before the purchased objects start to operate or carrying out one or more process cycles.

*Means of payment* are payment instruments, for example money in a particular currency.

Setting the price of goods, it is crucial to set the currency. This function can be performed by the money (currency) of the exporting country, the importing country, other countries (especially the U.S. dollar, the euro and the Japanese yen and other freely convertible currencies).

However, the currency which evaluates the goods in the contract and currency (or currencies) in which payments are made, can be different. In this regard, we can highlight the concept of "contract currency" and "currency of payment".

*Contract currency* is a currency in which a price of goods in international sales contract is set.

*Currency of payment* is the currency in which, according to the counterparties agreement, the actual payment is made for goods.

As the exchange rates may fluctuate, (which may result in additional profit for one party and losses for the other) currency clauses are used, fixing the exchange rate of one currency against another. This occurs in situations where the currency of the contract does not match the currency of payment.

*Forms of payment* differ in ways of money transfer from the buyer to the seller.

*Bank transfer* is the most common form of payment in the modern practice of export-import operations. For participants of foreign economic transactions bank transfer is the most convenient form of payment, while it is a commercial operation for bank, the execution of which is charged with a fee for services rendered. This operation is done in case of availability of the transfer of funds application (other name of the document – the payment order), and after a papers and account thorough examination, the bank begins the procedure of processing and execution of orders.

This bank charges from customer's account the amount of payment and the commission and in accordance with the established method sends the payment order to the exporter's bank or correspondent bank (usually it is elected by the importer's bank). Importer's bank also sends the final statement of his account, which reflects the appropriate funds withdrawal.

*Letter of credit* as a form of payment is associated with banks involvement as active participants. Letter of credit is a bank's action on behalf of a client to make payments to a third part (the beneficiary) or other bank issuing order for appropriate action to obtain the specified document and in accordance with agreed terms.

First of all, it concerns the conditions under which an exporter can use the Letter of credit, that is, to get pay for delivered him goods.

Letter of credit enables to make export and import operations the safest for both parties. It is typical for agreements conducting the payment against the documents provided by the exporter or such agreements, which suppose provision of short-term (1 year) trade credit.

Letter of credit usage in the International Cooperation is governed by Uniform Customs and Practice for Documentary Credits, developed by the International Chamber of Commerce [68].

***Collection of payments (Encashment)*** is a bank clearing transaction under which the exporter bank, in the prescribed order and in accordance with the calculation documents, receives money from the importer and enrolls them to the account of its client (possible variation of the encashment is to obtain the assurance that the appropriate amount will be paid on time).

Encashment in international trade are applied on the basis adopted in 1978 by the International Chamber of Commerce "Uniform rules on the encashment".

There are two types of collection of payments – clean remittance and documentary:

- *clean remittance (simple collection)* – collection of funds in accordance with the financial documentation (bill of exchange or promissory notes, checks and other instruments that are used for payments) without the use of commercial documents;
- *documentary collection* – collection of money based on financial documents, accompanied by instruments of a commercial nature (transport, shipping, insurance documents and bills, invoices, etc.).

The subjects of collection operations are the exporter, the exporting bank that are provided with the collection order, a correspondent bank that executes instructions, and the importer, who makes a payment [68].

*Open account payment* – periodic payments from the buyer to the seller, that may be used for stable, repetitive delivery of goods in terms of subsequent payment and the debt will be recorded to the account of the importer. In fact, it comes to credit on an open account, the repayment of which is carried out in accordance with the specific agreement of the exporter and importer.

Thus, there is no trade guarantees (for the seller) of reliability and timeliness of payment (the delivery is ahead of the relevant payment and the exporter does not pass the documents to the importer through the bank) and between counterparties, who have established supply relationships, as well as between the principal corporation structure and its affiliates.

The mechanism of *check payments* is governed by the national legislation and international normative sources (such as the Convention providing a Uniform Law for Cheques of 1931, a number of Anglo-Saxon countries follow the provisions of British law on Bills of exchange from 1982).

The owner of the check (such holder as a result of export-import operations can become an exporter) submits the bill to his own bank, which pays it either immediately upon presentation or after the sum transfer to its correspondent account.

*Payment by bill of exchange* is one of the most common credit and payment instruments which is used in export-import operations. It performs functions that are similar to cash. Application of these notes allows importers to defer payments and exporters – to account unexpired bills.

Promissory notes and bills of exchange can be used in international trade. *Promissory note* – a bond (or fixed desires) of the bill drawer to pay the payee (bill holder) a certain amount of money. *Bill of exchange* (or draft) is issued by the payee (that is exporter) and transferred to the drafter (that is the importer of the goods), whom is to accept and pay the bill within the specified period. It is the acceptance of a bill that converts the importer into a debtor in a legal sense.



### **Issues for self-examination**

1. Describe the features of the price of an international contract.
2. Consider the main types of discounts compromise quotations and preferences of buyers and sellers.
3. Describe the content of the sections of the foreign trade contract.
4. What are the methods of determining the quality of goods and the particulars of their use in foreign trade.
5. Consider ways to set the delivery date for foreign trade agreements.
6. Determine the order of acceptance of the goods.
7. Describe the individual and universal terms of the contract.
8. Consider modern methods for determining product quality.
9. Explain the transfer of ownership of the goods.

### **Issues for practical classes**

1. Types of foreign trade contracts.
2. Structure and features of contract execution.
3. Preparation of export and import agreement.

### **Issues for independent work**

1. Methods of contracting.
2. Forms of contracts of sale.
3. Methods of fixing prices in the contract.

## 7. RISKS IN FOREIGN ECONOMIC ACTIVITY



### KEY TERMS AND CONCEPTS

✧ <i>Insurance</i>	✧ <i>Credit insurance</i>
✧ <i>Vehicle insurance</i>	✧ <i>reinsurance</i>
✧ <i>Risk</i>	✧ <i>Guarantee insurance</i>
✧ <i>Marine insurance</i>	✧ <i>Escalator clause</i>
✧ <i>Aviation insurance</i>	✧ <i>Del credere</i>
✧ <i>Hedging</i>	✧ <i>Golden caution</i>
✧ <i>Foreign exchange risk</i>	✧ <i>Currency caution</i>
✧ <i>Credit risk</i>	✧ <i>Cargo</i>
✧ <i>Currency insurance</i>	✧ <i>Casco</i>



## 7.1. Types of risks in foreign trade activity

Foreign trade among other types of business has the highest level of risk, because, in addition to the risks within the country, the activities of economic agents are affected by the risks "of foreign origin". The process of identification, prediction and minimization is complicated by different legal standards and trade practices of other countries, as well as the ability to influence them or to have a level of legal protection.

*Risk* is the probability of some kind of a dangerous situation or a few situations that lead to financial, property and commercial losses [86].

The peculiarity of the risk nature in business is that in addition to the risk of loss it also provides the risk of winning. By itself, the entrepreneurship is a bilateral issue in terms of risk – you risk and either you win or lose. In order to be able to turn risk into a positive direction, you need to have and develop not just one solution, but a series of alternatives. In this case, the probability of the optimal solution is much higher, and the ability to avoid or minimize risks is more real.

For a specialist in foreign economic activity, perhaps the most important skill is the ability to identify and analyse risks. First of all, we must be able to classify them, to determine the level of danger and identify the interrelation and interdependence between different types of risk and to determine the nature of the negative results in case of happening.

An important factor is the degree of risk "purity". Quite common is risks insurance speculation. Unscrupulous employers insure pre-specified risk of loss of different character, thus violating the principle of insurance – only a probability, but not a certain fact of the insured event, and receive substantial profits from it [88].

The aim of any insurance company is to check and detect this kind of business and deny their service. A common practice is to combine efforts of insurance firms in this area with firms that collect information about the company, analysing their business reputation in a particular market.

The nature of risk origin is very diverse and consists of about 200 species, like political, transport, credit and foreign exchange, technological, organizational, technical, information, natural origin, customs etc.

**Political risks** are classified as macroeconomic, because they influence on the businesses activity outside. Political risks can be the following: political riots in the country, civil unrest, war, prohibition (embargo) on the importation of goods into the territory of a country due to deterioration or complete cessation of political and economic relations between the state and the state – exporter – importer.

Typically, the political risk is fairly easy to predict. But if it is impossible to minimize the risk with the direct effect on its nature, it makes sense for the company to change the direction of foreign trade and thus avoid risky situations.

This type of risks tends to occur in politically unstable countries and regions, such as Africa, Latin America, the Middle East. There are ongoing military outbreaks of the political and ethnic basis, the risk of expropriation of property of foreign companies, the inability to exercise control over the duties of the counterparty, and more.

Adverse political relations between countries may occur due to changes in foreign political and economic development of a country, which is contrary to the principles of partner country foreign policy.

**Transportation risks** occur in making direct delivery of goods from seller to buyer. They may occur in emergency accidents, resulting in a complete destruction or damage of the goods, theft during transportation, the negative impact of natural factors etc.

**Currency and credit risks** include risks related to the depreciation of certain currencies, fluctuations in exchange rates, inflation, resulting in the loss or gains on the difference between the price currency and the transaction payment currency. These risks are interrelated and may occur on the basis of political risks which lead to economic instability in the country or a particular region deterioration.

**Technical risks** are directly related to the scientific and technical human activity and the negative effects of these activities. It can be explosions in factories, destruction

of the hydropower plants, chemical and radiological contamination associated with the negligent attitude to a dangerous production.

*Organizational and technical risks* may arise in the case of poor logistics process – a miscalculation in the desired time delivery, poor organization of loading and unloading, provision the necessary transport, provision the required packaging to maintain the product and more.

*Risks of natural origin* (earthquakes, landslides, floods, tsunamis) are the most difficult to predict. We can minimize them through the insurance the goods and vehicles.

Making the goods to customs may be some risks that are grouped into *customs risks*. These risks are closely related to information risks, because the main problem with goods crossing the border is a lack of knowledge or poor knowledge of regulations of customs control, completion of documentation and identification of the goods. In Ukraine these types of risks are fairly distributed and real, as frequent changes of legislation and a large percentage of inconsistency between them, leading to misunderstandings and serious financial losses.

Insurance is the most common method of risk reduction. *Insurance* – a system of economic relations, that is the formation of special money fund of companies, organizations and public for damages caused by natural disasters and other adverse random events.

In insurance the prerequisite is the existence of two parties: the insurance company and the legal entities and individuals (that pay their subscriptions to insurance company).

*Characteristic features of insurance are:*

- targeted accumulation of funds used only to cover the cost of pre-specified cases;
- the likely nature of the relationship, as it is unknown in advance, when will the relevant event take place, which will be the influence and whom it will concern;
- repayment of funds, as they are designed to pay all policyholders.

*Foreign trade risk insurance* is a complex of different types insurance that secure interests of domestic and foreign participants of various forms of international cooperation. Foreign trade risk insurance includes insurance of export and import of goods, means of transportation (ship, aircraft, vehicles), construction risks insurance, export credits, international trade and industry and other exhibitions, created jointly with foreign firms, and so on. Such insurance operations are carried out in a convertible and the national currency. Most cases insurance is voluntary. Depending on the content of the relevant contracts, insurance costs can be carried by any of the parties.

In carrying out payment transactions in foreign operations, risks can be divided into *credit, financial and foreign exchange*.

*Credit risk* is the risk of non-payment by the borrower the loan principal and interest belonging to the creditor.

Credit risk protection may be carried out in the following ways:

- if the risks are internal, such methods as the limitation (according to regulatory assets) provisioning, assurance, mortgage, insurance, risk sharing are used;
- if risks are external, such methods as the choice of types and modes of operations, limitation, diversification of the loan portfolio (in relation to the terms of borrowers, security, interest rates and methods of their calculation), provisioning, obtain additional information, monitoring and control risk are used.

The essence of credit risk insurance is in its reduction or elimination. Subject to the risk are:

- commercial loans to the buyer;
- bank loans;
- obligations under the loan;
- long term investments and more.

Credit insurance includes the following: *del credere and guarantee (collateral) insurance*.

*Del credere* is an agreement which provides that the commission for an additional fee (fee for taking the risk of commission operations) guarantees the principal that a bill for goods sold on credit to be redeemed within a specified period.

The essence of the *guarantee insurance* is that the insurer for obtaining low insurance premium, assumes (instead of the debtor) the role of guarantor of payment of their total debt at a certain time in favour of the insured.

The main forms of credit insurance are:

- trade credit insurance – an operation that provides for losses that occurred due to failure of short-term credit requirements of commodity supply and services. More than 80% of world trade is carried out with the provision of trade credit;
- insurance loans for investment is based on the acquisition of investment funds provided by the suppliers of credit. Loans are both provided in the commodity (the creditors – the producers) and in the form of money (the lenders – the credit institutions).
- insurance of bail granted loans, is carried out when the borrower provides loan repayment pledged property as real estate or movable property.

One of the types of credit risk insurance is *export credit insurance* – insurance against the risk of non-payment by foreign firms export debts.

The risks for insurance of export credits are divided into 2 groups:

1) purely commercial or economic risks (bankruptcy of the private buyer, the rejection of the payment or acceptance of the goods, failure to pay the debt in due course);

2) those that combine types of political risk (military action, payments abroad ban, confiscation).

The basic principles of export credit include the following:

1) credit insurance must precede the appearance of a particular risk;

2) commodities which have been already shipped can't be insured (the main is the fact of signing the contract, which establishes commercial and credit terms);

3) loan insurance must either precede the establishment of product disposal terms and its actual exclusion or accompany it.

Financial risk insurance covers all types of insurance coverage of risks which appear in any area of financial relationships or directly cause financial losses. Among the more than 10 risks associated in the financial group, the most constituting the danger is the risk of profit loss.

*Currency risk* – the risk associated with a change in the real value of the payments denominated in foreign currency due to the fluctuation of exchange rate.

In other words, *currency risk* is the risk that arises when the export-import operations and the sale of goods on credit due to changes in foreign currency against the national or the fall of purchasing power due to higher export and import prices (deterioration terms of trade) in the period between the signing of the trade agreement and payment for it. Currency risk associated with changes in the real value of the financial liability for a certain period of time.

Currency risks are divided into a courses risks that are related to losses due to currency fluctuations and inflation risks, that are caused by currency depreciation due to inflation.

Insurance exchange risk is managed in the following ways:

- entering the precautions into foreign trade contract terms;
- implementation of the bank or other credit and financial institution operations to insure (hedge) changes in exchange rates on the price of the currency of payment.

In private international law the following types of safety precautions are distinguished.

1. *Golden precaution* is included in the contract terms under which payment must be made either directly determined by the amount of gold (bullion, coins), or the corresponding currency in the gold equivalent (based on the gold content of the currency) as stated in the contract. This clause is now rare because most of the world countries refers to the Jamaican currency system that does not involve fixing the gold content of the currency).

2. *Currency precaution* is included in an international commercial contract condition, under which the amount of payment varies in the same proportion, as the change of the payment currency exchange rate to the exchange rate of the precaution currency.

Currency precautions may be unilateral, that act in the interests of one side or can be bilateral, when the payment amount is reviewed as with an increase in the exchange rate, and when it is decreasing. An example of bilateral exchange restrictions is the price of the contract in several currencies.

When the price of goods is set in the same currency, we can use following types of precautions: *direct, indirect, multicurrency*. These reservations can be either bilateral or unilateral.

Direct currency precaution applies when the currency of the price and the currency of payment is the same, but the value of the payment amount due to contract, is set in accordance with the change of the payment currency exchange rate in relation to other, more stable currency – precaution currency.

Indirect exchange restrictions are applied in cases when the price of goods is fixed in one currency and the payment is expected to be made in the other (usually national). As the *direct and indirect currency precautions* are not highly effective, especially in the constant exchange rate fluctuations on the financial markets, *the multicurrency clause appears*. Their action is based on the payment sum correction in proportion to payment currency changes not to the one but to several currencies, the exchange rate of which is calculated as the average value determined by using the mathematical methods.

3. *Index disclaimer* under which the sum of payment depends on the price indices on the world commodity markets. Index clause provides that the price of goods and the payment sum are changed in accordance with changes to the date of payment of specified price index detailed in the contract, compared to its value at the time of conclusion of the contract.

4. *Precautions of the contract price revision* implies that the change of the exchange rate of the price currency, which goes outside the fluctuations limits set by

the agreement parties, the exporter is entitled to revise the contract price for the incomplete deliveries.

5. A variation of the above can be so called *escalator clause* that provides fixation of notional price in the contract, which may be revised based on changes in pricing factors.

Commonly, there are other forms of currency risk insurance, but unlike the reservations they are not contractual in nature, as are not included in the texts of international contracts – forwards, futures, options.

***Transportation risks and characteristics of their insurance.***

Insurance in foreign relations look from the perspective of security of water transport, air transport facilities, transport means and goods transported by these modes. Generally, under vehicle insurance means a series of insurance against the dangers arising in different ways transportation – sea, river, air, ground, mixed.

Objects of insurance can be a means of transport themselves and their goods transported. Cargo insurance is often referred to as *cargo*, and of transport insurance – *Casco*.

***Features of marine insurance.*** Marine transportation is one of the cheapest types of carriage of goods in foreign trade activity. Transportation of goods by sea is accompanied by various objective (principal) risks that are beyond human control and impersonal, and the effects are widespread. These risks include: earthquakes, floods, tsunamis, hurricanes, volcanic eruptions, and other manifestations of the elemental forces of nature. Wars, social conflicts and political interference are also included in this type of risk.

Subjective (specific) risks can be ranked risks, the causes of which are peculiar character. These risks include: theft, fire, accident and other displays based on the denial or disregard of objective approach to reality.

Marine insurance includes insurance of ships, cargo, freight, the ship owner.

The object in marine insurance is any property interest related to merchant shipping: ship, cargo, freight, rent, and the risk of being taken over by the insured.

Merchant Shipping – activities associated with the use of vehicles and cargo, passengers, baggage, mail, products, fish and other marine craft, exploration and mining operations, performance towing, rescue and more.

Consider the four typical types of contract of marine insurance:

1. Insurance of vehicles, as the vehicle, based on typical conditions are such contracts:

- clause RDC (running down clause);
- clause on liability to third parties;
- clause (free of particular average);
- clause of general average;
- clause litigation and labour relations;
- clause "abandonment";
- division of risk between the insurer and the insured;
- contractual guarantee (shipping clause, clause legitimacy).

2. Insurance to get payment for the freight owner of the vessel.

3. Insurance of the liability carrier or shipper of goods to third parties.

4. Cargo insurance.

Let's consider the peculiarities inherent in cargo insurance. Cargo insurance has three characteristics that distinguish it among all other types of insurance.

The first – a free transfer policy, which does not require any application to the insurer. It means that the goods from the beginning provide insurance coverage (which usually coincides with download) was extracted from well-known insurer, the goods handed over to the carrier. Insured is not in fact cares and nothing to do with the load can't therefore completely missing the so-called "subjective danger", that is one that is in causal connection with the insured. Therefore, the insurer does not matter who becomes the owner of the goods, and in whose hands is the policy.

The second feature – an opportunity to insure the goods higher than its value at the time of signing the contract. This does not contradict the basic provisions of the insurance amount does not exceed the value of the insured property. It is generally

insurance is not broken, because at the point where the goods are delivered and where it is in the form of goods will be realized, the price may be higher.

The third feature – an opportunity to cover the so-called general (open) policy. General policy – a contract with the insurer of the insured to the insurer for insurance transfer all cargo shipments this person or entity for a specified period (usually not more than 12 months). Through this contract, the insurer may simplify formalities insurance. From each insurer need only request a shipment. Payment for this policy is carried out periodically by the terms specified in the contract, but not for every shipment. In this case the facilities are obvious: simplicity and speed, that is exactly what is so necessary for transactions in foreign economic activity.

***Features of auto insurance.*** In motor insurance to be insured on a voluntary basis means vehicles, cargo, civil liability of owners of motor vehicles.

The object of insurance of motor vehicles are cars, trucks, buses and more.

Arising out of, which caused the loss or damage to the insured vehicle as a result of an accident, fire, explosion, earthquake, flood and other natural disasters.

The main types of accidents are: collisions, hitting, rolling over. In the scope of responsibilities also included theft and other unlawful acts of third parties. Not reimbursed losses that cause intentional action, driving of transport a person who does not have a driver's license, from the natural deterioration of motor vehicles, military actions and measures their impact, strikes, confiscation by order of the government and so on.

In the event of total loss of the vehicle, refund will be made within the sum insured, but not higher than the actual cost of transport at the time of the insured event, considering depreciation.

With the expansion of economic activity insurance has become an international scale. International insurance is known as the "Green Card System", which entered into force on 01.01.1953 was and got its name from the colour and shape of the insurance policy. Countries belonging to the international insurance took on a commitment to recognizing the territory of these countries policyholder for the insurance of civil liability of owners of vehicles in international road traffic. The main element of the

Green Card is a bureau of the participating countries, organizing control over the availability of insurance at the border crossing, and decide together with insurance companies to resolve the question of the alleged claims for insured events. Immediately refund for green card insurance companies authorized to carry out.

***Features of aviation insurance.*** The concept of aviation insurance includes the following specific types of risks, such as:

- insurance planes of death and injury;
- insurance liability to the passenger for loss of life and liability for loss or damage to passengers' luggage;
- insurance third party liability for damage to them or their property by the operation of air transport means;
- insurance team;
- insurance of liability for the cargo transported by air;
- insurance third party liability in the construction of aircraft and their repair.

The object of aviation insurance is any property interest related to the operation of vehicles.

Carrier and performer air operations must insure crew and aviation personnel on board the aircraft (own, rented, transferred in operation), and their responsibility for damages caused to passengers, baggage, mail, cargo accepted for transportation, air transportation to other users and third parties.

The coordination of the insurers in the industry aviation insurance performs aviation insurance bureau, which represents them in international associations of insurers. To compensate victims of aviation accident, natural disaster and improving aviation safety an insurance fund aviation safety was established. It was created by revenue deductions from payments of compulsory insurance, as defined by legislation of country. In establishing premium rates of aviation insurance, the principle of individual approach is to risk assessment. Insuring aircraft that operates flights for carriage of passengers, baggage and cargo, the main criteria to establish appropriate premium rates is data such as the fleet by number, model aircraft, aircraft insurance amount, the number of passenger seats, qualified pilots, annual rates of passenger-

kilometres, tonne-kilometres, quantitative and value terms the death planes in recent years.

**Reinsurance** is a system of economic relations between insurers that allows the insurance company that the insurance agreement, pass to take the risk to other insurers – insurers.

Reinsurance is a prerequisite for financial stability of the insurance operations and the normal activity of any insurance company regardless of the size of its capital and financial assets. The essence of the relationship between the reinsurer and the reinsurer is a reinsurance obligation to reimburse the share of insurance premiums insurance companies made for insured events that have already occurred in the client.

The economic essence of reinsurance is redistribution between insurance companies created (primary) insurance fund.

The Institute exists to realignment of insurance premiums that are accepted by insurance risks to bring potential liability for an aggregate sum insured under the insurer's financial capacity to ensure the financial stability of insurance operations and profitability, and for mutual participation in the risks taken on by other insurance insurers.

Reinsurance risk is the protection of the insurance portfolio of major influence on his insurance claims or other catastrophic event, and the payment of insurance compensation amounts several insurance companies, carried out collectively by all participants in the reinsurance of the object.

An insurer who has taken the insurance risk and gave it to another part in the reinsurer, called the reinsurer (transferor). An insurer who has taken risks in reinsurance, the reinsurer is called (assigns, retrotsedent). Taking risks in reinsurance, the reinsurer (retrotsedent) can partially pass it to another reinsurer, and this operation is called retrocession, and a party who has assumed the risk – retrocessionaire.

By the method of risk transfer and registration of the legal relationship of the parties, reinsurance transactions are divided into facultative, treaty and mixed.

## 7.2. The ways of risks minimization

For an effective management and minimization of possible risks on enterprises the departments or positions, that is responsible for monitoring, analysis and development of the management risks program should function.

Management risk stages closely related to the tactical, strategic planning and enterprise management.

The main objective of the risk managers on the first stage is a clear formulation and analysis of the risks reasons, the nature of their origin and degree of the potential threat for the company.

The main causes of risks generally include:

- unstable political and economic situation in a particular country and in the world globally;
- difficulty of predicting future demand trends (development of fundamentally new products, software, or type of service, which can lead to the gradual refuse of your product);
- national and cultural non-acceptance of the offered products;
- insufficient information for an objective analysis of market conditions;
- influence of factors of unforeseeable origin (technogenic catastrophes and accidents, natural calamities);
- insufficient knowledge of the legal characteristics of particular operations registration in other countries;
- receiving of false information about the financial and solvent condition of the partner, the presence of the term "commercial secret", fraud;
- wrong choice of available alternatives solutions etc.

The main way to minimize risks is the insurance of foreign economic activities and operations.

Insurance of external economic risks involves the development of complex management programs and the formation of a set of different types of insurance, which in the future will effectively provide protection or reduce the expenses of the enterprise

and its partners, from the financial losses, worsening of business reputation and litigation.

An insurance of foreign economic activity primarily includes insurance of export-import operations, transport, currency-financial operations, crediting, insurance of international fairs, exhibitions, auctions and bidding, ensuring against force-majeure and other.

The entities of insurance in foreign economic activity include:

- exporting firms;
- importing firms;
- intermediary firms;
- international banks and financial institutions;
- carriers;
- state, etc.

Objects of insurance in foreign economic activity are:

- estate of exporter or importer;
- vehicles;
- currency and credit transactions, etc.

The main document for insurance is an insurance contract. The main points of the contract of insurance include:

- document title (depending on object of insurance);
- name and address of the insurer and the insured;
- the amount of the insurance sum;
- list of insurance incident that fall under this contract, the size and terms of premium payments, the insurance compensation in case of the insured incident;
- term of validity of this agreement;
- procedure of the agreement changes and termination;
- rights, duties and responsibility of parties of the agreement in case of violation of conditions of the agreement;
- other terms are possible;
- signatures and essential elements of parties.

The main contracts of insurance are: insurance of currency risks, export commercial crediting of contractor, insurance of load (cargo), insurance of transportation (vehicle, Casco).

In world practice the standard cargo insurance conditions were developed under which there are three choices of insurance coverage:

- Form A (responsible for all risks). It provides the highest level of cargo insurance – against all risks. It is used to transport very valuable cargo, which are presented in a single item or produced of very valuable materials. At their insurance not only the risk of damage or accidental death, but also a high probability of car theft is considered;
- Form B (responsibility for a private accident). This form is used if you want to insure against the risk of technogenic or natural disaster risks, that can influence the safety providing of both the load and the transport vehicle as the whole. Such insurance claims include: fire, flood, technical damage, tsunamis, storms, volcanic eruptions, landslides, earthquakes, etc.;
- Form C (without liability for damages, except in cases of disasters). Under this form insurance coverage of cargo is minimal and provides insurance cases only if the total loss of all cargo, or in the case of a vehicle disaster.

In the international commercial practice basic conditions of supply INCOTERMS is used for sharing of risks and insurance duties. Two of them provide insurance terms, such as:

- CIF – "Cost, Insurance and Freight", that paid by the seller and provides for the use the maximum amount of insurance coverage of goods;
- CIP "Carriage and Insurance Paid to ...", that envisages coverage of standard risks arising during transportation of cargo in accordance with its features, and allows you to discuss and agree on the amount of insurance coverage between the exporter and the importer.

Depending on the type of transport, there are some features of insurance.

In international practice of marine insurance there are four types of agreements on marine insurance. We will consider them.

1. At insurance of marine transport the next terms of agreements are envisaged:

- warning at responsibility before the third persons;
- warning about a general average;
- "abandon" warning;
- warning of RDC (running down clause);
- warning of FPA (free of particular average);
- contractual guarantees (warning about legality, about a seagoing).

2. Cargo Insurance.

3. Insurance to obtain payment for the freight by the owner of the ship.

4. Insurance of the consignor of goods responsibility or carrier before the third persons.

While realization of marine insurance the activity of marine shipowners is widespread lately in this process. They unite in Clubs of P&I.

Such clubs insure carriers on two groups:

- by the risk of defence (protection) is responsibility for death or injuring of members of crew, passengers, collision of ship and other;
- by the risk of compensation (indemnity) is responsibility for a damage transported cargo by this carrier.

Marine transportations in general are the cheapest among other transport vehicles and it allows to transport the bulky and bulk loads of high-cube. However, a marine and river navigation directly depends on weather and climatic terms, and transportation stretches on a long enough period. Therefore, the choice of type of transport you should consider all these features and competently approach to expediency of its selection of a certain type of freight transportation. Marine transportation is inexpedient at transporting of loads, that deteriorate quickly, is valuable or need the special terms of transporting, that marine crafts are unable to provide.

An insurance on motor transport include insurance of vehicles, cargo, civil liability of vehicle owners. Major insurance cases include: damage to vehicles and cargo as a result of accidents, fires, earthquakes, snow slide, theft and so on.

For simplification of the insurance system among the countries International insurance system "Green Card" was developed, according to which, the countries that

have adopted this system should recognize this insurance policy of civil liability of vehicle owners on their territory.

In air transportation insurance is carried out for loss or damage, liability to the passenger for loss or damage of baggage and personal injury or loss of life insurance of the crew, cargo insurance during transportation, insurance of possible liability to third party for damage to or destruction of their property, that related to operation of an aircraft, etc.

The feature of most foreign economic operations between business entities is that on the certain stage of implementation of conditions of the agreement of purchase-sale a salesman becomes a creditor for a customer, as at first transportation of commodity, verification of its quantity and quality is carried out, and then – money transfer for it. An exporter may, firstly, to face the fact that during this period currency exchange rate has declined by consignment, that leading to the actual loss of certain percent of income, secondly, not to get payment in general, or through the refuse of customer in connection with improper according to his opinion quality of the given products, or through his insolvency about that nothing was known before. In this case an exporter should, certainly, to apply to the arbitration or the arbitral tribunal, but all of it, in turn, will result in the loss of time, money and not always will guarantee a positive result of the case.

To protect themselves against these risks the seller can insure at insurance company which compensates the cost of the consignment in case insolvency of the buyer.

Before giving such services, insurance companies study character of activity of the seller, partners, examine quality and composition of commodity, terms of delivery and payment, and then set a risk norm that is or normal or increase.

Most often, the insurance companies agree to provide its services, when the seller is able to give an acceptance from a trusted bank and insures this accepted bill.

Credit risks are directly related to changes in exchange rates, that is, with this type of risk as currency.

Currency risks can be exchange (a loss is on fluctuation of currencies exchange rates) and inflationary (related to depreciation of certain currency).

The basic methods of insurance of similar risks should be considered.

The currency warning is in the conditions of contract. According to this way, insurance against risks in the contract terms "cost of goods" and "conditions of payment", states that the payment amount will vary by the same percentage points (to a greater or lesser way) how to change the exchange rate during realization of payment for a commodity in relation to the course of the currency warning.

The main types of currency clause include direct, indirect and multicurrency warnings.

Direct warnings are used if the currency of payment for goods and currency of price for the product is the same. Payment amount is fixed according to the changes of a stable currency (currency warnings);

The indirect warning is such warning, when the cost of commodity is fixed in one currency, and payment is in other.

The multicurrency warning envisages as the currency warning the use of not one stable currency, but "basket" of stable currencies.

"Baskets" of currencies are converted for the convenience of calculation in conditional counting units, whereby the change in value of a specific currency is determined of relatively a set of stable currencies. Thus, the course-changing of one of currencies in a "basket" is compensated by a cost and stability of other currencies, that allows to minimize the currency risk of both seller and buyer.

Hedging is insurance by banks or credit-financial institutions against risk of course-changing of currencies, cost of contract in relation to the course of currencies, payments for a commodity by the conclusion of additional contract about a purchase from the seller commodity "on a term", i.e. for a certain payment it is possible to buy a right on a commodity at today's price, but the product itself will be purchased later. There is possibility for a salesman to get a guarantee, that a commodity will be bought in the future and to get for it certain money already today, for a customer – to reinsure against the possible increase of cost of commodity in case of dramatic changes of currencies course.

Thus, foreign economic activity itself has an increased level of risk, because it involved contractors from different countries with different cultural and national

characteristics, which makes it harder to check the business intentions of buyers and sellers in relation to a particular agreement.

It follows for minimization of certain risks, foremost, all factors of environment, analyse possible "failures" in-process in a middle a firm or company and to find the optimal way of minimization of potential risks.

To minimize certain risks, first of all, it is necessary to learn all the factors of influence to the external environment, to analyse the possible "failures" of the work within the firm or company and to find the best way to minimize potential risks.



### **Questions and Issues for self-examination**

1. What are the main causes of the risks?
2. Describe the standard cargo insurance conditions that are taking place in international trade practices.
3. Identify the features of insurance for transportation by sea, road, and air transport.
4. Describe the features of credit risk insurance.
5. Describe the features of currency risk insurance.
6. What is the essence of risk FEA?
7. Classification of risks in the implementation of foreign economic activity.
8. What is insurance and what is its essence?

### **Issues for practical classes**

1. Risks in foreign economic activity: causes and ways of origin.
2. Types of foreign economic risks, their characteristics.
3. Insurance in foreign economic activity as a means of minimizing losses from risks.
4. Features of transport insurance.
5. Features of credit and currency insurance.
6. The essence of currency risk and methods of its insurance.

7. What are the types of risks when transporting goods by different modes of transport.

8. Characteristic features and causes of risk.

**Issues for self-study**

1. World experience of insurance operations in the field of foreign economic activity.

2. Reinsurance and its role in foreign trade.

3. Give examples of shipping risks and analyse the methods of reducing or avoiding them.

4. Types of reinsurance operations.

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