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ECONOMICAL RELATIONS AND ITS TYPES

Olloboyeva Lobar Ro'zi Qizi

Assistant Of The Department Of Agribusiness, Accounting And Digital Technologies, Termez Institute Of Agrotechnologies And Innovative Development

ABSTRACT: - In a nation’s economy, the households, firms, and governments work together to fulfill the needs of individuals. However, human needs are diverse and continually increasing, and the national economy is typically unable to satisfy these needs, especially if satisfying these needs requires resources that are not abundant in the country. For instance, many countries do not have resources within themselves to obtain petroleum, and countries in colder climates lack the ability to grow tropical fruits, like bananas. This lack of available resources within a country poses an economic problem, which motivates individuals from different countries to establish trades.

KEYWORDS: Development, economy, commerce, culture

INTRODUCTION

International trade refers to transactions of goods or services between countries. Countries with abundant resources can sell them to other countries in exchange for monetary compensation, just like we would conduct transactions in marketplaces. We recall that net exports, which refers to the difference between exports and imports, is a component of national income, more specifically, GDP and GNI. Hence, statistics of international trade are used to determine the overall health of the national economy. In newspapers, we can read reports on trade surplus or deficits in different years as well as editorials expressing concerns for these numbers.

International trade is not limited to governments and large firms, although they are responsible for a bulk of transactions in

international trade. Economists consider transactions between individuals or firms in different countries to be trades between the economies of these countries rather than trades between individuals. No matter how small a transaction is, goods and services produced in one country's economy enter a foreign economy, and money flows into the country's economy in exchange. Residents or firms from different countries can establish trades in goods and services. Especially, thanks to the Internet, individuals can buy goods directly from foreign merchants and goods are delivered to the buyer's doorstep. Also, in tourism, residents travel to different countries and purchase foreign goods and services. Hence, tourism also falls under the category of international trade. In the previous example, we noted that economic activities, such as investment in the stock market, are not a part of international trade. However, investing in a foreign stock market does involve the movement of capital across borders, so such monetary movements should be considered together with international trades. The broader term used in this sense is international economic relations; these involve the different types of economic and financial interactions/inter-linkages across countries. International trade is an important part of international economic relations, and it is perhaps best understood by the public because of its inclusion in the national income. There are many components other than international trade that are included in international economic relations.

International investment, such as the one mentioned in the previous example, is a major component of international economic relations, which is often comparable in size of transactions to international trade. Here, investment covers more than trades of securities in foreign stock markets. Besides the exchange of securities, such as stocks and bonds, international investments include purchasing fixed capital (such as factory machinery) from abroad, buying foreign real estate, and playing a major role in entrepreneurship abroad. We will discuss this category in greater detail later in this explainer.

Let us consider a few other ways capital moves across borders. International economic aid from developed countries or international organizations also involves large sums of capital moving across borders and hence should be considered under international economic relations. Immigrants relocating to a country bring their wealth into the country's economy and hence move it across borders. Workers in an economy may send money to families living abroad, which also moves capital across borders. These, and many more examples where money moves across borders, constitute international economic relations.

As we have discussed above, international economic relations encompass a wide range of economic activities between countries. We can note the characteristics of international economic relations as follows:

- Existence of political borders is an apparent and essential characteristic of international economic relations, which distinguishes them from other domestic economic activities. Any monetary movement across borders is considered to be a component of international economic relations.
- Difference in currencies is also a characteristic of international economic relations, although it is possible for some countries to share the same currencies. When currencies of two countries differ, money moving across borders needs to be converted using currency exchange rates. Currency exchange rates change

frequently, which can cause discrepancies when keeping track of the total amount of transactions between countries.

- Differences in languages, customs, and values between countries are characteristics of international economic relations, particularly of international trade. On one hand, these differences are what drives international tourism as well as imports and exports of native goods and services. But on another hand, these differences also mean that consumers in different countries want different types of goods and services, which can cause challenges in trades.
- Cost of transportation is a characteristic of international trade, which is particularly relevant when the countries are far apart. Crossing oceans with a large quantity of goods can be quite expensive, in which case, transportation cost becomes a significant part of the trade.

A country's international economic relations represent all of its financial dealings with other countries. Activities in this matter are recorded in a document known as balance of payment (BOP) accounts. A country's BOP accounts are usually reported on a quarterly basis, and the annual figures are summarized based on the quarterly figures.

We can compare a country's BOP accounts to its public budget. Recall that the public budget is a document containing projections of a government's income and expenditure for the upcoming fiscal year. BOP accounts and public budgets are similar in the sense that they serve as budgets recording income and expenses, but they differ in several ways. The public budget contains estimated future activities, while BOP accounts record past fiscal activities. Another difference is that the public budget only records the government's income and expenditure, while BOP accounts contain activities of all residents where money is moved across borders. Also, while the public budget does serve legal purposes in approving certain expenditure items, BOP accounts only function as a record and do not hold any legal power.

A country's BOP accounts are useful in understanding economic trends especially in relation to other countries. BOP accounts of many different countries can be found on the websites of international economic organizations such as the IMF (International Monetary Fund) and World Bank. In particular, the IMF serves an important role in international economic relations, which we will discuss later. Through these BOP accounts, we can clearly see not only the net exports, which are the difference in value between exports and imports, but also how the trade deficit or surplus is materializing in the country's economy.

To this end, BOP accounts aim to include all monetary movements across the country's borders, including all unofficial private transactions as well as official public activities. However, since many private transactions are not officially documented, it is generally not possible to capture every activity. Instead, figures in the BOP accounts are a result of statistical analysis using smaller samples of transactions; hence, they are prone to small statistical errors. In addition, changes in currency exchange rates can cause discrepancies in these figures.

The movement of capital can be categorized as either credit or debit depending on the direction of monetary flow. Credit refers to monetary movement into a country's economy, that is, money received by the country's government or residents from foreign economies. Conversely, debit refers to

capital going out of the economy, or money paid by the country's residents or government to foreign entities. When credit exceeds debit in a certain category in BOP accounts, we say that the balance of the category is in surplus. Similarly, the balance is in deficit in the converse scenario.

Since BOP accounts contain all monetary movements in and out of a country's economy, the net balance should, in principle, equal zero. To understand this principle, we can consider an analog in personal finance. If we spend more money than our income in a year,the balance containing income and expenditure will be in deficit. We will then need to borrow the amount of deficit so that we can cover the additional expenses. This loan, which counts as money received by us, is recorded as credit precisely equal to the deficit amount from the expenses. Hence, the net balance containing expenses and loans would precisely be equal to zero. While this should also be true in principle for a country's BOP account, BOP accounts almost never carry the zero balance in practice. This is a discrepancy in BOP accounts as mentioned previously, as they consist of statistical errors and fluctuations in currency exchange rates. Due to these factors, a country's BOP accounts generally carry some balance at the end. However, the net balance is usually a small fraction of the national economy, reflecting this principle.

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