

**Course „Economics and Business Management“  
Prof. Dr. Marius Dannenberg**

**Chapter 3**

**Markets and Government in the Global Economy**

**Syllabus: Economics and Business Management**

**Chapter 1 Introduction – Understanding the contemporary economics and business environment**

**Chapter 2 Key Principles of Economics**

 **Chapter 3 Markets and Government in the Global Economy**

**Chapter 4 Supply, Demand, and Market Equilibrium**

**Chapter 5 Understanding Entrepreneurship and Ownership**

**Chapter 6 Conducting Business Ethically and Responsibly**

**Chapter 7 Understanding the Business of Managing**

**Chapter 8 Organizing the Business Enterprise**

**Chapter 9 Understanding Principles of Marketing**

**Chapter 10 Developing and Pricing Products**

**Chapter 11 Designing and Managing Marketing Channels**

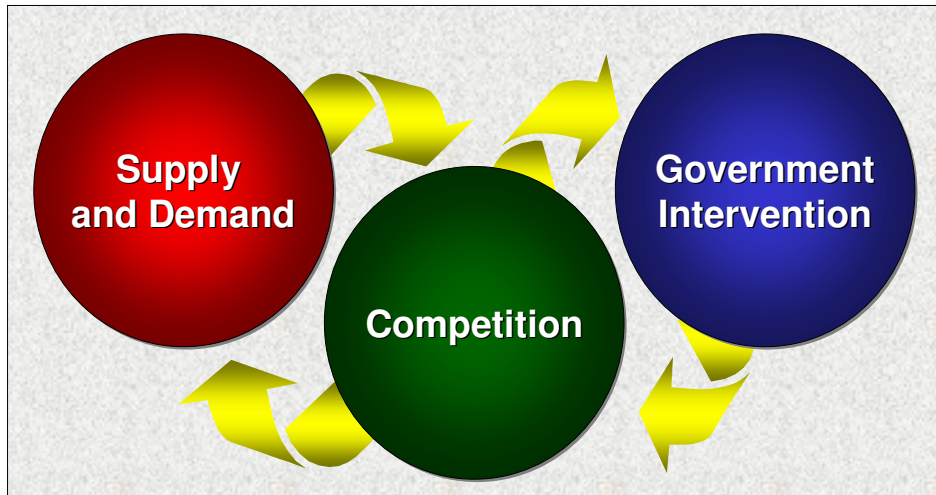
### Chapter Outline

- **The Rise of International Business**
- **International Business Management**
- **Barriers to International Trade**

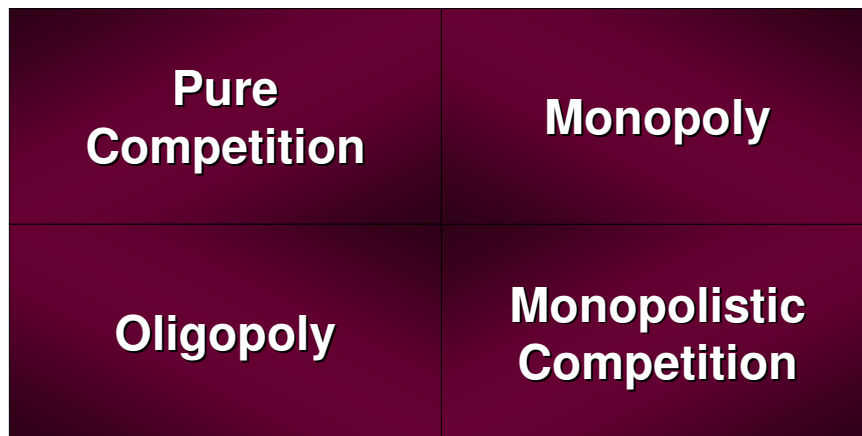
### Why Do Markets Exist?

- **Markets exist because we aren't self-sufficient but instead consume many products produced by other people.**
- **The typical person is not self-sufficient but instead specializes by working at a particular job and uses his or her income to purchase goods and services.**

### How Does a Free-Market Economic System Work?



### Free-Market Competition



### Characteristics of Different Types of Markets

	<i>Perfect Competition</i>	<i>Monopolistic Competition</i>	<i>Oligopoly</i>	<i>Monopoly</i>
Number of firms	Very large number	Many	Few	One
Type of product	Standardized (homogeneous)	Differentiated	Standardized or differentiated	Unique
Demand faced by individual firm	Price taker: demand is perfectly elastic	Demand is price elastic but not perfectly elastic	Demand is less elastic than demand facing monopolistically competitive firm	Firm faces market demand curve
Entry conditions	No barriers	No barriers	Large barriers from government policies or economies of scale	Large barriers from economies of scale or government policies
Examples	Wheat, soybeans	Toothbrushes, clothing, music stores	Air travel, beverages, automobiles, long-distance phone service, cigarettes	Local phone service, patented drugs

### Degrees of Competition

Characteristic	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Example	Local farmer	Stationery store	Steel industry	Public utility
Number of competitors	Many	Many, but fewer than in pure competition	Few	None
Ease of entry into industry	Easy	Fairly easy	Difficult	Regulated by government
Similarity of goods or services offered by competing firms	Identical	Similar	Can be similar or different	No directly competing goods or services
Level of control over price by individual firms	None	Some	Some	Considerable

## Specialization and the Gains From Trade

- We can use the principle of opportunity cost to explain the benefits from specialization and trade.

### **PRINCIPLE of Opportunity Cost**

The opportunity cost of something is what you sacrifice to get it.



## Specialization and the Gains From Trade

- High degree of specialisation and exchange is a feature of modern economies.
- No individual agents (consumers, producers, firms, countries) produce for themselves everything they use.
- Instead they specialise in the production of certain goods or the supply of certain factors
- Then they trade
- In essence agents "export" some (or all) of what they produce themselves and "import" goods produced by others.
- This division of labour and trade enable individuals to increase consumption and have a higher standard of living than they could if they attempted to be self-sufficient.

## Specialization, Exchange and Comparative Advantage

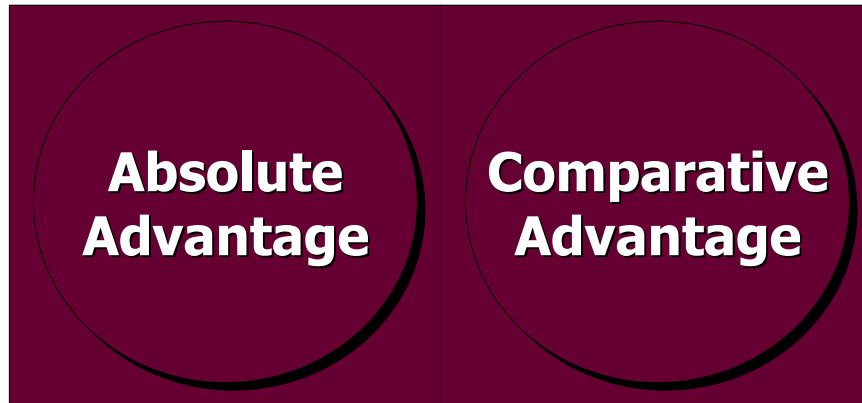
David Ricardo (1772-1823) developed the *theory of comparative advantage* to explain the benefits of specialization and free trade. The theory is based on the concept of opportunity cost:

- *Opportunity cost* is that which we give up or forgo, when we make a decision or a choice.
- According to the *theory of competitive advantage*, specialization and free trade will benefit all trading parties, even those that may be absolutely more efficient producers.

## Why Do Nations Trade?



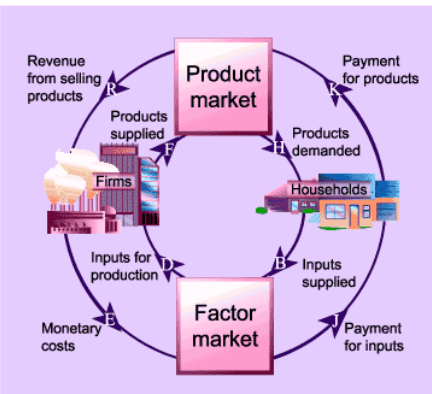
## Theories of Production and Trading



## How Do Markets Operate?

- Exchanges occur in two markets:
  - **Factor or input market:** The owners of the factors of production—natural resources, labor, physical capital and human capital—sell these inputs to organizations that use the inputs to produce goods and services.
  - **Product or output market:** The organizations that produce goods and services sell their products to consumers.

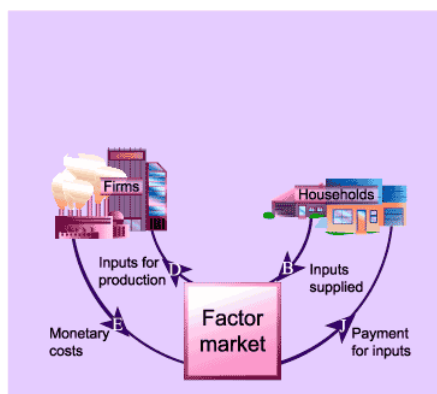
## The Circular Flow Diagram



- The circular flow diagram is a diagram showing the flow of money and goods between markets.

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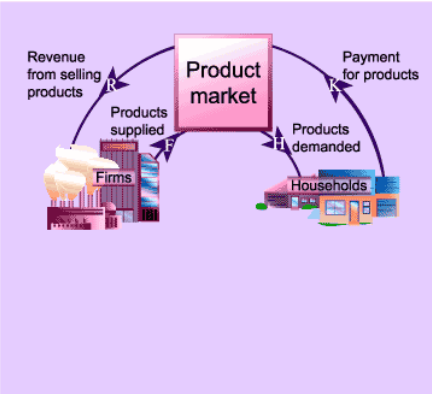
## Households as Sellers and Buyers



- In labor markets, households sell their labor to firms for wages. About 75% of income is earned by households.
- In capital markets, households provide savings that firms use to purchase physical capital. Households receive interest or a share of the firm's profits in return.

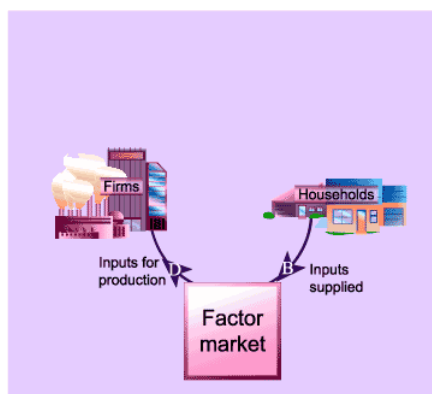
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### Households as Sellers and Buyers



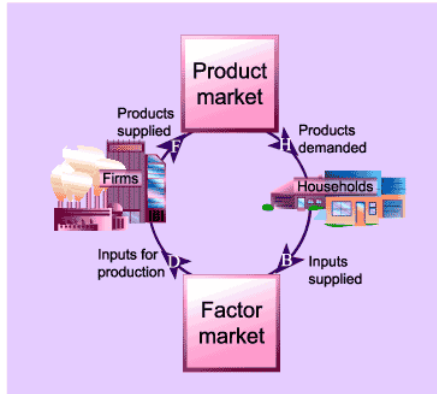
- In natural resource markets, **households sell natural resources to firms to use as inputs in the production process.**

### Households as Sellers and Buyers



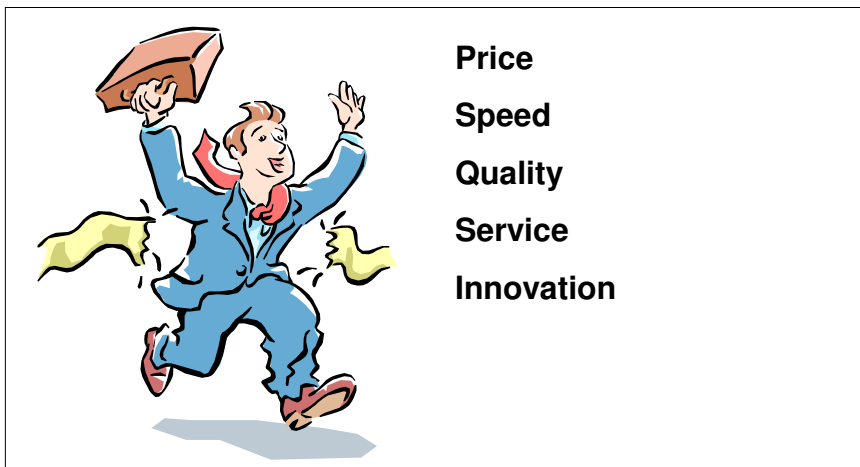
- **Inputs flow from households into factor markets where they are purchased by firms and then transformed into products.**

### Households as Sellers and Buyers



- **Products flow from firms to product markets where they are purchased by households.**

### Competitive Advantage



### What Is Globalization?

- Process by which the world economy is becoming a single interdependent system



### What Are Imports and Exports?

- *Imports* are products made or grown abroad but sold domestically, while *exports* are products made or grown domestically but shipped and sold abroad



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### The Contemporary Global Economy

Several forces have combined to spark and sustain globalization:

- Governments and businesses are aware of the benefits of globalization to businesses and shareholders.
- New technologies make international travel, communication and commerce much faster and cheaper.
- Competitive pressures sometimes force a firm to expand into foreign markets to keep up with competitors.

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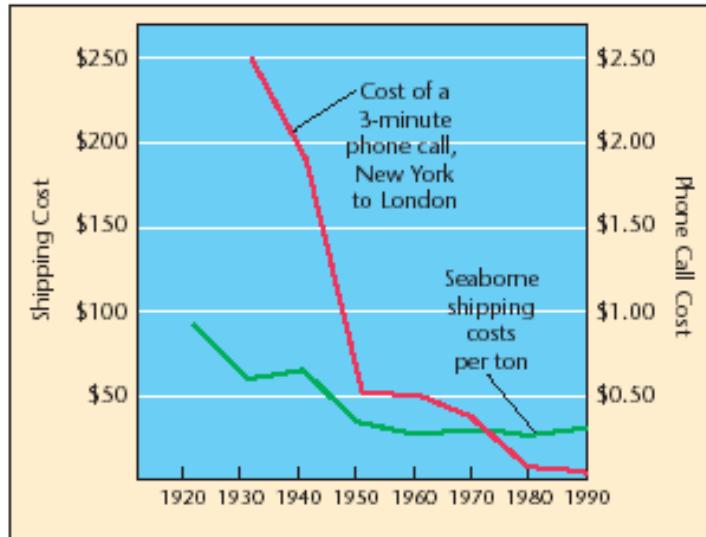
### Challenges of Globalization

- Products and services
- Managing a small business
- Globalization and workforce diversity
- Ethics and social responsibility
- Technology and electronic commerce

### The Global Business Environment

<b>Opportunities</b>	<b>Challenges</b>
<ul style="list-style-type: none"><li>▪ Growth Potential</li><li>▪ Increased Sales</li><li>▪ Operating Efficiencies</li><li>▪ New Technologies</li><li>▪ More Consumer Choices</li></ul>	<ul style="list-style-type: none"><li>▪ Laws and Customs</li><li>▪ Consumer Preferences</li><li>▪ Ethical Standards</li><li>▪ Labor Skills</li><li>▪ Politics and Economics</li></ul>

### The Price of Global Communication



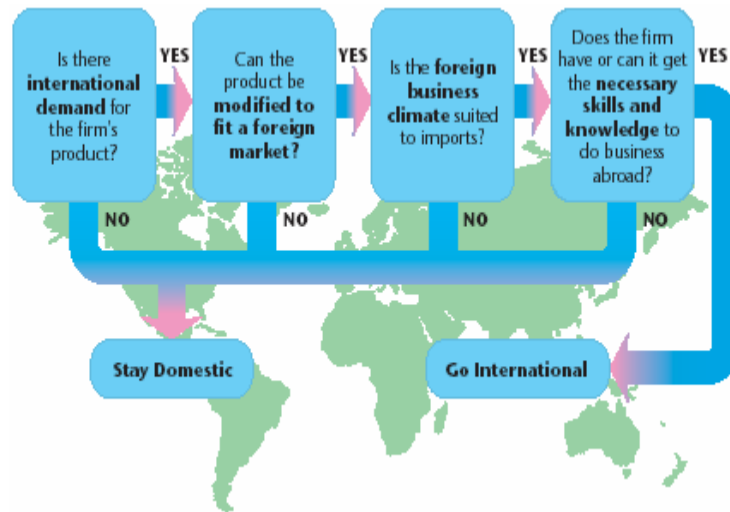
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### The Global Economy and Interdependence

- **Export:** A good produced in the “home” country (for example, the United States) and sold in another country.
- **Import:** A good produced in a foreign country and purchased by residents of the “home” country (for example, the United States).

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## Going International



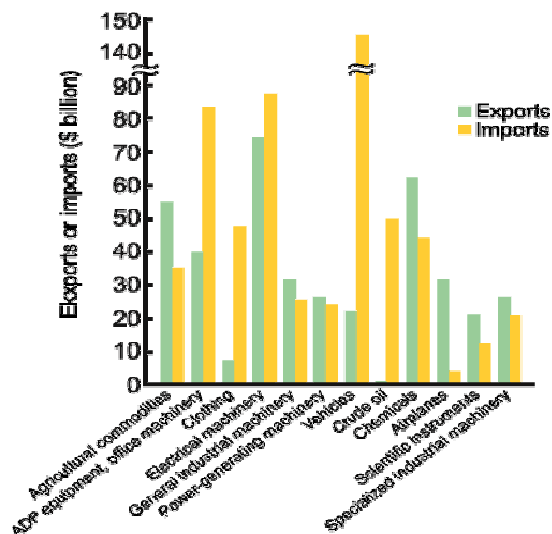
## Levels of Involvement

- Exporters **make products in one country to distribute and sell in others**
- Importers **buy products in foreign markets and import them for resale at home**
- International firms **conduct a significant portion of their business abroad**
- Multinational firms **design, produce and market products in many nations**

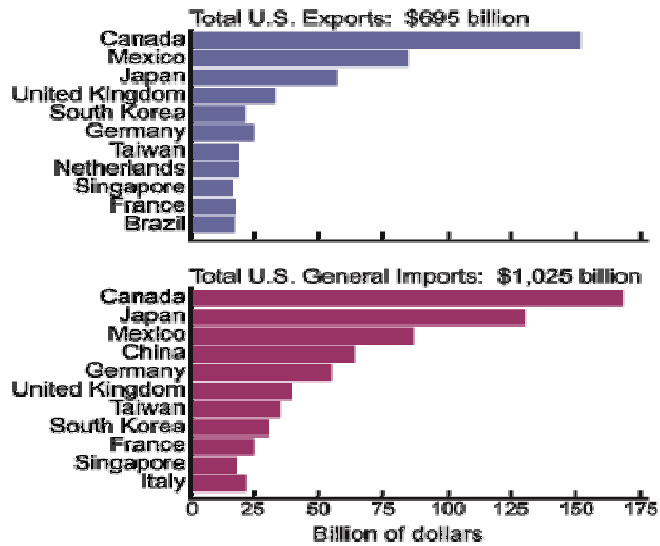
### International Organizational Structures

- Independent agents **are foreign individuals or organizations that represent an exporter in foreign markets**
- Licensing arrangements **are arrangements in which firms choose foreign individuals or organizations to manufacture or market their products in another country**
- Branch offices **are foreign offices set up by an international or multinational firm**
- Strategic alliance (also called Joint venture) **is an arrangement in which a company finds a foreign partner to contribute approximately half of the resources needed to establish and operate a new business in the partner’s country**
- Foreign Direct Investment (FDI) **involves buying or establishing tangible assets in another country**

### Major Imports and Exports of the United States, 1999



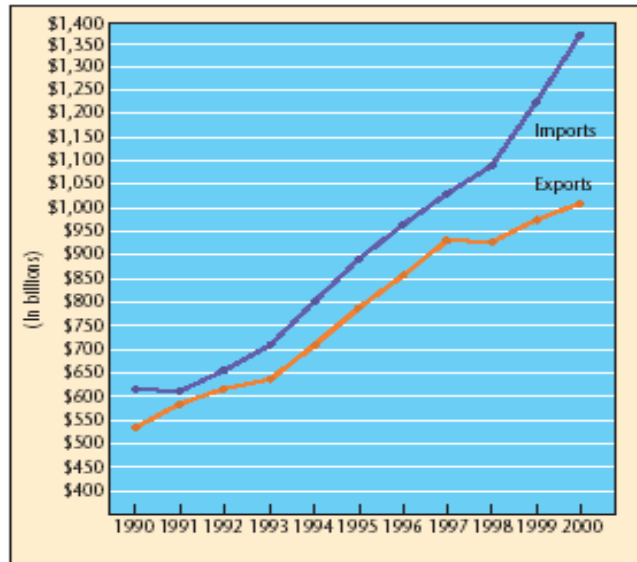
### Major Trading Partners of the United States, 1999



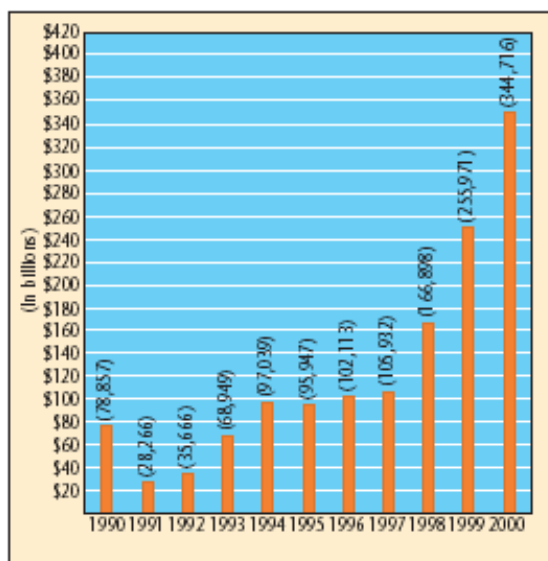
### The Major Trading Partners of the U.S.

TOP 25 U.S. SUPPLIER COUNTRIES			TOP 25 U.S. EXPORT MARKETS		
Rank/Country	2000 Imports (\$ bil.)		Rank/Country	2000 Exports (\$ bil.)	
1	Canada	230.8	1	Canada	178.9
2	Japan	146.5	2	Mexico	111.3
3	Mexico	135.9	3	Japan	64.9
4	China	100.0	4	United Kingdom	41.6
5	Germany	58.5	5	Germany	29.4
6	United Kingdom	43.3	6	Korea	27.8
7	Taiwan	40.5	7	Taiwan	24.4
8	Korea, South	40.3	8	Netherlands	21.8
9	France	29.8	9	France	20.4
10	Malaysia	25.6	10	Singapore	17.8
11	Italy	25.0	11	China	16.2
12	Singapore	19.2	12	Brazil	15.3
13	Venezuela	18.6	13	Hong Kong	14.6
14	Ireland	16.5	14	Belgium+ Luxembourg	14.3
15	Thailand	16.4	15	Australia	12.5
16	Saudi Arabia	14.4	16	Italy	11.1
17	Philippines	13.9	17	Malaysia	10.9
18	Brazil	13.9	18	Switzerland	10.0
19	Israel	13.0	19	Philippines	8.8
20	Hong Kong	11.4	20	Israel	7.7
21	India	10.7	21	Ireland	7.7
22	Nigeria	10.5	22	Thailand	6.6
23	Indonesia	10.4	23	Spain	6.3
24	Belgium+ Luxembourg	10.3	24	Saudi Arabia	6.2
25	Switzerland	10.2	25	Venezuela	5.6

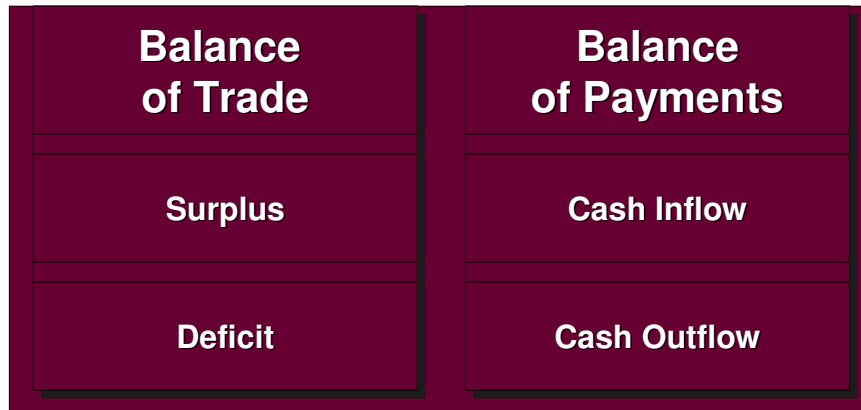
### U.S. Imports and Exports



### U.S. Trade Deficit



## Measuring International Trade



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## Import-Export Balances

Balance of trade is the economic value of all products a country imports minus the economic value of all products it exports

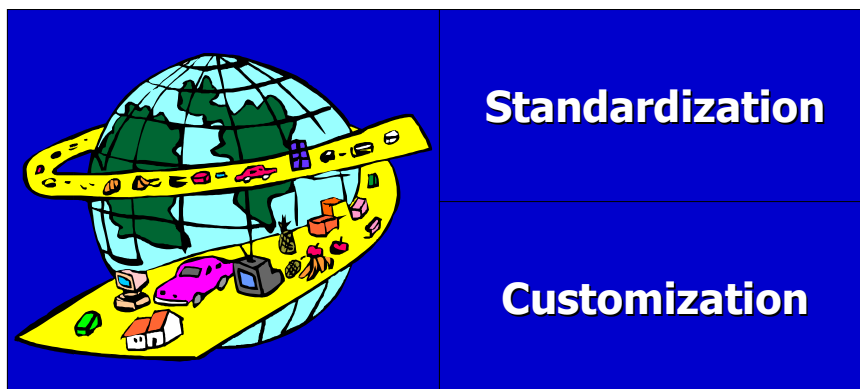
- *Trade deficit* occurs when a country's imports exceed its exports (a negative balance of trade), while a *trade surplus* occurs when exports exceed imports (a positive balance of trade)
- **Balance of payments** is the flow of money into or out of a country

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### International Business Activity

Common Forms	Levels of Commitment		
	<i>Ownership</i>	<i>Financial</i>	<i>Risk</i>
Importing and Exporting	Low	Low	Low
Licensing and Franchising	Low	Low	Low
Strategic Alliances and Joint Ventures	Moderate	Moderate	Moderate
Direct Foreign Investment	High	High	High

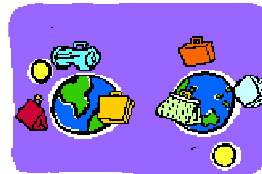
### International Product Strategies



## The Major World Marketplaces

Per capita income **is the average income per person.**

- **High-income countries:** those with per capita income greater than \$9,386.
- **Middle-income countries:** those with per capita income of less than \$9,386 but more than \$765.
- **Low-income countries (or Developing countries):** those with per capita income of less than \$765.



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## Canadian vs. U.S. Prices

Common Product	Niagara Falls, New York	Niagara Falls, Ontario
Saturday stay at Days Inn, with jacuzzi	\$260	\$165
Whopper with cheese at Burger King	\$2.39	\$2.18
	Seattle	Vancouver, British Columbia
Lauryn Hill CD	\$17.99	\$12.60
Nintendo 64 game system	\$130	\$119
Grande latte at Starbucks	\$2.70	\$2.29
Levi's 501 jeans at the Original Levi's Store	\$50	\$45

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## The Major World Marketplaces

### North America

- World's largest marketplace and most stable economy
- U.S. dominates



### Europe

- Western Europe is a mature but fragmented marketplace
- Eastern Europe has gained importance as a marketplace and a producer



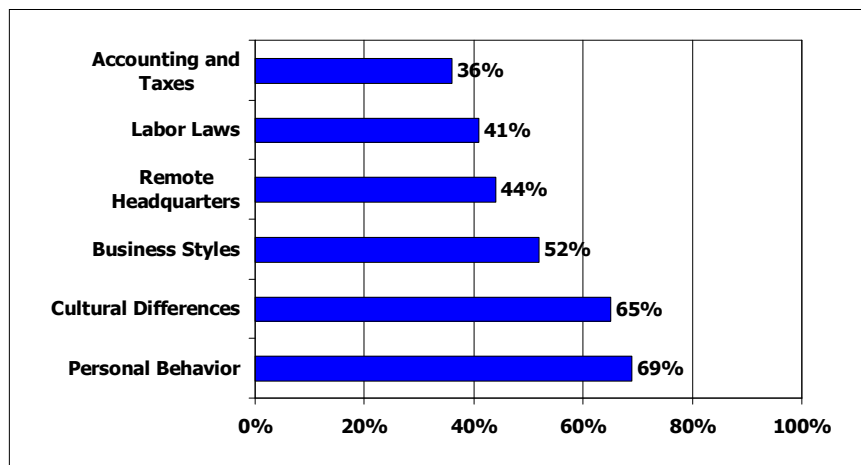
### Pacific Asia

- Nations of the ASEAN are an important force in the world economy and a major source of competition for North American firms



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## Barriers to Going Global



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## Barriers to International Trade: Social and Cultural Differences

Firms planning to conduct business abroad must understand the social and cultural differences between host country and home country. Differences in:

- *Language*
- *Tastes and preferences*
- *Sense of value*
- *Shopping habits*



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## Barriers to International Trade: Economic Differences

Economic differences can be pronounced:

- A firm must know how much the government is involved in a given industry operating within a mixed economy.
- The impact of economic differences can be great in planned economies.



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## Barriers to International Trade: Legal and Political Differences

Governments can affect international business in many ways. They can:

- Set conditions for doing business within their borders and even prohibit doing business together
- Control the flow of capital and use tax legislation to discourage or encourage activity in a given industry
- Confiscate the property of foreign-owned companies



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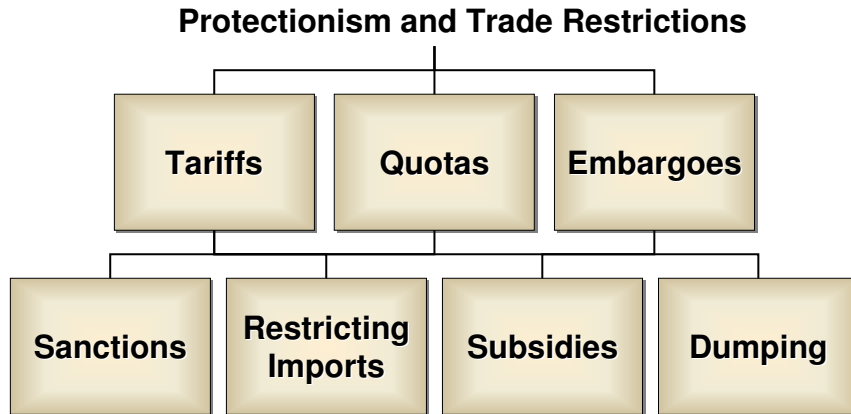
## Legal and Political Differences: Quotas, Tariffs and Subsidies

- Quota is a restriction on the number of products of a certain type that can be imported into a country
- Tariff is a tax levied on imported products
- Subsidy is a government payment to help a domestic business compete with foreign firms



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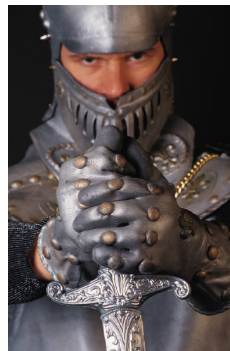
## Legal and Political Differences: Quotas, Tariffs and Subsidies



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## What is Protectionist Policies?

- Practice of protecting domestic business against foreign competition
- Rules that restrict the free flow of goods between nations, including tariffs (taxes on imports), quotas (limits on total imports), voluntary export restraints (agreements between governments to limit imports), and nontariff trade barriers (subtle practices that hinder trade).



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## History of Tariff and Trade Agreements

- **General Agreement on Tariffs and Trade (GATT):** An international agreement that has lowered trade barriers between the United States and other nations.
- **World Trade Organization (WTO):** An organization that oversees GATT and other international trade agreements.
- **North American Free Trade Agreement (NAFTA):** An international agreement that lowers barriers to trade between the United States, Mexico, and Canada (signed in 1994).
- **European Union (EU):** An organization of European nations that has reduced trade barriers within Europe.
- **Asian Pacific Economic Cooperation (APEC):** An organization of 18 Asian nations that attempts to reduce trade barriers between their nations.

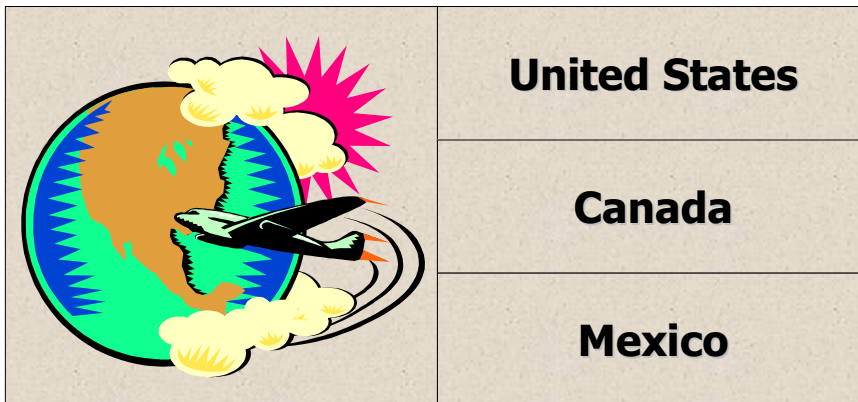
## Trading Blocs

<b>Advantages</b>	<b>Disadvantages</b>
<ul style="list-style-type: none"><li>• Help smaller countries</li><li>• Promote competition</li><li>• Widen markets</li><li>• Foster economic growth</li></ul>	<ul style="list-style-type: none"><li>• Economic isolation</li><li>• Trade restrictions</li><li>• Decline in world trade</li><li>• Fewer choices</li></ul>

### Global Trading Blocs

European Union (EU)	North American Free Trade Agreement (NAFTA)	Association of Southeast Asian Nations (ASEAN)	South America's Mercosur
Austria Belgium Finland France Germany Ireland Italy Luxembourg Netherlands Portugal Spain	Canada Mexico United States	Brunei Indonesia Philippines Singapore Thailand	Argentina Brazil Paraguay Uruguay

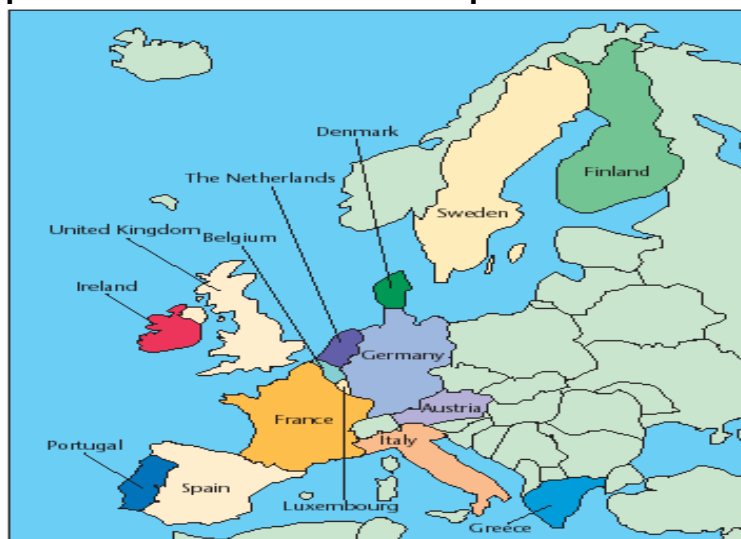
### North American Free Trade Agreement (NAFTA)



### The North American Marketplace and the Nations of NAFTA



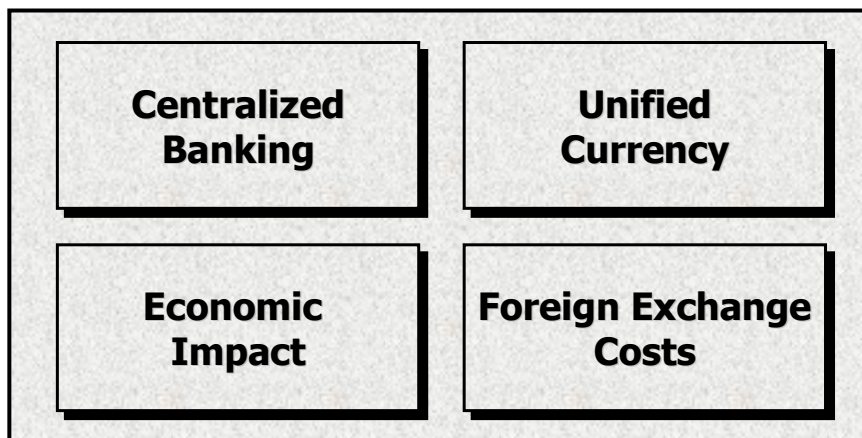
### Europe and the Nations of the European Union



### The European Union

<b>Minimizing</b>	<b>Establishing</b>
Local Regulations	Global Product Standards
Variations in Product Standards	Consumer Protection
Trade Protectionism	Environmental Protection

### Impact of the Euro



### The Nations of ASEAN



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### Legal and Political Differences: Local Content Laws

Local content laws **require that products sold in a particular country be at least partly made there.**

- **Firms seeking to do business in a country must either invest there directly or take on a domestic partner.**
- **Profits from doing business in a foreign country stay there rather than flowing to another nation.**



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## Legal and Political Differences: Business Practice Laws

Business practice laws are laws or regulations governing business practices in given countries.

- Cartels are associations of producers that control supply and prices
- Dumping is the practice of selling a product abroad for less than the cost of production



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## Currency Markets and Exchange Rates

- Foreign exchange market: A market in which people exchange one currency for another.
- Exchange rate: The price at which currencies trade for one another.

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## Exchange Rates

Exchange rate is the rate at which the currency of one nation can be exchanged for that of another

- **Fixed exchange rates:** the value of any country's currency relative to that of another remain constant
- **Floating exchange rates:** the value of one country's currency relative to that of another varies with market conditions
- **Euro:** a common currency shared among most of the members of the EU



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## Exchange Rates and Competition



When a country's currency rises—becomes **stronger**—companies based there find it harder to export products to foreign markets and easier for foreign companies to enter local markets

When the value of a currency declines—becomes **weaker**—companies based there find it easier to export to foreign markets and harder for foreign companies to enter local markets

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### Global Interdependence

- **Multinational corporation:** An organization that produces and sells goods and services throughout the world.
- **Worldwide sourcing:** The practice of buying components for a product from nations throughout the world.
- **Financial liberalization:** The opening of financial markets to participants from foreign countries.
- **International Monetary Fund:** An organization that works closely with national governments to promote financial policies that facilitate world trade.

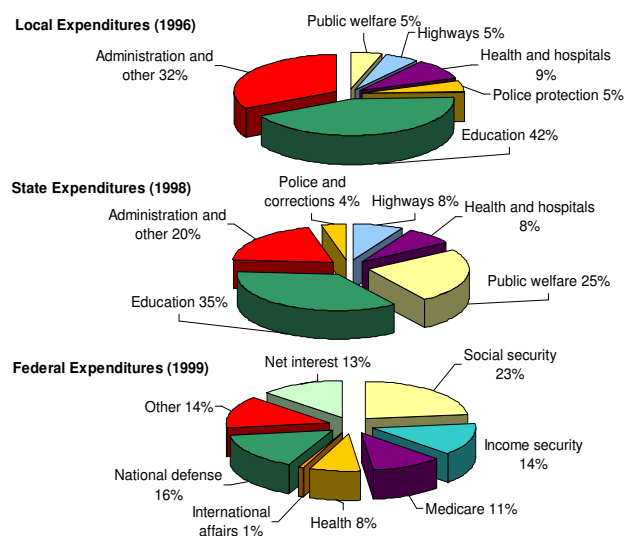
### Impact of Terrorism on Global Business

<b>Tighter Security</b>	<b>More Delays</b>
<b>Cargo Restrictions</b>	<b>Increased Costs</b>

## Government in a Market Economy

- The government has five general responsibilities in a market-based economy:
  1. Providing goods and services
  2. Redistributing income
  3. Taxation
  4. Regulation of business practices
  5. Trade policy

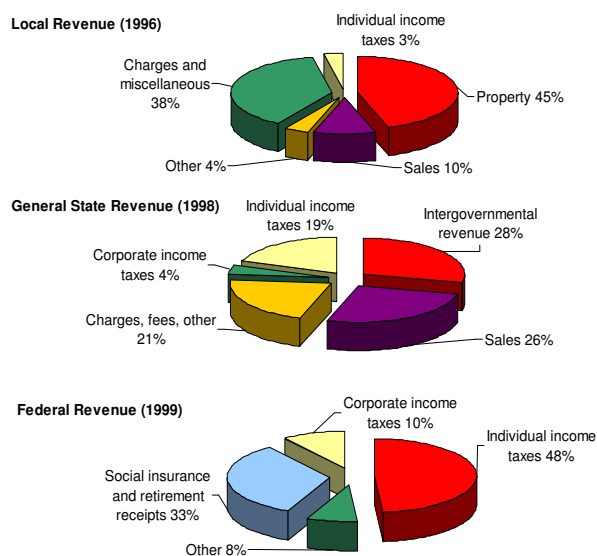
## Percentage of US-Government Spending on Various Programs



### Criteria for a Tax System

- The benefit-tax approach suggests that a person’s tax liability should depend on his or her benefits from government programs.
- Horizontally equitable: The idea that people in similar economic circumstances should pay similar amounts in taxes.
- Vertical equity: The idea that people with more income or wealth should pay higher taxes

### Percentages of US-Government Revenue from Different Sources



## Government Regulation of Markets

- **Mixed economy:** A market-based economic system in which government plays an important role, including the regulation of markets, where most economic decisions are made.

## Alternative Economic Systems

- **Centrally planned economy:** An economy in which a government bureaucracy decides how much of each good to produce, how to produce the goods, and how to allocate the products among consumers.
- **Transition:** The process of shifting from a centrally planned economy toward a mixed economic system, with markets playing a greater role in the economy.
- **Privatizing:** The process of selling state firms to individuals.

## Fostering Competition



**Antitrust  
Legislation**

**Mergers and  
Acquisitions**

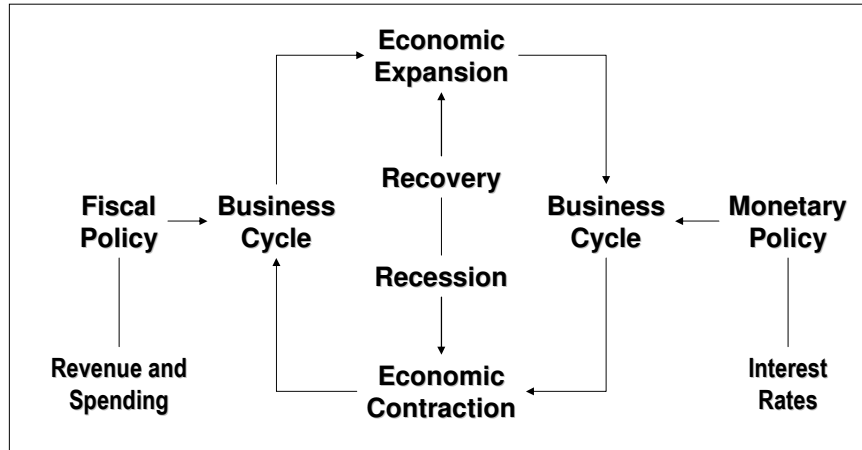
### Regulating and Deregulating Industries



### Protecting Stakeholders: Example USA



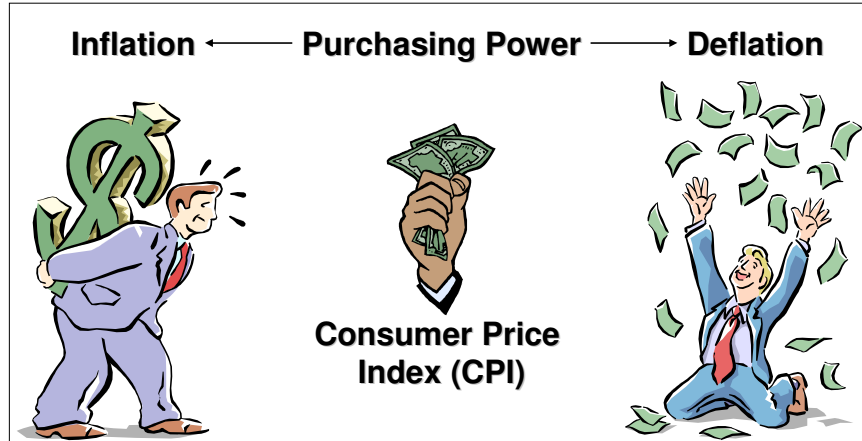
### Contributing to Economic Stability



### Monitoring Major Economic Indicators



### Measuring Price Changes



### Measuring National Output

Dollar Value	Gross Domestic Product (GDP)	Gross National Product (GNP)
Final Goods and Services	Yes	Yes
Domestic Businesses	Yes	Yes
Foreign-Owned Businesses	Yes	No
Overseas Operations	No	Yes