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| ***External influences – Policies; floating currency & common currency*** |

**Introduction:** (p124-131)

* ***Non-price factors and macro-economic policies***
* ***Decision to float currency or adopt common currency (such as the Euro)***
* ***Interest rates***

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| *International competitiveness* ***– non-price factors*** |

SO far we’ve concentrated on **price competitiveness** of **domestic businesses** against their **foreign rivals**

* ***Price*** *is only* ***one factor*** *consumers consider when purchasing*
* ***Price alone*** *won’t make a business successful if they are only* ***slightly less*** *than those of competitor*
* ***Japanese*** *and* ***German*** *companies became worldwide success during the 1970s and 1980s despite their ‘high’ exchange rates (the Yen and the Deutschmark) which made their goods relatively expensive abroad*

*How did they* ***compete*** *so* ***successfully*** *despite other countries having a* ***price advantage*** *over them?*

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***Factors****, other than* ***price****, that can determine international success – or competitiveness – of a business:*

* ***Product design*** *and* ***innovation*** *– premium prices can still be charged*
* ***Quality*** *of* ***construction*** *and* ***reliability*** *– again, people are willing to pay more for this*
* ***Effective promotion*** *and* ***extensive distribution*** *– McDonald’s being a good example*
* ***After-sales service*** *– extended guarantee periods*
* ***Investment*** *in trained* ***staff*** *and* ***modern technology****– flexibility of production/high labour productivity*

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| **Macro-economic policies**  Policies that are designed to impact on the whole economy (macro-economy)   * Influence the total or aggregate demand in the economy * Demand then works through to determine the value of output of goods and services (GDP) and hence the level of employment |

***Fiscal policies***

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| Fiscal policy |

In many countries, the government is **responsible** for:

* **Spending** (and raising taxes) up to 40% of GDP
* Major **expenditure programmes** include
  + *Social security, health service, education, defence, and law & order*
* Government **raises finance** to pay for these through taxation
  + *Income tax*
  + *Value Added Tax (VAT)*
  + *Corporation Tax*
  + *Excise duties (cigarettes, petrol, alcohol)*
* Each year, government (chancellor) announces spending and tax plans for the coming year
  + The **difference** between the two (spending and income: taxation) is called either a ***BUDGET DEFICIT*** or ***BUDGET SURPLUS***
* Many **changes** are relatively **minor** and only affect **individual product markets**
  + *i.e. increase on duties on petrol or reduction on spending on defence equipment - impact certain businesses but* ***NOT*** *on the macro-economy*
* Only an **overall change** in **total tax revenues** or **total government expenditure** will have a **macro-economic effect** – noticed by virtually **ALL** businesses

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| The book illustrates two scenarios that may government may make changes:   1. *The economy is in* ***recession*** *and* ***unemployment*** *is* ***rising****:*  * *Raise government spending – increase in aggregate demand* * *Lower tax rates - increase in aggregate demand* * *The above is an example of ‘expansionary fiscal policy’*  1. *The economy is* ***booming*** *and is in danger of* ***overheating****:*    * + *Reduce government spending*      + *Raise tax rates*      + *The above is an example of ‘contractionary’ or ‘deflationary’* |

***Monetary policy***

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| Monetary policy |

* *Concerning the monthly review of the level of interest rates – current and likely future inflation*
* *Monetary policy is mainly concerned with changes in* ***INTEREST RATES***
  + *Determined by the* ***base rate*** *set by the central bank*
  + *Central banks are given a clear* ***inflation target*** *– they use* ***INTEREST RATES*** *to achieve these targets*
    - *If the forecast for is that it will* ***RISE*** *above government targets – central bank will* ***RAISE*** *its base rate and other banks/lending institutions will follow*
    - *If inflation is* ***LOW*** *and forecast to remain* ***LOW****, central bank may* ***REDUCE*** *interest rates*

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| Using **higher interest rates** will have an impact on businesses in THREE main ways:   1. *Increase* ***interest costs*** *and reduces profits for businesses that have* ***very high debts*** 2. *Reduces* ***consumer borrowing*** *and this reduce demand for goods* ***bought on credit****: houses, cars, washing machines* 3. *Tends to lead to an* ***appreciation*** *of the country’s* ***exchange rate*** |

*Summary for these two policies*

***Exchange rate policy:***

*In addition to the monetary and fiscal policy, the government also has to have a view about the* ***exchange rate*** *of the currency*

* Should they allow the exchange rate to **‘float’** or try to **‘fix’** it (such as join a common currency such as the euro)?

***Floating the currency***

* Allow it to find its own level based on **supply** and **demand** for it
  + **Advantages** and **disadvantages** of this decision
  + The UK constantly considers: Keep the **Pound** or join the **Euro**?

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| ***Claimed drawbacks to floating rates or the benefits of joining a common currency***   1. Frequent **appreciation** and **depreciation** of a currency against others causes industry problems. These include:    * ***Fluctuating prices*** *of imported raw materials and components, making costing of products difficult*    * ***Fluctuations*** *in* ***export prices*** *and overseas competitiveness, which lead to* ***unstable*** *levels of demand*    * ***Uncertainty*** *over* ***profits*** *to be earned from trading abroad or from investing abroad – the value of overseas assets also varies with currency fluctuations*   These factors when combined may **DISCOURAGE** firms from engaging in international trade because of the **increased risk** caused by **currency movements**. A common currency would encourage trade and investment between the participating countries.   1. *When firms are planning to* ***purchase goods*** *from abroad, it is difficult to make cost comparisons because suppliers from different countries will be using* ***different currencies*** *that change frequently – lack of* ***‘price transparency’*** 2. Having different **exchange rates** adds to the costs of firms trading overseas:    * *Currencies have to be* ***converted*** *into the domestic currency –* ***commission cost*** *to the bank*    * *Different* ***price lists*** *have to be printed (and updated) for each separate country*    * *Attempts to take the risk out of dealing in different currencies by using currency ‘contracts’ and* ***‘hedging’*** *can be expensive* 3. *Due to popularity of overseas trade in the world economy, concerns that foreign investment may be lost to countries that do not have a common currency (the Eurozone for example)* 4. Adopting business strategy for those outside **common currency** – may decide to relocate.    * *A few prominent European economies such as Denmark, Sweden and the UK have done okay since the introduction of the Euro – considering the troubles of Greece and other Eurozone countries, interest for the UK, Sweden and Denmark has cooled. Latvia will join in January 2014.* |

Claimed **advantages** of floating rates – or reasons for **not joining** a common currency

1. *Keep control of* ***interest rates***
2. *Replacing the currency with a common currency may lead to* ***tax policies*** *– losing independence of tax rates*
3. *Interest rate can be adjusted to achieve other* ***economic objectives****(Greece now finds this hard)*
4. ***Conversion costs*** *from one currency to a common currency – dual pricing (for example the price in* ***pounds*** *and* ***euros****) and changeover over of systems etc.*

***Government policy, economic efficiency and business competitiveness***

Governments need to be aware of the possible **negative impact** on business competitiveness of certain fiscal and monetary policy changes.

* *The ability of industry to compete* ***overseas*** *is vital to long-term growth*
* *Government policies that aim to increase industrial competitiveness are often referred to as* ***SUPPLY-SIDE policies*** *as they aim to improve the* ***supply efficiency*** *of the economy.*

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| *Three examples of policies:*   1. **Low rates of income tax** – high tax for workers and managers may be demotivating to work hard and gain promotion 2. **Low rates of corporation tax** – tax on net profits of limited companies    * High taxes leave fewer fund for reinvestment, discourage new investment and new projects    * Lack of investment reduces competitiveness of firms 3. Increasing **labour market flexibility** and **labour productivity** – increase skills and efficiency of country’s labour force    * *Subsidies for* ***training programs****,* ***college training***    * *Increased funding of* ***higher education***    * ***Low rates of income tax*** *to encourage workers to set up own business and work incentives (i.e. more money, promotion)*    * *Encouraging* ***immigration*** *of* ***skilled workers*** *to assist industries increase total output*    * *Ensuring that only those* ***genuinely*** *need state benefits receive them: productive workers don’t just ‘live off the state’* |

For example in Finland: The government encourages education as a way to strengthen the country’s competitiveness and economic growth.

As a country with few resources, its **people** are seen as the most valuable resource. Education is ‘free’ and every child has the right to a university place if they meet the fair criteria. It is also top of the PISA tables for **educational performance** (with South Korea).

Finnish companies are everywhere (perhaps not so known though)

* Finnish architects design many Chinese buildings; Shipbuilding too
* Rovio – Angry Birds
* Nokia (mmm...)
* KONE lifts (you’ve probably been in many of them)
* Stora Enso, Metso

***For a country of only 5.3 million people, it ‘punches above its weight’ due to strong, stable and transparent policies by the government (joint top least corrupt)***

***Worksheet summary quiz and research:***

1. DO you think that **Latvia** should adopt the euro as its currency in 2014? Briefly summarise and justify your answer.

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| 1. Should governments **interfere** with the free market? Briefly explain and justify your answer. |
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**Summary of the worksheet in your own words (in English and Chinese):**

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*Vocabulary check:*

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| **English** | **Chinese** |
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