



# COMM1150 Global Business Environments

Global Business Environments (University of New South Wales)

# COMM1150: GLOBAL BUSINESS ENVIRONMENTS

## WEEK 1: Introduction & Socio-Cultural Lens

### Learning Objectives:

1. Examine the many dimensions of globalisation
2. Appreciate the complexity of global business environments
3. Understand the ideas of levels and lenses as heuristic devices for making sense of global business environments
4. Framing contemporary issues and problems using levels and lenses

### Lecture Notes

#### WHAT DOES GLOBALISATION MEAN TO YOU?

#### Globalisation and its Many Dimensions

- Political globalisation
  - Basic structure of contemporary world
    - World of nation-states
  - Acephalous world society - associational nature of global world
  - Framework of our understanding of globalisation - borders and boundaries
- Economic globalisation
  - Increasing rates of cross-border transactions
  - Greater interdependence of countries, industries, organisations, and people
- Cultural globalisation
  - Diversity of cultures
  - Culture of globalisation (progress + justice)
- Climate change and sustainability
  - UN Sustainable Development Goals

#### International Business and Multinationals

- International business consists of all commercial transactions that take place between 2 or more countries
- International business refers to business activities that straddle 2 or more countries
- A multinational enterprise (MNE) or multinational corporation is a business that has productive activities in 2 or more countries
- Multinationals are “rootless cosmopolitans”

#### Firm Internationalism

- Through internationalisation, domestic firms become multinationals expanding their geographic reach and mindsets
- Internationalism is a process by which firms establish and conduct transactions with firms and customers in other other countries, and international operations have an increasing influence on their future

#### Intergovernmental + International Non-governmental Organisation

- Intergovernmental organisations (IGOs)
  - Entities by treaties among 2 or more countries to cooperate on common interest
  - Mechanisms for the world's nation-states to work together for peace and security as well as economic, social, and environmental questions

- Rule setters of global orders
- E.g. UN, WTO, EU
- International non-governmental organisations
  - International NGOs are NGOs that receive funds in more than one country and either fund or directly manage programs in several other low and lower middle income countries

## GLOBAL BUSINESS ENVIRONMENTS: LEVELS, LENSES & COMPLEXITY

### Analytical Framework for Understanding Global Business Environments

- Global environments consist of several dimensions requiring different lenses to see and understand them
  - Socio-cultural lens
  - Political-legal lens
  - Economic lens
  - Sustainability lens
- Global business environments are complex
  - Heterogeneity
    - As we move from one location to another we are more likely to experience different environments
  - In an interconnected world, phenomena could move across levels and involve several dimensions
  - Suez canal accident (Evergreen) could have been a local incident but the length of time meant that everyone in the globe felt the effect of the accident
    - Effect probably more than economic

## DIFFERENT NOTIONS OF “ENVIRONMENT” OR CONTEXT AT DIFFERENT LEVELS

### Global Operation Across Levels of “Environment”

- Different kinds/levels of environment
  - Domestic
  - Foregin
  - International/transnational
  - Global

## WEEK 2: Socio-Cultural Lens

### Learning Objectives:

1. Understand what we mean by culture
2. Appreciate the diversity of culture and its manifestations at different levels
3. Examine frameworks for making sense of national cultures
4. Understand the importance of cultural intelligence

## Lecture Notes

### WHAT IS CULTURE?

“Culture is the collective programming of the mind which distinguishes the members of one category of people from another.”

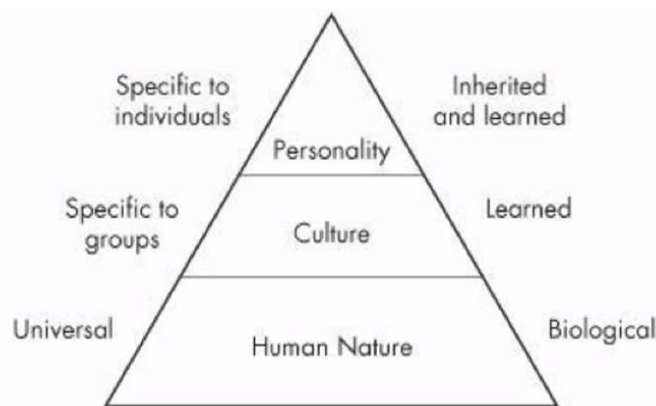
“Culture is a learned, shared, compelling interrelated set of symbols whose meanings provide a set of orientations for members of society.”

“Culture is everything that people have, think and do as members of their society.”

“Culture is a system of values and norms that are shared among a group of people and that when taken together constitute a design for living.”

“Culture is that complex whole which includes knowledge, belief, art, morals, law, custom, and any other capabilities and habits acquired by a person as a member of society.”

- Culture is:
  - Shared
  - Learned and enduring
    - Build up over time and into institutions -> passed down through generations
  - Interrelated and organised
    - Mutually reinforcing
  - Dynamic
  - Exists at multiple levels
    - Many subcultures exist
      - E.g. national, regional, ethnic, organisational, professional



**FIGURE 2.1. Three levels of mental programming**

### GLOBAL CULTURE: FROM UNESCO'S CULTURE REPORT (2001)

- Culture is a set of distinctive spiritual, material, intellectual and emotional features of society or a social group. It encompasses, in addition to art and literature, lifestyle, ways of living together, values systems, traditions and beliefs, respects and safeguarding culture is a matter of human rights
- Cultural diversity presupposes respect of fundamental freedoms namely freedom of thought, conscience and religion, freedom of opinion and expression, and freedom to participate

### CHARACTERISTICS OF CULTURE

- Culture powerfully shapes behaviour but it is largely invisible
  - Culture influences an individual's behaviour (in particular and systematic ways)
  - Culture relates to an individual's values and understanding of the world

- Culture can be tight or loose

## FRAMEWORKS FOR UNDERSTANDING CULTURAL DIVERSITY/HETEROGENEITY

- Globalisation means crossing 'boundaries' and 'borders'
  - In socio-cultural terms this means encountering different cultures out there in the global world
- If we think about what constitutes culture, we immediately realise the heterogeneity of cultures
- Understanding different cultures is essential for multinational corporations
  - Main question: how do we make sense of cultural diversity in the global world and reduce or manage complexity associated with cultural heterogeneity

## CULTURAL + GLOBAL BUSINESS ENVIRONMENTS

- Scholars have classified countries according to specific cultural characteristics or dimensions and group them into 'clusters' of countries that share similar cultural attributes
- Hofstede Study of Value Dimensions
  - Based on survey of 100 000 employees of large corporation in 50 countries
- The Globe Study
- The World Values Study

### Hofstede's Value Dimensions

Value Dimension	Relevance to Business Context
Power Distance (Distribution of Power)	Relations between superiors and subordinates; degree to which less powerful accept power distribution
Uncertainty Avoidance (Tolerance for Ambiguity)	Propensity for risk; threatened by unknown situations or ambiguity
Individualism vs Collectivism (Integration into groups)	Individual's identification with organisation and group dynamics; loose ties between individuals
Masculinity vs Femininity	Emotional gender roles are clear and distinct; men are supposed to be more assertive, tough, and focussed on material success vs emotional gender roles overlap and both men and women are supposed to be modest, tender, and concerned with quality of life
Long vs Short-term Orientation	Oriented toward future rewards (perseverance and thrift) vs present and past orientation; time horizon for decision making

## "STAKEHOLDER" VIEW OF CORPORATIONS

- "Not like that American-style 'shareholder only', not that way of doing things, but managers have after all a responsibility toward all stakeholders"
- "If I were to say for what the company exists, it is to make the employees...it is embracing happy, and to maintain their happiness, we have to give a return to the shareholders from whom we have received the money"
- "As an individual manager, I think the most important thing is, it has to be a company that can continue to contribute to society in its own way in the respective country, including overseas."

## SIMILARITIES AND DIFFERENCES ACROSS CULTURES

### ● 9 cultural dimensions:

- Power distance -> distribution of power
- Uncertainty avoidance -> reliance of social norms to alleviate unpredictability of future events
- Institutional collectivism -> collective distribution of resources and collective action
- In-group collectivism -> pride, loyalty + cohesiveness of in-group
- Humane orientation -> collective rewards for being fair, altruistic, etc.
- Assertiveness -> confrontational + aggressive with others
- Gender egalitarianism -> collective minimises gender inequality
- Future orientation -> future-oriented behaviour, delayed gratification, planning
- Performance orientation -> performance improvement + excellence

## HOW CULTURE AFFECTS BUSINESS COMMUNICATION

Low Context	High Context
<p><i>US, Australia</i></p> <ul style="list-style-type: none"> <li>● Written agreements <ul style="list-style-type: none"> <li>○ Attention to detailed terms</li> </ul> </li> <li>● Explicit communication <ul style="list-style-type: none"> <li>○ Clear, direct, to the point</li> </ul> </li> <li>● Emphasis on verbal</li> <li>● Business relationship governed by detailed formal contract</li> <li>● Dispute settled through litigation</li> </ul>	<p><i>Japan, Asian countries</i></p> <ul style="list-style-type: none"> <li>● Spoken agreements <ul style="list-style-type: none"> <li>○ Emphasis on personal ties based on trust</li> </ul> </li> <li>● Implicit communication <ul style="list-style-type: none"> <li>○ Ambiguous, indirect</li> </ul> </li> <li>● Emphasis on non-verbal <ul style="list-style-type: none"> <li>○ 'read between the lines'</li> </ul> </li> <li>● Business relationship built on informal and personalised relationships</li> <li>● Dispute settled out of court</li> </ul>

## DEALING WITH CULTURE AT ORGANISATIONAL LEVEL

EXTERNAL	INTERNAL
<ul style="list-style-type: none"> <li>● Negotiations with governments + other firms</li> <li>● Understanding different consumer preferences</li> <li>● Using local expertise <ul style="list-style-type: none"> <li>○ E.g. distributors, joint venture partners</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● Managing a cross-cultural workforce</li> <li>● Cross-border communication</li> <li>● Expatriate management</li> <li>● Management orientation</li> <li>● Cross-cultural training</li> <li>● Adapting functions and operation; learning</li> </ul>

### ● Avoid:

- Ethnocentrism -> belief that one's own group is superior to others
- Self-reference criterion -> unconscious use of one's own culture to assess new environments

### ● Cross-cultural literacy + making cultural adjustments is necessary

## Possible Cultural Blunders

'What works at home will work abroad.'

'English is the language of international business so we don't need to translate our website.'

'There's one best way to manage people in an organisation.'

'Everyone around the world wears blue jeans so national differences no longer matter.'

## Cross-Cultural Aspects of International Business

- Business contract
- Negotiations
- Communication
- Teamwork
- Organisational structure
- Decision-making
- Workplace norms
- Managing employees
- Performance incentives
- Product choice and promotion

## WEEK 3: Political-Legal Lens I

### Learning Objectives:

1. Recognise the central importance of the international political order based on the nation state system
2. Examine the diversity of political systems around the world and the consequences of their diversity
3. Understand the relationship between political system and political risk
4. Understand the nature and complexity of corruption as a cultural, political, and legal issue in a global world

### Lecture Notes

#### FROM SOCIO-CULTURAL LENS TO POLITICAL-LEGAL LENS

- Nations are politically organised as states (political entities or polities)
  - A nation-state combines a nation (cultural group) with a state (political entity)
  - Strict definition is one nation (usually ethnic or cultural group) and one state
  - Only about 10% of nation-states meet this definition
  - International system is built upon this notion
- Political-legal lens
  - Political systems
    - System of gov and collective decision-making and implementation
    - Set of institutions, organisations, and practices
  - Legal systems
    - System of rules and laws that regulate behaviour and processes of enforcement
- Implications -> need a particular lens/perspective for this dimension

## STRUCTURE OF INTERNATIONAL SYSTEM: NATION-STATE SYSTEM

- Sovereignty
  - Ultimate authority in a given territory lies with the state
    - Backed by its monopoly over means of coercion or violence (police + military)
  - Principles of equality among states and non-intervention in domestic/internal affairs
  - In democratic political systems, the sovereign ppl via democratic processes give legitimacy to the gov
  - When thinking about regional integration like the EU, states are giving up sovereignty in certain areas
- States have legitimate power and authority
  - Control “flow” of ppl, goods, and others across its borders (immigration, trade barriers)
- States have legitimate power and authority to control and restrict activities in areas circumscribed by the law
  - Economy, welfare, health, education, immigration
  - Taxation, industries + private properties
  - Law and regulation
  - Military and police including declaration of war on other countries
- States have legitimate power and authority to construct international order through:
  - UN
  - EU
  - NAFTA
  - WTO

## SOURCES OF HETEROGENEITY + COMPLEXITY

- Source of authority
  - Rule of law provides MNEs with less uncertainty and more stability
- Political ideologies may be pro/anti-business
- Democratic freedom
  - Lack of political freedom can also restrict many actions
  - Oppression can lead to instability
    - E.g. Google in China
- Interest aggregation
  - MNEs will be affected by dominant interests
- Unitary vs federal systems
  - How many govts does MNE need to deal with?
- Policymaking
  - MNEs need to know how policies are made and by whom



- Gov system
  - MNE needs to know where power lies
    - E.g. executive or legislature
- Political risk
  - Assessments + active responses

## 10 TYPES OF POLITICAL RISK

“21st century political risk is the probability that a political action could significantly affect a company’s business.”

1. Geopolitics
2. Internal conflict
3. Laws, regulation, policies
4. Breaches of contract
5. Corruption
6. Extraterritorial reach
7. Nature resource manipulation
8. Social activism
9. Terrorism
10. Cyber threats

### Political Risk at Different Levels

Local/National	International/Global
<ul style="list-style-type: none"> <li>● Stability of gov</li> <li>● Socio-eco conditions</li> <li>● Investment (un)certainities</li> <li>● Contract enforcement</li> <li>● Internal conflict</li> <li>● Corruption</li> <li>● Ethnic tensions</li> <li>● Military and religious group</li> <li>● Quality of governance</li> </ul>	<ul style="list-style-type: none"> <li>● Wars (hot and cold)</li> <li>● Sanctions</li> <li>● International terrorism</li> <li>● Negative media; international protests</li> <li>● Withdrawal of international loans/aid</li> <li>● Changes in borrowing/trade terms</li> <li>● Default on debt repayments</li> </ul>

## 5 LEVEL OF ACTION GENERATING POLITICAL RISKS

- Individuals
- Local organisations
- National governmental actors + their institutions
- Transnational groups
- Supranational and international institutions

## OTHER RELEVANT POLITICAL ACTORS

- State is not a unitary entity - different branches of gov + agencies vying for power + influence
  - Different ministries
  - Regional govts
- Opposition groups/political parties
  - Within party differences + struggles
- Organised interest/pressure groups/NGOs
- Social movements

- Terrorist/guerrilla groups
- International organisations and institutions
- Opinion-makers
- Civic action/public opinion

## STATE CAPACITY + EFFECTIVENESS

- Consequences of failed/fragile states
  - Demographics
  - Refugees
  - Illegitimate govts
  - Brain drain
  - Poor public services
  - Human rights violation
  - Inequality
  - Factionalized elites
  - External intervention
  - Security forces within a State

## Bureaucracy

- Bureaucracy usually refers to a form of gov in which non-elected officials (“bureaucrats”) implement rules and policies
- Several elements to bureaucracy
- 2 important ingredients particularly related to corruption and eco growth
  - Meritocratic recruitment
    - Internalised shared norms and goals among equally qualified individuals -> identification with colleagues -> less likely to succumb to corruption
  - Long-term career ladder
    - Increase competence in long run
    - Less likely to be attracted to short-term gains through corrupt behaviour
    - Competitive salaries, promotion ladder, etc. -> disincentives for corruption
- Bureaucracy could foster eco development + growth

## Corruption: Cultural Understanding

“Abuse of public office for private gain.”

“Perversion or destruction of integrity in the discharge of public duties by bribery or favour”

NOTE: what is seen as a criminal dealing in one society may be accepted as normal in another

- “Public” -> individuals acting on behalf of the public, normally gov officials at some level
- “Duties” -> corruption entails abuse of the trust and formal responsibility someone has undertaken by virtue of a position held in some organisation
- “Integrity” is defined by social and professional norms that vary by time and place
- “Bribery” is elastic and negotiable
  - Bribery -> initiated by citizens
  - Extortion -> initiated by officials
  - Difficult to tell in reality
- Level of corruption depends on:
  - Effectiveness of legal system + law enforcement
  - Social/cultural attitudes towards corruption

- State bureaucracy

### Bribery and Corruption: Legal Framework

- Aus is party to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions
  - OECD Anti-Bribery Convention
- Provides the international framework for foreign bribery laws in Aus
  - In 2009 in *Criminal Code Act 1995 (Cth)* - the “Criminal Code”
- Local and international stakeholders pressing Aus to do more in law reform and enforcement
  - Given rise to Crimes Legislation Amendment (Combating Corporate Crime) Bill 2017
    - Introduced into Aus Parliament in Dec 2017 and lapsed
    - Re-introduced in Dec 2019 and currently before parliament
    - Changes are designed to simplify and broaden the scope of the offence, and to remove practice and evidential barriers to successfully investigating and prosecuting individuals and corporations engaged in foreign bribery

### Criminal Offences

- The criminal offences that most commonly apply to bribery or corruption conduct include the following:
  - Bribery of a foreign public official
  - Bribery of a domestic public official
  - Accessorial (or secondary) offences of conspiracy, aiding and abetting or complicity in the primary offence conduct
  - Money laundering
  - False accounting or false or misleading documents under state criminal laws, or the false or reckless dealing with accounting documents under the Criminal Code
  - Breach of statutory director and officer duties

### Legal Definition of Bribe

- ‘Bribe’ is broadly defined under the Criminal Code
  - It is an offence to directly or indirectly provide or offer someone a benefit that is not legitimately due to that person, with the intention of influencing a foreign public official in the exercise of their duties, in order to obtain or retain business or a business advantage
  - NOTE: the nature of what is or is not a bribe under the foreign bribery offence is defined as a ‘benefit’ or ‘business advantage’ that is not ‘legitimately due’ to the person receiving the benefit or advantage
- The nature of any benefit that might arise can include any advantage and is not limited to property
  - It can include any type of financial or non-financial benefit involving any amount of money or thing of value
- A ‘business advantage’ is defined as “an advantage in the conduct of business”
  - NOTE: whether something is or is not legitimately due is problematic, as there is no definition of this phrase and it can often turn upon what is or is not legitimate in a foreign jurisdiction
  - Lesson: understand your business risk - be familiar with the law, culture and customs of the foreign jurisdiction

### **Gifts, Hospitality and Expenses?**

- Giving of gifts, hospitality and other expenses is in itself not illegal under Aus law

- Whether these items are a bribe depends on whether it amounts to a benefit or business advantage that is not legitimately due to the recipient intent to secure a business advantage that is prohibited by, for example, the foreign bribery offence
- Otherwise, so long as any gift, hospitality or expense payment is **reasonable and proportionate to the business relationship between the parties**, and is unconnected to any discretionary decisions such as the award of a licence or a contract sought by tender, such payments are legal

### Extraterritoriality

- Application of a country's laws beyond its borders
  - Governments apply their laws to their domestic companies' foreign operations
    - E.g. US Foreign Corrupt Practices Act, UK Bribery Act
- What do they have in common:
  - It is an offence to provide anyone an undue benefit with the intention to influence a Foreign Public Official to obtain or retain business or business advantage
  - The laws are extraterritorial and can apply even if the act of bribery takes place abroad
- Legal Risk management
  - Great care is required when providing gifts and hospitality and expense payment
    - Especially to Australian public officials than when providing the same to private sector employers - latter usually bound by Agency specific code of conduct
  - Gifts of more than token value and excessive hospitality should be avoided
  - It is usually inappropriate to pay for transport or accommodation for a public official without prior approval from the relevant agency

## WEEK 4: Political-Legal Lens II

### Learning Objectives:

1. Appreciate the diversity of legal systems around the world and the different types of law relevant for (international) business
2. Understand the importance of the rule of law and the legal system as a source of heterogeneity and complexity
3. Explore the growing importance of international law in global business environments
4. Reflect on the implications of the political-legal lens for understanding legal risk

### Lecture Notes

#### LAW AND LEGAL SYSTEM: WHAT IS A LEGAL SYSTEM?

- (Official) law
  - Network of rules and regulations
    - E.g. breaking the 'law' or obeying the 'law'
  - Governmental Social Control
    - Encouraging useful or good conduct
    - Discouraging harmful or bad conduct
    - Attaching 'legal consequences' to particular behaviours
      - E.g. Criminal justice and torts
- A legal system: a system of rules and laws that regulate behaviour and the structures, institutions, and processes that 'breathe life' into them (rules and rules about rules)
  - Content, structure, and culture

- Social control
- Claims of right
- Dispute resolution/settlement
- Distribution of goods and services
- Social change and maintenance
- Diversity ('families') of legal systems in the world
  - 2 dominant traditions: civil law + common law
  - Others: customary law, mixed or pluralistic law, and religious law (including Islamic law)
    - Canada: common law system except in Quebec (civil law based on the French civil code)
    - Papua New Guinea: mixed legal system of English common law and customary law
    - China: civil law influenced by Soviet and continental European civil law systems
    - Philippines: mixed legal system of civil, common, Islamic (sharia), and customary law

## CIVIL LAW SYSTEMS

- Derived from Roman law and developed in continental Europe in the Middle Ages and applied to the colonies of Spain and Portugal (e.g. South America) and to Africa except former British colonies, and later adopted by Russia and Japan and others when reforming legal systems
- Codified systems: a complete code of written laws whose primary source of law is legislation arranges the whole field of law in an 'orderly, logical, and comprehensive' way
- The civil law country has a body of law passed by parliament that can be referred to in each individual case and there is no such thing as binding precedent
- It is an inquisitorial legal system where the court takes more control of the proceedings
- The court must apply the code to specific factual situations; where the code doesn't provide the answer, the court fills in the gaps with general principles
- The parties have a relatively passive role compared to the adversarial system
- The court can rely on evidence not introduced by either party and can even go to the crime scene to gather evidence
- Under a civil code, your inquiry stops with the statutes rules and regulations or the civil code itself. There are no creative interpretations of the law
- Most Civil codes were in the 19th and 20th centuries

## COMMON LAW SYSTEMS

- Developed in English during the Middle Ages and applied within British colonies
- Uncodified (no comprehensive compilation of legal rules and statutes)
- The basic principles were found in case law
  - Body of opinions written by judges, and developed by judges in the course of deciding particular cases
- Doctrine of precedent; a judge is bound by what has already been decided
- Adversarial in form
  - Parties control what evidence is produced in court and the judge plays a relatively passive role compared with the Civil law system
  - Court can only rely on evidence that is introduced into the court by the party's when coming to a decision
  - Court is not entitled to rely on evidence not submitted by the parties when coming to a decision
- Common law is made up of statute law and case law and the court is required to interpret statute law as parliament intend
- The legal principles from higher courts are binding on lower courts who are required to apply

these same principle when faced with a similar factual scenario

## OTHER LEGAL SYSTEMS AND TRADITIONS

- Religious or theocratic law
  - Legal systems stemming from sacred texts of religions
  - Sharia is the most widespread religious legal system in the world
    - About 30 countries in the world
- Customary law
  - Earliest systems of law in human society
  - Based on customs of a community and there is no single history like the civil law transition
  - Rules governing social relations among members of a community
  - Seldom written down, but during colonisation written down and incorporated into legal systems imposed by colonial powers
  - About 40 legal systems around the world in Africa, the Pacific Islands, Europe, the Near East
- Mixed or pluralistic law
  - Some combinations of some or all of the main types of legal systems
    - Civil, common, religious, and customary
  - Combination of retained elements of colonised regions and imposed external legal systems by colonial powers

## AUSTRALIAN LEGAL SYSTEM

- Developed from the legal system of Britain, brought to Australia as part of the colonial settlement process
- The Australian Constitution was passed as an Act of British Parliament on 1 Jan 1901, which marks the beginning of an independent Australian legal system as part of the system of government in Australia
- Under a federal system, power is divided between the federal government and the state/territory governments
- Section 51 of the Constitution lists the powers of the federal government:
  - Defence
  - External affairs
  - Interstate and international trade
  - Marriage and divorce
  - Taxation
  - Corporation
  - Immigration
  - Bankruptcy
- State and territory governments have the power over anything else within their borders
- Therefore, we are subject to Federal laws and the law of the state/territory
- Common law system

## CATEGORIES OF LAW

### Private Law

- Private law deals with the relations among individuals (and organisations)
  - Contract law governs legally enforceable agreements between individual and/or business

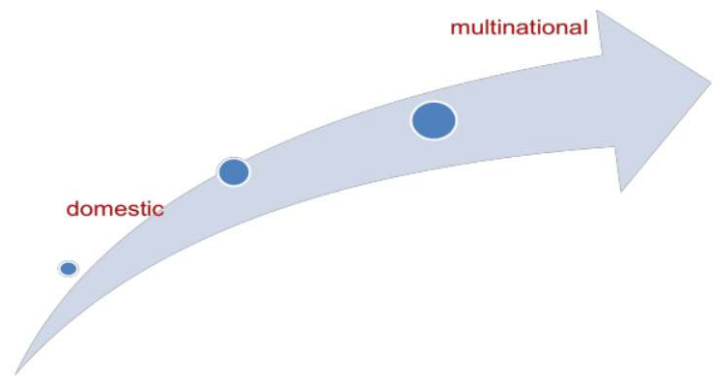
- Competition law places restrictions on the conduct of companies when they form arrangements with each other in an attempt to reduce competition in the marketplace for goods and services
- Consumer protection law protects individuals and businesses against unscrupulous conduct of others such as misleading and deceptive conduct, unconscionable conduct and unfair terms in contracts, etc.
- Examples:
  - An individual takes legal action against another individual for a breach of contract or for negligence
  - You sue an insurance company for not complying with their insurance policy, this comes under private law
  - Consumer Protection legislation that applies to consumers is also private law so is the law that applies to companies

## Public Law

- Public law is the body of law that deals with the powers, rights, obligations of the government and the governed and includes, for example, constitutional law, criminal law, and administrative law
  - An individual or an Australian state could sue the Commonwealth for an apparent breach of the constitution
  - Parliament may pass certain laws which may infringe one's rights in a specific way which may be protected under our constitution
  - The Commonwealth has certain powers under the constitution and if they go beyond these powers they may face an action from either an individual or a state
- Constitutional Law in action
  - Constitutional Challenges to the Tobacco Plain Packaging legislation
  - The Commonwealth passed in 2011 a law mandating that all tobacco be sold in drab dark brown plain packaging without designs or logo and with large graphic health warnings
  - Two cases were heard by the High Court of Australia in April 2012
    - *British American Tobacco Australasia Limited and Ors v Commonwealth of Australia*
    - *JT International SA v Commonwealth of Australia*
  - This law infringed their IP rights. The court found no such breach and dismissed the action
- Administrative law in action
  - Dispute over the amount of tax you pay
    - Make an appeal or appeal to the ATO (Australian Taxation Office)
    - ATO will review your appeal
  - If you need to put in a development application to the local council for certain works, this is an example of the public law in action
  - If you appeal a decision of a tribunal or court for not giving you a fair hearing or if that court or tribunal made a legal error in their decision, you can appeal that decision to a higher court arguing that an administrative error was alleged to have occurred
- Criminal law in action
  - If the police suspect you to have committed a crime, they will arrest and charge with that crime
  - You will be brought before a court and have your matter heard before the magistrate
    - If you are found guilty you will be either fined, jailed or both
  - The executive arm of government is responsible for arresting and charging you but the legal arm of government is responsible for sentencing you. This whole process takes place in the public sphere and is dealt with by the public legal system

## FIRM INTERNATIONALISATION

- International business consists of all commercial transactions that take place between two or more countries
- International business refers to business activities that straddle two or more countries
- A multinational enterprise (MNE) or multinational corporation is a business that has productive activities in two or more countries
- Through internationalisation, domestic firms become multinationals expanding their geographic reach and mindsets
- The process by which firms establish and conduct transactions with firms and customers in other countries, and international operations have an increasing influence on their future



## LEGAL RISK AND LEGAL ENVIRONMENT

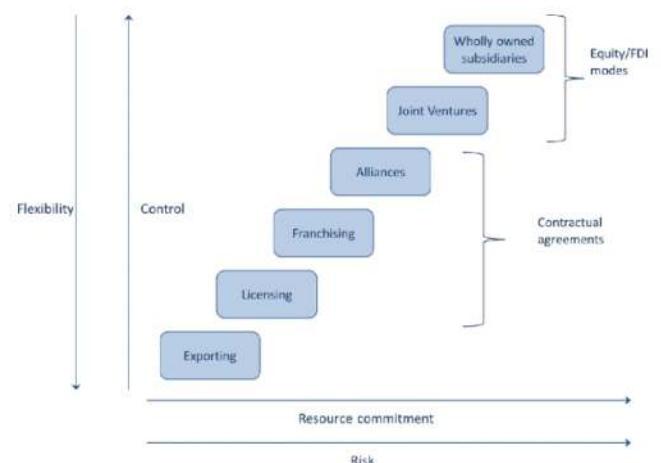
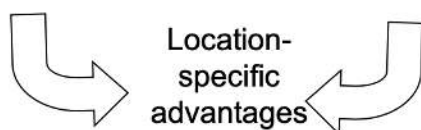
### What do multinationals do?

#### Demand Conditions

- important for MNEs selling goods/services in local market
- quantity and quality of demand
- composition of demand

#### Factor Endowments

- important for investors producing in local market
- consist of inputs to production (e.g. human, physical, knowledge resources)



## CONTRACT LAW

- A contract spells out the conditions under which an exchange is to occur and specifies the rights and obligations of the parties to the contract
  - A contract is an agreement or a bargain between two or more people to do work (buy/sell, build a house, etc.) in which one person or business promises something in exchange for something else (e.g. product/services for money)
  - "Contract" is a legal/technical term that needs to meet certain standards/conditions
  - For example, a valid contract requires two parties with 'legal capacity'
- Contract Law is body of law that governs that governs 'voluntary agreements' or legally



enforceable agreements between individuals and/or businesses

- Civil law and common law differences in contract law:
  - Common law system
    - Very detailed with all contingencies spelled out whereas in civil law countries, they are shorter
    - Expensive to draft contracts and contract disputes are adversarial
    - But more flexible and allows for judges to be more sensitive to the situation
  - Civil law
    - Shorter and less specific because many issues are covered in a civil code
- Contract disputes in international trade
  - The United Nations Convention on Contracts for the International Sale of Goods (CISG) in 1988
  - Uniform set of rules governing commercial contracts between sellers and buyers
  - Part of the *Competition and Consumer Act 2010* (Cth)
  - About 89 countries, including NZ, Japan, etc. have ratified it

## COMPETITION LAW

- Competition law promotes competition by preventing business from obtaining and using market power to engage in anticompetitive practices
  - Most Australian businesses increase their customer base and their profits honestly through:
    - Continual innovation to improve products or services
    - Sales and marketing showing the genuine benefits of their products or services
    - Keeping costs down so they can offer competitive prices
- Competition Policy Reform and Misuse of Market Power amendments updated the *Competition and Consumer Act 2010* (Cth) in 2017, prohibiting certain types of anti-competitive practices, for example:
  - Price fixing
  - Price rigging
  - Cartel conduct
    - When businesses agree to act together instead of competing with each other
- Australian Competition and Consumer Commission (ACCC) implements the legislation
  - E.g. Flight Centre vs ACC

## CONSUMER PROTECTION LAW

- Consumer protection law protects individuals and businesses against unscrupulous conduct of others such as misleading and deceptive conduct, unconscionable conduct and unfair terms in contracts, and provides consumer guarantees in goods and services, etc.
- The Australian Consumer Law (ACL) is in schedule two of the *Competition and Consumer Act 2010* (Cth)
  - ACL prohibits misleading and deceptive conduct (s 18) and unconscionable conducts (s21) in trade or commerce and includes a provision that makes unfair terms (s 23) in consumer contracts void
  - ACL also prohibits certain false or misleading representations (s 29), the supply of unsolicited goods or services, pyramid schemes and harassment or coercion
  - ACL also provides certain consumer guarantees in relation to goods and services (s 51-67)
- International Consumer Protection Enforcement Network (ICPEN)
  - A cooperative and collaborative forum of consumer protection authorities that encourages global cooperation aimed at combating fraudulent, deceptive and unfair practices that affect consumers around the world

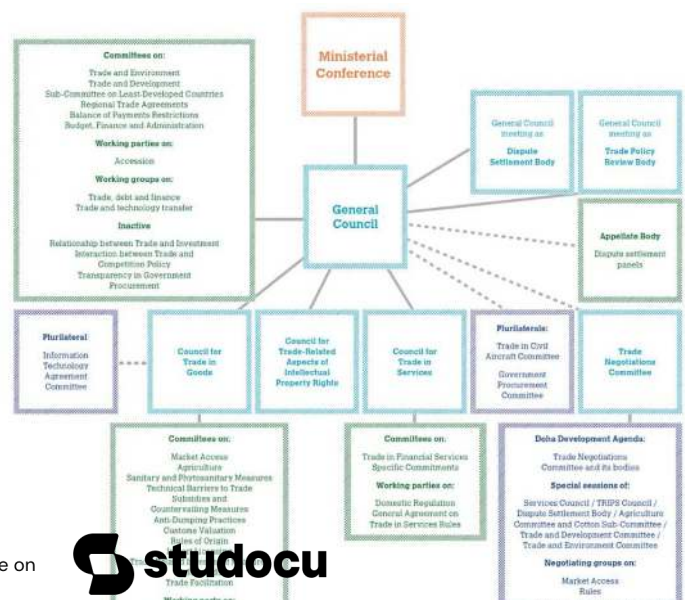
- There are 65 member countries in the group and they respond to cross border issues faced by consumers

## INTERNATIONAL LAW AND GLOBAL BUSINESS ENVIRONMENTS

- International law is a body of law that regulates the conduct of sovereign states and other legal entities possessing international legal personality
  - Established by sovereign states
  - Rules and principles facilitating the conduct of states and international organisations
  - Customary rules and treaty rules that are legally binding among sovereign political entities
- General international law, examples include:
  - Air & space law (jurisdiction on air craft, aviation standards, etc.)
  - Law of the Sea and maritime boundaries
    - E.g. access to maritime resources, navigation, safety at sea
  - Antarctic law
- International security law
  - Legal constraints on the use of military force
  - International humanitarian law
    - E.g. detention of persons during armed conflict
  - Disarmament, non-proliferation, safeguarding of conventional weapons and weapons of mass destruction
- International human rights law
- International trade law

## WORLD TRADE ORGANISATION

- A successor international organisation to the General Agreement on Tariff and Trade (GATT)
- Located in Geneva
- Established in 1 Jan 1995 by the Uruguay Round of GATT (1986-94)
- Currently there are 164 member states
- Representing 98% of world trade
- Aims to ensure trade flow as freely as possible
- Provide forum for trade negotiations and settle trade disputes
- Monitor and enforce agreements
- WTO's overriding objective is to help trade flow smoothly, freely and predictably. It does this by:
  - Administering trade agreements
  - Acting as a forum for trade negotiations
  - Settling trade disputes
  - Reviewing national trade policies
  - Building the trade capacity of developing economies
  - Cooperating with other international organisations
- Ministerial conference
  - All members
  - Every 2 years
  - Rounds of negotiations
  - Last meetings: Bali in 2013 and Nairobi in 2015, and Argentina in 2017
- General Council/Dispute Settlement Body/Trade Policy Review Body



- Councils for Trade in Goods, IP, Services
- Appellate Body
- Secretariat: supports the work of councils

### WTO's 3 Agreements

- General Agreement on Tariff and Trade (goods)
  - Principles of non-discrimination
    - Most favoured nation principle: treating everyone equally as most favoured partner
    - National treatment principle: equal treatment of domestic and foreign firms
  - Progressive trade liberalisation through negotiations
  - Reciprocity: a country's trade liberalising measures should be matched by trading partners
  - Fair: rule-based competition
- General Agreement of Trade in Service
  - Substantially higher rates of tariffs for services than goods
  - Extends GATT principles to services
  - Member countries commit to schedule for market access
  - Has been extended to cover new sectors
    - E.g. telecoms, financial institutions
  - Still behind access for goods
  - Council for Trade in Services
- Trade Related Aspects of Intellectual Property Rights
  - Extends GATT principles to IP
  - Specifies norms of protection for forms of IP
    - E.g. copyright, patents, etc.
  - Sets out obligations for domestic enforcement of IP rights
  - Most comprehensive, global minimum standard, and enforceable through trade sanctions
  - Lots of national differences and controversy especially in the public health system and agricultural support
  - Copyright for 50 years and patents for 20 years
  - No global system for copyright and patents

### Challenges of WTO

- Less effective in area of primary products
- Slow reduction in non-tariff barriers
- Lack of environmental/social principles
- Problem of national sovereignty
- Discrimination against developing world
- Rise in no. of bilateral/regional agreements
- Doubts over likely success of new trade round

### Example: Doha Development Agenda

- Formally launched in Nov 2001
- Aims to place development issues at the core of new trade round
- Very broad (possibly too broad) agenda for negotiations; agriculture the 'make or break' issue
- Deadlines not met
- Main problem area: agriculture (cuts in tariffs, export subsidies)

### CASE OF THE FORBIDDEN FRUIT

- A long-running trade dispute between Aus and NZ over exports of Kiwi apples since 1921 on the grounds that NZ has fire blight disease
- In 2006, Aus allowed apples to be imported under strict conditions (quarantine)
- In 2007, NZ took the case to WTO
  - 2007 - Consultations started
  - 2008 - A panel was established
  - 2009 - Final oral hearing
  - 2010 - A panel report -> NZ won
- John Corboy, chairman of Apple and Pear Australia's fire blight task force, says: "When you can have a third party such as the WTO decide what risks a country should take, you've abrogated your responsibility in that," he said. "No doubt this will give confidence to people to start challenging all of those issues, be it Australia, New Zealand or any other country in the world. So it's not just about the apple and pear industry."

## THE KNOWLEDGE SOCIETY AND INTELLECTUAL PROPERTY RIGHTS

- Knowledge Society (Economy)
  - The growing importance of high-technology goods as % of international trade
  - Economy based on production and distribution of knowledge
  - Increasing importance of intellectual property assets
  - Multinationals are important drivers of innovation and knowledge production
- Patents
  - Legal right granted by the government to investors, for a fixed period of years, to exclude other persons from making, using or selling a patented product or using a patented method or process
  - A patent is valid only within the territory of the state granting it. Some implications:
    - There is NO global patent
    - There are variations in national patent laws

## LEGAL ENVIRONMENT AND LEGAL RISK (AND OPPORTUNITY?)

- Legal risk = likelihood of a legal system failing to provide safety (to businesses) and the likelihood of a lack of legal knowledge or understanding and/or illegal, reckless behaviour negatively affecting business
  - Contractual risks in overseas markets
    - I.e. risk of contract being broken/nullified
  - Risks of liability for injuries or defective products, and subsequent litigation
  - Risks of corruption in the legal system
  - Violation of property rights, including intellectual property
  - Risk of infringement of data protection requirements (importance to e-commerce)
- Stability/effectiveness of legal system
  - Rule of law: supremacy of law over government and citizens
    - Principle of equity before the law
  - Independence of judiciary/degree of corruption
  - Judicial system load (potential delays)/costs
  - Implementation/enforcement of laws/regulations
  - Extent of appeals procedure

## WEEK 5: Economic Lens I

## Learning Objectives:

1. Understand how business decisions depend on a complex and dynamic economic environment
2. Apply and interpret key economic indicators
3. Explain how these measures are constructed and their shortcomings
4. Appreciate the importance of economic inequality

## Lecture Notes

### MACROECONOMICS

- Local environment depends on the complex, dynamic global environment
- Businesses must:
  - Understand the main forces that drive the macroeconomic environment
  - Be able to interpret key economic indicators and predict changes to their local environment
- Macroeconomics is the study of economy-wide phenomena, like the growth rate of a country's total economic output, the inflation rate, or the unemployment rate
- Macroeconomics historically focused on aggregate statistics
  - E.g. GDP, inflation, unemployment
  - Whole economy is too complicated to focus on the details
- Typically addressing 2 key questions:
  - Growth: the level of prosperity of societies in the long-run
  - Cycles: fluctuations in levels of prosperity in the short-run
- Modern macroeconomics is also concerned with **distribution**
  - i.e. how prosperity is divided across individuals
- Omission reflects two different approaches to macro:
  - Representative agent macro -> everyone is the average
  - Heterogeneous agent macro -> income and wealth diversity
- Macroeconomics builds on microeconomics
  - The whole economy is just the result of lots of individual decisions and interactions
- Macroeconomic tools are necessary to examine a dynamic economic environment

## Thinking Like an Macroeconomist

1. The Paradox of Thrift
  - If we all try to save more, we might end up saving less
2. Self-fulfilling prophecies
  - If we all believe it will happen, we make it happen
3. Aggregate resource constraint
  - What if everyone increases their input demand at the same time?

## Measuring the Economy

Domestic Eco	International Eco
<ul style="list-style-type: none"><li>● Gross Domestic Product (GDP)</li><li>● Price level + inflation</li><li>● Employment + unemployment</li><li>● Interest rates</li></ul>	<ul style="list-style-type: none"><li>● Exchange rates</li><li>● Trade balance + balance of payments</li></ul>

### GDP

- GDP is the total market value of all final goods and services produced in the economy in a given period
- $GDP = C + I + G + X - M$

### 3 ways of measuring GDP

<b>Expenditure</b>	How much we spent on final goods	<p><b>GDP equals total spending on final goods</b>          which embodies the value created at earlier stages</p> <p>Stevenson/Wolfers, <i>Principles of Economics</i>, 1e, © 2020 Worth Publishers          (forest) Alalal/Shutterstock.com; (lumber) Vasily Gamayunov/Shutterstock</p>
<b>Production</b>	How much stuff we made (output)	<p><b>GDP equals total output</b>          which is measured as the sum of value added at each stage</p> <p>Stevenson/Wolfers, <i>Principles of Economics</i>, 1e, © 2020 Worth Publishers          (forest) Alalal/Shutterstock.com; (lumber) Vasily Gamayunov/Shutterstock</p>
<b>Income</b>	How much we received	<p><b>GDP equals the sum of all income = total wages + total profits</b></p> <p>Stevenson/Wolfers, <i>Principles of Economics</i>, 1e, © 2020 Worth Publishers          (lumber) Vasily Gamayunov/Shutterstock</p>

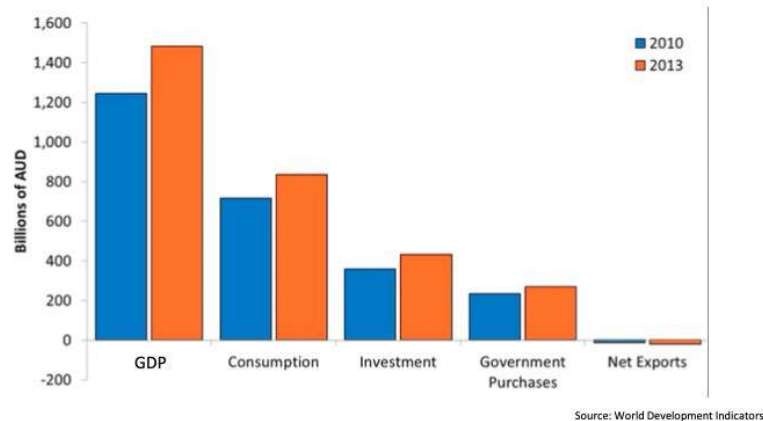
Expenditure Approach	Production Approach	Income Approach
GDP = Consumption + Investment Spending + Government Spending + Exports - Imports	GDP = Value added from each sector <ul style="list-style-type: none"> <li>• Primary</li> <li>• Manufacturing</li> <li>• Construction</li> <li>• Services</li> </ul>	GDP = Wages and Salaries + Profits + Rental Income + Government Subsidies - Taxes

- GDP excludes nonproductive transactions
  - Transactions where no production of goods or services occurs
- 2 major types of nonproductive transactions
  - Purely financial transactions
    - Public transfer payments
    - Private transfer payments



- Buying + selling of shares and securities
  - Sales of second-hand goods
    - These do not reflect current production
    - Involve double counting
- Nonmarket transactions are also not counted in GDP figures
  - Underground economy
  - Engaged in illegal activities such as gambling
  - Also include legal activities that do not fully report their income

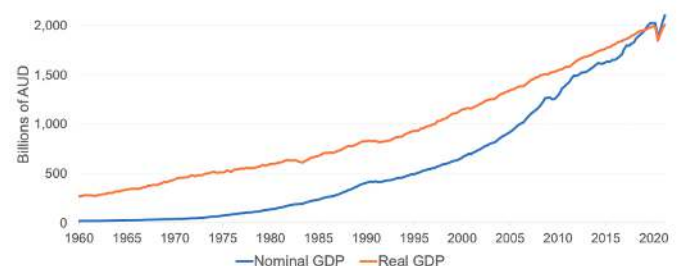
## Components of Australian GDP



## Comparing GDP Over Time

- Nominal GDP
  - Total value of output at CURRENT MARKET PRICES
  - Can increase because:
    - We produced more stuff
    - Prices went up (inflation)
    - Population grew
- Real GDP
  - Total value of output at BASE-YEAR PRICES
- GDP per capita
  - Total value of output per person in the economy
- Real GDP per capita is a measure of economic well-being
  - How much output/income is available per person, at fixed prices
  - Not always good measure as it does not measure:
    - Household production
    - Underground economic activity
    - Environmental quality
    - Health and life expectancy
    - Leisure
    - Economic equality

## Australian Nominal and Real GDP



## INFLATION

- Inflation = rise in general level of prices of goods and services over time
- Inflation rate = percentage change in price level from one year to the next

## Price Index

- Price index = measures average price for 'basket' of goods and services
- 2 key price indices
  - GDP deflator -> basket contains everything in GDP
  - Consumer Price Index -> basket contains goods and services purchased by a typical household
- Inflation rate = annual % increase in the price index ()

### Costs of Inflation

- Indexing costs
  - Have to incorporate into contracts
- Menu costs
  - Have to change prices more often
- Shoe-leather costs
  - Consumers must go to bank more often
- Inconvenience
  - Hard to plan when prices keep changing
- Relative price distortions
  - Prices of some goods adjust more rapidly than others
- Uncertainty
  - Can distort investment

### Benefits of Inflation

- Source of revenue for gov
  - Called seigniorage
- If nominal wages are "sticky", government can use inflation to reduce real wages in recessions
- Causes nominal interest rates to be higher than real interest rates
  - Gives central bank "room to work" by cutting interest rates

### Redistributive Effects of Inflation

- Lowers wealth of lenders -> retirees + banks
- Raises wealth of borrowers -> young home-owners + gov

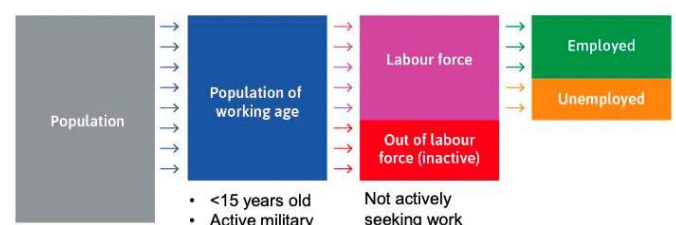
### Deflation

- Deflation = a decrease in the general price level of goods and services in the economy
- Issues:
  - Consumers delay purchases -> demand falls
  - Asset prices fall -> real debt grows -> borrowers default -> banks go bankrupt -> people lose savings -> panic -> Great Depression

## UNEMPLOYMENT

- An unemployed person:
  - Has not worked in the previous week
  - Is actively looking for work
  - Is immediately available for work
- Unemployment rate = percentage of labour force who are unemployed

### The labour market



### Why Unemployment is a Problem



- Lost potential production and income for economy
- Increased inequality
- Loss of human capital (skills)
- Increased stress on individuals and families
- Increase in crime
- Loss of human dignity or self esteem

$$\text{participation rate} = \frac{\text{labour force}}{\text{population of working age}}$$

$$\text{unemployment rate} = \frac{\text{unemployed}}{\text{labour force}}$$

### Labour Market Statistics

- 2 countries with the same unemployment rate can differ in their employment rates if one has a high participation rate and the other has a low one

$$\text{employment rate} = \frac{\text{employed}}{\text{population of working age}}$$

### Types of Unemployment

- Frictional
  - It takes time to find a job
  - There are enough jobs for everyone, but the matching process is not instantaneous
- Structural
  - Mismatch in skills and geographic location
  - Workers are a mismatch for the available jobs
- Cyclical
  - The number of people who want to work is temporarily larger than the number of people that firms want to hire at the prevailing wage rate
- Hidden
  - Discouraged job seekers give up actively looking for work and are no longer counted in the official unemployment statistics
  - E.g. long term unemployed parents with no available child care

## WEEK 6: FLEXIBILITY WEEK

## WEEK 7: Economic Lens II

### Learning Objectives:

1. Develop a simple macroeconomic model of income and expenditure with sticky prices
2. Apply economic principles to analyse household consumption/savings decisions
3. Evaluate how household marginal propensity to consume determines the aggregate expenditure multiplier
4. Articulate the key mechanism and limitations of fiscal policy

### Lecture Notes

#### UNEMPLOYMENT

- An unemployed person:
  - Has not worked in the previous week
  - Is actively looking for work
  - Is immediately available for work
- The unemployment rate is the percentage of the labour force who are unemployed

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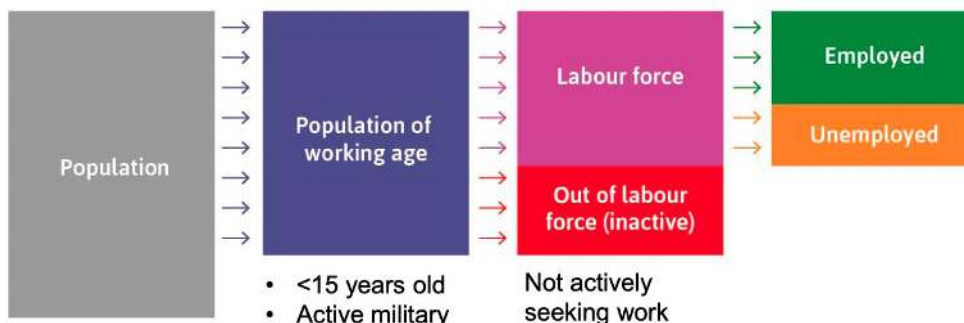
$$\text{participation rate} = \frac{\text{labour force}}{\text{population of working age}}$$

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## MACROECONOMIC QUESTIONS

- Macroeconomists tend to focus on:
  - Long run:
    - Growth in living standards over time
    - Differences in living standards across countries



■ Distribution of living

standards across individuals

- Long-term structural changes in economies
  - Short run:
    - Fluctuations in living standards
    - Rising and falling levels of unemployment
    - Deviations from potential output
    - How disruptions are

## BRIEF + INCOMPLETE HISTORY OF ECONOMIC THOUGHT

- Classical/Neoclassical approach - Adam Smith, Alfred Marshall
  - Prices clear markets -> economy is self-regulating
  - Laissez-faire -> no need for gov intervention
- Keynesian approach - John Maynard Keynes, John Hicks

- Sticky prices -> prices (including wages) adjust slowly
- Government policy plays a role in the short run

## Keynesian View

- “Demand creates supply”
- Governments should intervene to reduce unemployment
- Expansionary fiscal policy
  - Increased government spending
  - Lower taxes
  - Typically financed by increasing government budget deficit

## VERY SIMPLE MODEL

- GDP:  $Y = C + I + G + EX - IM$
- Assume  $I, G, (EX - IM)$  are exogenous
  - Determined outside the model
- $C$  depends on disposable income
  - Income - taxes and other commitments
- Let  $C = c + k(Y - T)$ 
  - $c$  - exogenous
  - $k$  - marginal propensity to consume (MPC)
- Neoclassical approach: suppose  $G$  (or  $I$  or  $EX$ ) increases
  - No change to the productive capacity of the economy
  - Prices adjust
  - GDP/employment do not change
- Keynesian approach: suppose  $G$  (or  $I$  or  $EX$ ) increases
  - Businesses increase production to meet demand
  - Businesses demand more labour
  - Household incomes go up
  - Households demand more goods and services

## Expenditure Multiplier

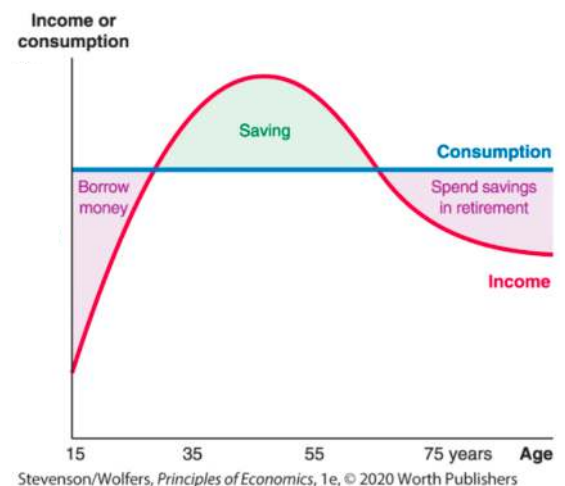
- Suppose  $G$  increases by \$10 billion
- Suppose that  $k = 10\%$ 
  - $Y = C + I + G + EX - IM$
  - $Y = c + k(Y - T) + I + G + EX - IM$
- $Y$  increases by  $\$10b + \$1b + \$0.1b + \dots == \$1.111b$

## Spending and Saving

- Person decides how much of extra \$1 to spend by comparing marginal benefit and cost
- MB of \$1 consumption today = MB  $\times (1+r)$  of \$1 of consumption tomorrow

## Consumption Smoothing

- Diminishing marginal benefit -> want to spread consumption over time
- Permanent income hypothesis
  - $c = r(a + H)$ 
    - $a$  = assets
    - $H$  = human capital



■  $r$  = real interest rate

## Hand-to-Mouth Households

- Many households are **borrowing constrained**
  - Would like to borrow to increase consumption today but cannot
- For hand-to-mouth households:
  - $c = a + H$
- 2 types:
  - Poor hand-to-mouth
    - Households with little wealth
    - Small share of GDP
  - Wealthy hand-to-mouth
    - Households with little liquid wealth
    - Substantial illiquid wealth
    - Significant share of GDP

## Responses to a Rise in Income

Effect of . . .	Consumption smoothers	+	Hand-to-mouth consumers	=	Total consumption
<i>A temporary rise in income</i>	Small $\uparrow C$		Large $\uparrow C$		Intermediate $\uparrow C$
<i>A permanent rise in income</i>	Large $\uparrow C$		Large $\uparrow C$		Large $\uparrow C$
<i>An anticipated rise in income</i>	No change		Large $\uparrow C$		Intermediate $\uparrow C$
<i>News of a future rise in income</i>	Large $\uparrow C$		No change		Intermediate $\uparrow C$

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## FISCAL POLICY

- Use of government spending and tax policy to reduce economic fluctuations
- Fiscal policy works in 2 ways:
  - Automatic stabilisers
    - Tendency for a system of taxes and transfers to automatically reduce the size of GDP fluctuations
    - $\uparrow$  spending or  $\downarrow$  taxes during a downturn
    - Mechanisms: UE insurance, social safety net, progressive income taxes
  - Discretionary fiscal policy
    - Deliberate changes in government spending, transfer payments or tax rates to influence the level of economic activity

## Problems with Fiscal Policy

- Time lags - takes time to:
  - Recognise the need for policy action
  - Decide on appropriate action
  - Pass legislation to implement fiscal policy
  - See effects of policy once implemented

- Funding - expansionary policy requires higher taxes or increased borrowing
  - Taxes have distortionary effects, reducing potential output
  - Government debt
    - May **crowd out** private investment, by increasing interest rates
    - May not be sustainable in the long run

## WEEK 8: Economic Lens III

### Learning Objectives:

1. Define the main forms and functions of money
2. Understand how prices depend on the supply of money
3. Explain how the central bank influences economic activity

### Lecture Notes

#### FISCAL POLICY & GOVERNMENT DEBT

- With sticky prices, an increase in G or a decrease in T or transfers to households increase GDP and decrease unemployment in the short run
  - $Y = c + k(Y-T) + I + G + EX - IM$
- Problems with fiscal policy
  - Time lags - it takes time for the political process to respond
  - Funding - expansionary policy requires higher taxes or deficit spending
    - Taxes have distortionary effects, reducing potential output
    - Government debt
      - May **crowd out** private investment, by increasing interest rates
      - May not be sustainable in the long run

#### WHAT IS MONEY?

- Many functions for money:
  - Medium of exchange - used to exchange for goods and services
  - Unit of account - used to measure the economic value of goods and services
  - Store of value - used to hold wealth
- Many types of money:
  - Commodity money
    - Something with intrinsic value used as money
    - E.g. gold, silver, rice, salt, beads, feathers, cigarettes, shells, noodles
  - Fiat money
    - Money with no intrinsic value

- Many measures of money:
  - Currency - notes and coins in circulation
  - M1 - currency + cheque and savings accounts
  - M3 - M1 + all deposits of the private non-bank sector
  - MZM - currency + cheque and savings accounts + money market funds

## Money and Prices

$$\text{Velocity of money} = V = \frac{P \times Y}{M}$$

- Measures spending per dollar in a period in time
  - How fast a dollar travels around the economy
  - If GDP = \$20 and there are 4 x \$1 notes in the economy, then V = 5

## Quantity Theory of Money

- Assumes that in the long run:
  1. Real output Y is independent of the money supply M
  2. Velocity V is constant - P changes proportionately with M
- Implies that:
  - Price level is determined by the money supply
  - Inflation is determined by growth in money supply

## Output and Inflation in the Short Run

- Phillips Curve
- Short-run inflation depends on:
  - Inflation expectations
  - The output gap = actual output - "potential" output
  - Supply shocks

## AUSTRALIAN FINANCIAL SYSTEM

- Key players:
  - Reserve Bank of Australia (RBA)
  - Commercial banks
  - Financial intermediaries
    - Non-bank financial institutions like investment banks and hedge funds
- Common features:
  - Deal in credit and debt
  - Act as an intermediary between savers and borrowers
  - Move funds to productive uses

## The Central Bank

- Issues currency
- Banker to the banks
  - Banks hold accounts to settle debts owing to other banks
  - Banks short on cash can borrow from the central bank if they cannot borrow enough from other banks

- Banker to the government
- Regulates financial markets
- Implements monetary policy

## Reserve Bank of Australia

- Reserve Bank of Australia = Australia's central bank

It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank ... are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:

- the stability of the currency of Australia;
- the maintenance of full employment in Australia; and
- the economic prosperity and welfare of the people of Australia.

*Reserve Bank Act 1959*

- RBA had 3 goals and 1 major tool
  - Central banks used to target the money supply
  - Today, most target interest rates
- Interbank Overnight Cash Rate (Cash Rate)
  - Interest rate on unsecured overnight loans between banks
  - (Near) risk-free benchmark rate for the Australian economy

## MONEY SUPPLY AND THE CASH RATE

### Setting the Cash Rate

1. It announces the rate, say  $i = 0.75\%$
  2. It allows banks borrow for  $i + 0.25\%$  and save for  $i - 0.25\%$
  3. It conducts open market operations
    - If  $i < \text{target}$ , it sells government bonds from banks for new cash
    - If  $i > \text{target}$ , it buys government bonds from banks, taking cash out of the market
- To decrease  $i$ , increase the money supply
  - To increase  $i$ , decrease the money supply

### Nominal Interest Rates

- Mortgage interest rates depend on the cash rate
- The cash rate is the bank's opportunity cost of lending money
  - Lenders charge an interest rate that covers their lending cost
  - Plus compensation for risk
    - i.e. interest rate = risk free rate + risk premium
- Cash rate  $\approx$  risk free rate
  - Short-term, backed by government bonds

### Real Interest Rates

- The Fisher equation:

$$i = r + \pi^e$$

Real interest rate      Expected inflation

- Not to be confused with the definition:  $i = r + \pi$ 
  - $\pi$  = actual (past) inflation
- If lenders expect high inflation, they will demand a higher interest rate
- If prices are sticky:

- Inflation will adjust slowly to changes in  $i$
- The central bank can influence REAL interest rates

## INTEREST RATES AND THE ECONOMY

- Household consumptions/savings
  - Lower  $r \rightarrow$  less costly to borrow/spend today
  - Increase in  $C, I$  (new housing)
- Business investment
  - Lower  $r \rightarrow$  lower opportunity cost of new capital equipment
  - Increase  $I$
- Cash flow
  - Lower mortgage rates, means more cash in pockets to spend today
  - Increase in  $C$  (especially for hand-to-mouth households)
- Asset prices
  - Lower  $r$  tends to increase asset prices
  - Easier for (wealthy hand-to-mouth) consumers to get loans
  - Consumption smoothers feel richer and spend more today
  - Increases  $C$
- Exchange rates
  - Lower  $r$  tends to cause Australian dollar to depreciate
  - Australian goods and services are cheaper for foreigners
  - Increases  $EX$ , decreases  $IM$
- Fiscal policy
  - Lower  $r \rightarrow$  government debt is less of a concern
  - Increase  $G$

## TRANSMISSION OF MONETARY POLICY

- Recall our short-run income-expenditure model
  - $Y = c + k(Y-T) + I + G + EX - IM$
- The components of GDP all increase with a decrease in  $r$ 
  - $Y = c(r) + k(Y-T) + I(r) + G(r) + EX(r) - IM(r)$

## Why Macroeconomic Policy is Hard

- Monetary and fiscal policy are blunt instruments
  - There are many competing objectives but two main tools
- Data availability
  - Not clear what is happening until after the fact
- What is the “potential” output?
  - Supply-side shocks
  - Short-run output-inflation tradeoff
- Zero lower bound for nominal interest rates

## RECAP

- Money is anything that can be easily exchanged for goods and services
- Quantity theory
  - In the long run, prices depend on the money supply
  - Real output depends on factors of production and technology
- Phillips curve
  - In the short run, prices depend on expectations and strength of demand



- Monetary policy
  - The RBA sets interest rates
  - Lower REAL interest rates encourage more expenditure today
  - But, risks increased inflation if it pushes output beyond its potential

## WEEK 9: Sustainability

### Learning Objectives:

1.

### Lecture Notes

#### SUSTAINABILITY THINKING

- Looking through the sustainability lens, recognises the interconnectedness of our social, economic, and political systems
- When we think about sustainability, we need to look below the surface and question the biases, assumptions and mental models underpinning much of what we see when we use other lenses

### Sustainable Development

- “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs”
- “Brundtland” Report: Our Common Future
  - 1. The concept of needs, in particular the essential needs of the world’s poor

## WEEK 10:

### Lecture Notes