Chapter 4: Government and economic influences on business

The impact of business activity on society

All business activity has benefits and undesirable effects on society. These reasons are why governments want to have some control over business activity:

Possible benefits:

- Production of **useful goods** to satisfy customer wants.
- Create **employment**/increases workers **living standards**.
- Introduction of new products or processes that **reduces costs** and**widen product range**.
- **Taxes** help finance public services.
- Business earn **foreign currency** in exports and this could be spent on imports.

Possible undesirable effects:

- Business might **ruin** cheap but **beautiful areas**.
- **Low wages** and **unsafe working** conditions for workers because businesses want to lower costs.
- **Pollution**
- Production of **dangerous** goods.
- **Monopolies**
- Advertising can **mislead** customers.

Governments tend to pass laws that restrict **undesirable** activities while supporting **desirable** activities.

Governments and the economy

Government economic objectives:

Governments all have aims for their country, and this is what they are:

- Low **inflation**.
- Low **unemployment**.
- Economic **growth**.
- **Balance of payments**.

Low inflation:

Inflation occurs when prices rise. When prices rise rapidly many bad thing could happen:

- Workers wages **buy less** than before. Therefore their **real income**(how much you can buy with so much money) falls. Workers will be unhappy and demand for higher wages.
- Prices of **local** goods will **rise more** than that of other countries with lower inflation. People may start **buying foreign goods** instead.
- It would **cost more** for businesses to **start** or **expand** and therefore it does not **employ** as many people.

- Some people might be made **redundant** so that the business can cut costs.
- **Standards of living** will **fall**.

This is obviously why governments want to keep inflation as low as possible.

Low levels of unemployment:

When people are **unemployed**, they **want** to work but **cannot find** a **job**. This causes many problems:

- Unemployed people do not work. Therefore **national output** will be**lower** than it should be.
- The government will have to pay for **unemployment benefits**. This is**expensive** and money cannot be use for other purposes.

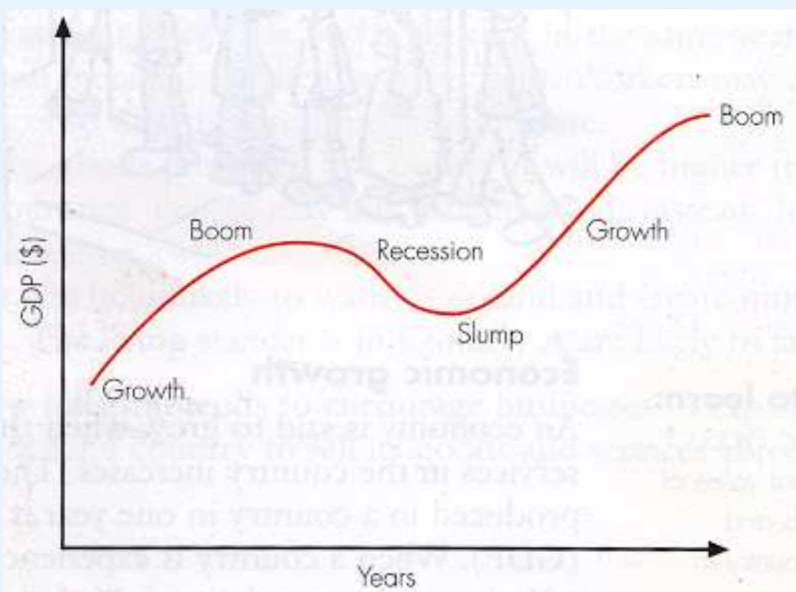
If the level up unemployment is low, it will increase national output and improve standards of living for workers.

Economic growth

A country is said to grow when its **GDP** (Gross Domestic Product) is increasing. This is the total value of goods produced in one year. The standards of living tends to increase with economic growth. Problems arise when a country's GDP fall:

- The country's output is falling, fewer workers are needed and**unemployment** occurs.
- **Standards of living** will fall.
- Businesses will **not expand** because they have less money to **invest**.

Economic growth is not achieved every year. There are years where the GDP falls and the **trade cycle** explains the pattern of rises and falls in national GDP.



The trade cycle has 4 main stages:

- **Growth:** This is when GDP is rising, unemployment is falling, and the country has higher standards of living. Businesses tend to do well in this period.

- **Boom:** Caused by overspending. Prices rise rapidly and there is a shortage of skilled workers. Business costs will be rising and they are uncertain about the future.
- **Recession:** Because overspending caused the boom, people now spend too little. GDP will fall and businesses will lose demand and profits. Workers may lose their jobs.
- **Slump:** A long drawn out recession. Unemployment will peak and prices will fall. Many firms will go out of business.

After all of this happens the economy **recovers** and begins to grow again. Governments want to avoid a **boom** so that it will not lead to a recession and a slump. Currently, the government of China is spending a lot of money so that their economy would continue to grow and avoid a boom.

Balance of payments

Exports earn **foreign currency**, while **imports** are paid for by foreign currency (or vice versa). The difference between the **value** of exports and imports of a country is called **balance of payments**. Governments try to achieve a balance in imports and exports to avoid a **trade deficit**, when **imports** are higher than**exports**. Of course, the government will lose money and their **reservoir** of foreign currency will **fall**. This results in:

- If the country wants to import more, they will have to **borrow** foreign currency to buy goods.
- The country's **currency** will now worth less compared to others and can buy less goods. This is called **exchange rate depreciation**.

<u>Government economic policies</u>

Governments want to influence the national economy so that it would achieve their aforementioned **objectives**. They have a lot of power over business activity and can pass laws to try to achieve their goals. The main ways in which governments can influence business activity are called **economic policies**. They are:

- **Fiscal Policy:** taxes and public spending.
- **Monetary policy:** controlling the amount of money in the economy through interest rates.
- **Supply side policies:** aimed at increasing efficiency.

Fiscal policy

Government spending could benefit some firms such as:

- Construction firms (road building)
- Defense industries (Iraq war)
- Bus manufacturers (public transport)

Governments raise money from **taxes**. There are **Direct taxes** on **income** and**Indirect taxes** on **spending**. There are four common taxes:

- Income tax
- Profits tax
- VAT (Value Added Tax)
- Import tariffs

Income tax

Income tax is based on a percentage of your income. Income tax is usually**progressive**, meaning that the percentage of tax you have to pay rises with your income. Effects on business and individuals if there was a rise of income tax:

- People will have less **disposable income.**
- **Sales fall** because people have less money to spend.
- Managers will cut costs for more profit. Workers might be made**redundant**.
- Businesses producing **luxury goods** will lose the most, while others producing **everyday needs** will get less affected.

Profits tax or corporation tax

This is a percentage of the profit a business makes. A rise in it would mean:

- Managers will have less **retained profit**, making it **harder** for the business to **expand**.
- Owners will get l**ess return on capital employed**. Potential owners will be **reluctant** to start their own business if the **profit margin** is too low.

Indirect taxes

These taxes are a percentage on the price of goods, making them more expensive. Governments want to **avoid** putting them on **essential goods** such as foods. A rise it it would mean:

- The effect would be almost the same as that of an increase in income tax. People would **buy less** but they would still spend money on**essential goods**.
- Again, **real incomes** fall. Costs will rise when workers demand higher wages.

Import tariffs and quotas

Governments put tariffs on imports to make local goods look more competitive and also to reduce imports. When governments put import tariffs on imports:

- Sales of local goods become **cheaper** than imports, leading to**increased sales**.
- Businesses who **import raw materials** will suffer higher costs.
- Other countries will **retaliate** by putting tariffs on the country's**exports**, making it less competitive.

Quotas maybe used to limit the amount of imports coming in.

Monetary policy and interest rates

Governments usually have to power to change **interest rates** through the central bank. Interest rates affect people who borrow from the bank. When interest rates rise:

- Businesses who owe to bank will have to **pay more**, resulting in less**retained profit**.
- People are more reluctant to **start** new businesses or **expand**.
- Consumers who took out loans such as **mortgages** will now have less**disposable income**. They will spend less on other goods.
- Demand will **fall** for businesses who produces **luxury** or **expensive**goods such as cars because people are **less willing to borrow**.

- Higher interest rates will **encourage** other countries to **deposit money** into **local banks** and earn **higher profits**. They will change their money into the local currency, increasing its demand and causing**exchange rate appreciation**.

Supply side policies

These policies aim to make the countries economy more efficient so that they can produce more goods and compete in the international economy. In doing so their GDP will rise. Here are some policies:

- **Privatisation:** Its aim is to use profit as an incentive to increase efficiency.
- **Improve training and education:** This obviously increases efficiency. This is crucial to countries with a big computer software industry.
- **Increase competition:** Competition causes companies to be more efficient to survive. Governments need to remove any monopolies.

Government controls over business activity

Government also influence major areas of business activity:

- what goods can be produced
- responsibilities to employees and working conditions
- responsibilities to consumers
- responsibilities to the natural environment
- location decisions

Undesirable effects created by business activity make governments want to control business activity:

- Business might **ruin** cheap but **beautiful areas**.
- **Monopolies**.
- Advertising can **mislead** customers.

<u>**Why government control business activity**</u>

Production of certain goods and services:

Governments can pass laws to restrict and ban certain dangerous goods such as:

- Weapons like guns and explosives.
- Drugs
- Goods that harm the environment

Consumer protection:

Consumers are easily misled by advertising. It is because consumers lack the technical knowledge and advertising can be very persuasive. In the UK, these laws are passed to protect customers from being exploited by businesses:

- **Weights and Measures Act:** to stop underweight goods being sold to customers.
- **Trade Descriptions Act:** all advertisements must be truthful.
- **Consumer Credit Act:** makes it illegal to not give customers their copy of the credit agreement to check how much money they really have.
- **Sale of Goods Act:** Makes it illegal to sell:

 - Goods which have serious flaws or problems.

- Products that are not fit for the purpose intended by the consumer.
- Products that do not function as described on their label or by the retailer.

- **Consumer Protection Act:** Make false pricing claims illegal. Consumers can now sue producers or retailers if their products cause harm to them.

Competition policy: Control of monopolies

Monopolies could cause a lot of harm to an economy because there are nobody to compete against them:

- They exploit consumers with high prices.
- They prevent new firms from starting up.
- Monopolies are not encouraged to be efficient because there are no competitors.

In some countries, monopolies are banned and must be broken up into smaller firms. In the UK, monopolies can be investigated by the **Competition Commission**. This government body reports two main types of problems:

- Business decisions that are **against consumer interests**, such as trying to **eliminate all competitors**.
- Proposed **mergers** or **takeovers** that will result in a monopoly.

Protecting employees:

Employees need protection in the following areas:

- Unfair discrimination
- Health and safety at work
- Unfair dismissal
- Wage protection

Protection against unfair discrimination:

Often workers are discriminated in a job because of various reasons. There are laws that protect the employee from such reasons to be discriminated against:

- **Sex Discrimination Act:** people of different genders must have equal opportunities.
- **Race Relations Act:** people of all races and religions mush have equal opportunities.
- **Disability Discrimination Act:** it must be made suitable for disabled people to work in businesses.
- **Equal Opportunities Policy:** That is what everything is all about.

The UK is currently working on an age discrimination act.

Health and Safety at work:

Laws protect workers from:

- protect workers from **dangerous machinery**.
- provide **safety equipment and clothing**.
- maintain reasonable workplace **temperatures**.
- provide **hygienic** conditions and **washing** facilities.
- do **not** insist on excessively **long shifts** and provide **breaks** in the work timetable.

Managers not only provide safety for their employees only because laws say so.
Some **believe** that keeping employees safe and happy improves their **motivation**and keeps them in the business. Others do it because it is present in their **moral code**. They are then considered making an **ethical decision**. However, in many countries, workers are still exploited by employers.

Protection against unfair dismissal

Employees need protection from being dismissed unfairly. The following reasons for the employee to be dismissed is unreasonable:
- for joining a **trade union**.
- for being **pregnant**.
- when **no warnings** were given beforehand.

Workers who thing they have been dismissed unfairly can take their case to the**Industrial Tribunal** to be judged and he/she might receive compensation if the case is in his/her favour.

Wage Protection

Employers mus pay employees the same amount that has been stated on the**contract of employment**, which states:
- Hours of work.
- Nature of the job.
- The wage rate to be paid.
- How frequently wages will be paid.
- What deduction will be made from wages, e.g. income tax.

A **minimum wage** rate is present in many Western countries and the USA. There are pros and cons of the minimum wage:

Pros:
- Prevents strong employees to exploit unskilled workers who could not easily find work.
- Encourages employers to train unskilled employees to increase efficiency.
- Encourages more people to seek work.
- Low-paid workers can now spend more.

Cons:
- Increases **costs**, increases **prices**.
- Owners who cannot afford these wages might make employees**redundant** instead.
- Higher paid workers want higher wages to keep on the same **level difference** as the lower paid workers. Costs will **rise**.

Location of Industry

How governments want to locate businesses:
- They **encourage** businesses to move to areas with a high level of**unemployment**, or called **development areas**.

- They **discourage** firms from locating in **overcrowded cites** or sites noted for their **natural beauty**.

How governments will influence the decisions of firms to locate:

- Businesses will be refused **planning permission** (permit to build in a place) if they wish to locate in overcrowded cities or beautiful areas. Building in these areas might be banned altogether.
- Governments can provide **regional assistance**, such as **grants and subsidies** to encourage firms to locate in undeveloped areas.

<u>Governments can help businesses too</u>

Governments can help businesses to:

- to encourage businesses to locate in poorer regions.
- to encourage enterprise by helping small businesses set up and survive.
- to encourage businesses to export.

Regional Assistance:

- Governments want development to be spread evenly over the whole country.
- Grants and subsidies can be used to attract firms to an area.

Small firms

Small firms are important for and economy because:

- They provide **most** of the **employment** because they are usually**labour intensive**.
- Small firms operate in **rural** areas where unemployment tends to be high.
- They can **grow** into very important businesses employing thousands of workers and producing output worth millions of dollars.
- Provides more **choice** for customers. They **compete** against bigger companies.
- They are often managed in a very **flexible** way, and is quicker to adapt to changing demands.

Governments help them by:

- Lower rates of **profits tax**, so they can have more **retained profit**.
- Giving **grants** and **cheap loans**.
- Providing **advice** and **information centres** to small firms.

Exporting goods and services

Why governments want businesses to export:

- Exports earn **foreign currency**, which can be use to buy imports.
- More exports means more people needed to produce them, increasing**employment** and **standards of living**.
- Successful exporters earn more money and have to pay more **profits tax**.

Governments can support exporters by:

- Encourage banks to lend to exporting businesses at **lower interest rates**.
- Offering **subsidies** or **lower taxes** to firms. However, other countries would **retaliate** and there would be no overall advantage.

- Trying to keep the **local currency** as **stable** as possible to make it easier for businesses to know how much they are going to make from exports.
- Organising **trade fairs** abroad to encourage foreign businesses to buy the country's exports.
- Offering **credit facilities**. This means that if a foreign customers refuses to pay for goods, the company could be compensated by the government.

Businesses in the economic and legal environment

Businesses could not ignore the power of the government in controlling business activity. **Multinationals** are an exception although normally businesses cannot afford to move to other countries. Government decisions create the **environment**in which businesses will have to **operate** and **adapt** to. The environment created by **legal** and **economic controls** are one of the **constraints** to managers when making decisions.

Whew! What a long chapter! I know there are a lot of redundant stuff but they are necessary for the text. Chapter 5 will be coming out next week!