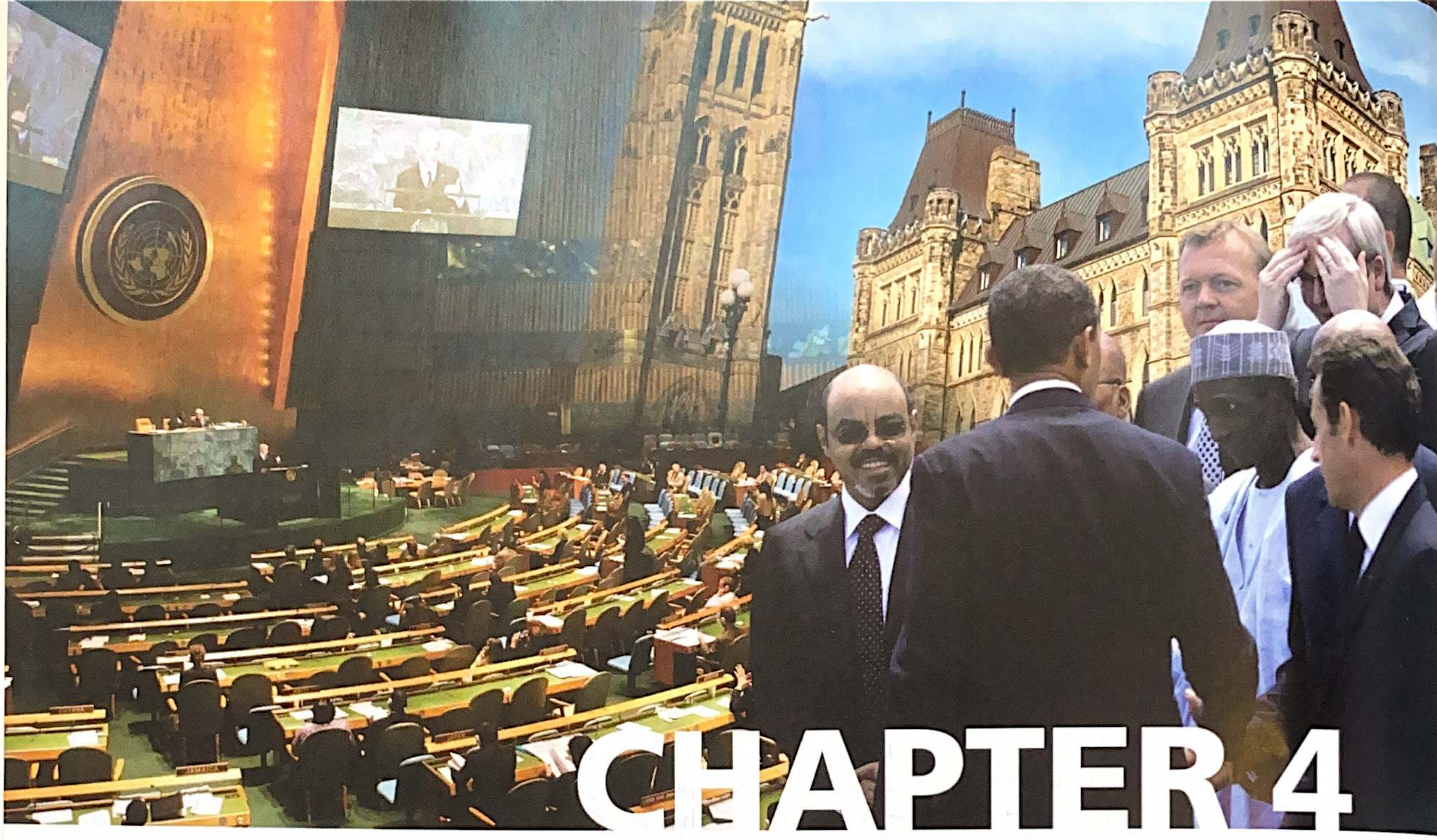


CHAPTER 4

ECONOMICS AND POLITICS

Key Terms

- political system
- economic system
- market economy
- centrally planned economy
- mixed economy
- democracy
- autocracy
- underdeveloped countries
- developing countries
- developed countries
- gross domestic product (GDP)
- business cycle
- absolute advantage
- opportunity cost
- comparative advantage
- lobbying

By the time you finish this chapter you should be able to:

- Evaluate the advantages and disadvantages, in both developed countries and developing countries, with regard to business opportunities (e.g., size of consumer base, government regulations, infrastructure, cost of labour)
- Analyze the rationale for, and the impact of, Canadian government initiatives and policies relating to international trade (e.g., intergovernmental contacts, embassy and consulate networks, government trade missions, taxation, trade barriers, investment)
- Assess the ways in which political, economic, and geographic factors influence international business methods and operations
- Describe the roles corporations can play in setting international and domestic policy (e.g., lobbying, participating in trade missions)

Economic and Political Systems

A **political system** is the type of government by which a country is run. An **economic system** is the way a country organizes its resources and distributes goods and services to its citizens. Economic and political systems are closely linked.

Economic Systems

The answers to the four questions below define a country's economic system:

1. What should the country produce and in what quantities?
2. How should scarce resources such as labour and capital be allocated?
3. How should goods and services be distributed throughout the country?
4. What should be the price of the goods and services?

Market Economy

A **market economy** is also known as capitalism or private enterprise. In a market economy, the above questions are answered by individuals and businesses. Businesses, consumers, and government act independently of one another. Market forces and self-interest determine what goods are created and sold. These market forces ensure that there is variety in goods and services to attract consumers. The government has little direct involvement in business. Its main duty is to create an atmosphere in which citizens and corporations can be successful.

Each economic system addresses the three major components of private property, profit, and competition, but in different ways. The way in which these components are viewed in a market economy are provided below:

- **Private property.** Corporations and people are encouraged to own property, including real estate, buildings, equipment, furniture, and automobiles. Owners can purchase, rent, trade, sell, give, or will their property to whomever they want.
- **Profit.** Profit is the reward for the risks taken. It is encouraged because profitable companies provide employment, create new products, expand, and start new ventures. The profit belongs to the owners of the business, and they can choose how to spend their rewards. They can reinvest in the business or buy personal goods, such as a house or a new car.
- **Competition.** Competition is critical. Companies compete on quality, services, price, reputation, and warranties. Competition encourages companies to provide quality products at a reasonable price so that consumers do not switch to other brands. As a result of competition, consumers have access to greater selection and new products, and companies have an incentive to innovate in order to bring in more profit.

There are no true market economies in the world because every country has some government intervention; the United States comes the closest to having a market economy.

In a market economy, consumers have the opportunity to choose from a wide variety of goods.


Cuba is an example of a centrally planned economy, in which the government determines how income is distributed.

Centrally Planned Economy

At the opposite end of the economic system continuum is a **centrally planned economy**. In a centrally planned economy, also known as communism or command economy, decisions are made centrally by the government. The government controls all elements of the economy and establishes how income is distributed. The government provides education, health care, employment, and housing to all members of society. A centrally planned economy deals with the economic system characteristics in the following ways:

- **Private property.** Ownership of property is restricted. Citizens may own small household items and furniture. The government owns all of the housing and businesses including factories, offices, and farms. The government determines who will work in the businesses and where they will live. All workers are employed by the government, which sets the wages.
- **Profit.** All profit belongs to the government, and citizens do not receive a portion of the profits they help to make. If the government needs to increase its revenues, it raises prices or cuts costs such as wages or capital investment. The profit made by the government is re-invested into the businesses or used for social programs such as education or the military.
- **Competition.** Competition is limited. The government determines the price, quality, style, and amount of goods and services. Consumers have little choice in products sold.

North Korea and Cuba are run as centrally planned economies. Countries which traditionally were thought of as centrally planned, such as Russia and China, are still predominantly centrally planned; however, each has recently adopted some market economy practices.


Sweden and Canada are countries with mixed economies, offering programs such as maternity leave, universal health care, and employment insurance.

Mixed Economy

Most economies in the world sit somewhere between a market economy and a centrally planned economy—they have a **mixed economy** (also known as a modified free enterprise system). For example, Sweden offers many social programs, such as an eighteen-month maternity leave, two months of which must be taken by the minority parent (usually the father). Sweden also has successful international businesses, such as IKEA. It has characteristics of both market and centrally planned economies. Canada is also a mixed economy. Canada has strong social programs, such as universal health care, employment insurance, and the Canada Pension Plan. In addition, it has thriving businesses that compete successfully in the world market. A mixed economy has the following characteristics:

- **Private property.** Property is owned by individuals, corporations, or government. The government owns schools, parks, and real estate. It sets regulations that affect private property; in Canada, there are strict regulations regarding ownership of financial institutions and the media. Corporations operated by the Canadian government are called Crown corporations. Examples include Canada Post and the CBC.
- **Profit.** Profit is encouraged, but is taxed to support government projects and provide social assistance. Taxes are collected at the federal and provincial levels through sales tax, income tax, and corporate taxes. Municipal projects are funded through property taxes.
- **Competition.** Strong competition amongst corporations exists; however, the government may also be a competitor. For example, in the Canadian transportation industry, the federal government operates VIA Rail, and municipal governments run their own transit systems. In the overnight delivery industry, Purolator, run by Canada Post (a Crown corporation), competes against FedEx, UPS, and DHL.

Impact: Society

Should Crown corporations be privatized?

- Yes: Crown corporations have traditionally performed poorly. They have limited incentive to be efficient and productive because the government will back them regardless of economic results.
- No: Crown corporations provide public accountability for businesses that provide essential services, such as water, electricity, transportation, and culture. No corporation should have control over services that are critical to Canadian lives and culture.

Table 4.1: Advantages and Disadvantages of Different Economic Systems

Economic System	Advantages	Disadvantages
Market Economy	▪ Freedom of speech, religion, assembly ▪ Efficient use of resources ▪ New products ▪ Economic growth ▪ Good quality products ▪ Low prices	▪ Gap between rich and poor expands ▪ Lack of consumer education ▪ Unhealthy products
Centrally Planned Economy	▪ All citizens are assured a minimum standard of living ▪ Health, education, and other social programs are provided free to all citizens ▪ No unemployment ▪ Long-term stability	▪ Restriction of individual freedoms ▪ Little motivation to work hard ▪ Large military presence ▪ Lack of innovation ▪ Corruption
Mixed Economy	▪ Individual incentive ▪ Basic social services ▪ Consumer protection	▪ Higher taxation ▪ Individuals have little input into how taxes are spent ▪ Government intervention may stifle growth ▪ Less motivation to work hard

Political Systems

As mentioned earlier, a country's political system is linked in many ways to its economic system. There are many types of political systems in the world. Some are based on religion (theocracy), others on a ruling king or queen (monarchy), while others are governed by the wealthy, educated class (aristocracy). Although these types of government still exist (for example, Jordan is ruled by a king and the Vatican is ruled by the Pope, the head of the Catholic Church), they are not common. The most prevalent forms of government are **democracy** and **autocracy**.

Democracy

The term "democracy" comes from the Greek word meaning "government by the people." A democracy is characterized by free and fair elections, the rule of law, free speech, the right to assembly, a free press, and freedom of religion. In a democracy, all people have the right to govern themselves, and each citizen is entitled to an education. Finally, in a democracy there is economic opportunity for all citizens. If a business is successful, the owners reap the benefits as a reward for the risk they have taken. Democracies are accompanied by a market economy.

Countries such as Canada, the United States, and the countries of the European Union have a representative democracy. Each citizen of legal voting age casts a vote to elect a representative to sit in parliament and vote on their behalf.

Democracy is not a perfect system. Politicians may be more concerned with being re-elected than with what is good for their country. This could lead them to focus on short-term solutions, just in time for another election, rather than taking a long-term perspective. Politicians who rely on funding from large corporations may have in mind the businesses' needs, rather than the needs of the citizens they represent. Many of our politicians come from similar backgrounds and are not representative of groups such as women, minorities, and the poor. Democracies are difficult to establish and expensive to maintain. Many newly emerging economies—for example, those in Latin America—lack the judicial systems and other infrastructure that help maintain political stability.

Each of the member countries of the European Union is a representative democracy, in which citizens have the right to vote.

Think About It!

4.1. What are the four questions all economic systems answer?

4.2. Define market economy.

4.3. Describe how a market economy deals with private property, profit, and competition.

4.4. State three advantages and three disadvantages of a market economy.

4.5. Define a centrally planned economy.

4.6. Describe how a centrally planned economy deals with private property, profit, and competition.

4.7. State three advantages and three disadvantages of a centrally planned economy.

4.8. Define a mixed economy.

4.9. Describe how a mixed economy deals with private property, profit, and competition.

4.10. State three advantages and three disadvantages of a mixed economy.

Think About It!

4.11. Describe democracy.

4.12. What are the drawbacks of a democracy?

4.13. Describe autocracy.

4.14. Name four countries that have an autocratic government.

Autocracy

An autocracy is ruled by a single individual or a small group of people. Proponents of autocracies believe that one consistent government allows decisions to be rational, in the interests of the entire country rather than special groups, and have a long-term focus.

This political system has many disadvantages. Autocracies usually have a strong military presence to ensure that the leader or leaders stay in power and maintain stability. An autocratic government strives to control all aspects of its citizens' lives, including the media, professions, businesses, and religion. Citizens have no influence on the government and if they disagree with its decisions, they are often dealt with by the military; they also have their ability to travel outside of the country curtailed.

Current examples of autocracies include North Korea and Cuba, each of which is led by a single leader, and China, which is led by a single party. Other examples include Zimbabwe, Indonesia, Egypt, and Libya. The economic system most closely associated with autocracy (or authoritarianism) is a centrally planned economy. However, some countries, such as Egypt and Indonesia, have attracted foreign investment to help stimulate their economies.

Newsworthy: Regulating Happiness

Gross National Happiness

Bhutan is a country of 700,000 people that sits high in the Himalayan Mountains between the two growing world powers of India and China. It has only one airport, and two commercial airplanes. The capital city has no traffic lights and only one traffic officer is on duty.

Traditionally, the country was ruled by a king. In 2006 King Jigme Singye Wangchuck stepped down to pave the way for the country to have its first democratic elections.

Bhutan's new constitution establishes that the worth of the country will not be measured by gross national product as most other countries are, but rather by the happiness of its citizens. Government programs such as agriculture, transportation, and even foreign trade are to be judged not by economic criteria, but by the happiness they generate in the citizens of Bhutan. The king himself came up with the idea of gross national happiness (GNH) in the 1970s.

Gross national product is easy to measure. It is the sum of all goods and services produced in one country in one year. How does Bhutan measure gross national happiness? The government has established four areas of a happy society: the economy, culture, the environment, and fair government. It divides each of these areas into nine groupings: psychological welfare, ecology, health, education, culture, standard of living, time use, community strength, and good governance. Each of these is given a weighted GNH index. For example, psychological welfare is measured by time spent meditating and praying, and emotions such as generosity, calmness, and compassion.

Bhutan believes that GNH will help its citizens preserve the country's identity and culture, where cigarettes are banned, television arrived in the 2000s, and traditional dress and architecture are mandated by strict laws. The GNH will ensure that the country can manage the changes brought on by globalization by remaining distinct and different from the rest of the world.

❐ Questions

1. Describe Bhutan.
2. What is GNH?
3. How is GNH measured?
4. Explain whether you think Bhutan will be able to keep its distinctive culture.
5. Do you think Canada should measure its success by GNH? Why or why not?

Classifications of Economic Development

The world's countries are also classified by their level of economic development. Some nations have strong economies, while others are just beginning to harness their potential. Many other nations are well below the poverty line and their citizens suffer from malnutrition and disease as a result. Countries fit into one of the following general classifications determined by the United Nations (UN) and the International Monetary Fund (IMF):

- Underdeveloped
- Developing
- Developed

Underdeveloped Countries

Underdeveloped countries, also referred to as the least developed or the third world, are nations that are at the lowest level of the world's economies. These countries are characterized by severe poverty and substandard living conditions. They lack social services, such as health care and education, and have poor infrastructure. Underdeveloped countries have low levels of literacy, limited access to technology, and economies that are predominantly agricultural or resource based. They are often plagued by long-term political issues, such as war, dictatorships, and corrupt, unsound governments.

Table 4.2: List of Least-Developed Countries

Afghanistan	Guinea	Samoa
Angola	Guinea-Bissau	São Tomé and Principe
Bangladesh	Haiti	Senegal
Benin	Kiribati	Sierra Leone
Bhutan	Lao People's Democratic Republic	Solomon Islands
Burkina Faso	Lesotho	Somalia
Burundi	Liberia	Sudan
Cambodia	Madagascar	Timor-Lesté
Central African Republic	Malawi	Togo
Chad	Maldives	Tuvalu
Comoros	Mali	Uganda
Democratic Republic of the Congo	Mauritania	United Republic of Tanzania
Djibouti	Mozambique	Vanuatu
Equatorial Guinea	Myanmar	Yemen
Eritrea	Nepal	Zambia
Ethiopia	Niger	
Gambia	Rwanda	

Source: United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States

Geography also plays a role in underdeveloped countries. These countries frequently experience environmental or natural catastrophes (hurricanes, earthquakes, floods, tsunamis) that result in famine, poverty, destruction, and displacement of the population. Examples of underdeveloped countries, according to the United Nations, are Afghanistan, Madagascar, and Rwanda.

Developing Countries

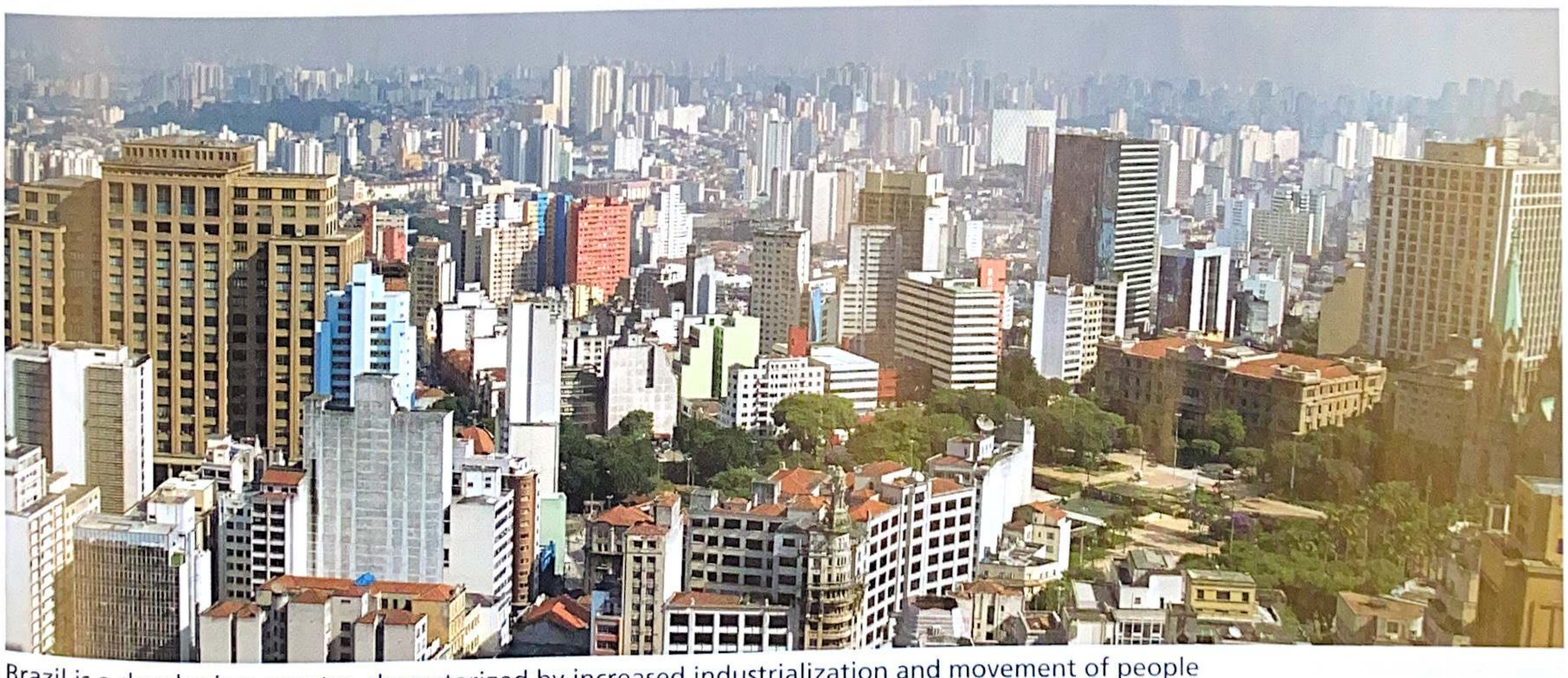
Developing countries, also known as emerging countries, are characterized by improved literacy rates, increased access to health care, and technological advancement. There is a movement away from agriculture and natural resources towards more industrialization and a manufacturing base. These nations are in transition from a poor economy to a prosperous one. Many of these countries are growing quickly. Examples include China, Brazil, India, South Africa, and Russia. In these countries, people are moving from rural locations to cities and the skill level of the workforce is improving. These nations are becoming more important in the world of global trade.

Developing countries provide opportunities for Canadian businesses. These countries need improved infrastructures, which Canadian businesses like Bombardier can provide. They are now also able to afford Canadian exports. Mexico is an excellent example. Trade between Canada and Mexico has been dramatically increasing because Mexico can now afford more imports from Canada. In 2008, Canada exported $5.8 billion to Mexico, an increase of 17.9 percent from the year before.

Developing countries are also a threat to Canadian businesses. They have lower labour costs that Canadian businesses cannot match. They provide strong competition for Canadian products. Canadians must be careful of investing in developing countries. These countries often have weak regulatory and legal systems; as a result, Canadian investors may experience long delays, inconsistent regulations, and corruption. For example, a Canadian company may find it difficult and expensive to sue a foreign company for breach of contract.

Global Gaffes

The literacy rate in underdeveloped countries in Africa turned out to be a problem when a baby food company designed its label to show a picture of a cute baby, with words beneath the picture describing the container's contents. Packaging in that region traditionally only used pictures of the contents on package labels. Unfortunately, potential customers assumed the package contained ground-up baby. Of course, sales plummeted.



Brazil is a developing country, characterized by increased industrialization and movement of people from rural areas to cities such as Sao Paulo.

Impact: Society

Is it fair to demand that businesses in underdeveloped countries be environmentally friendly?

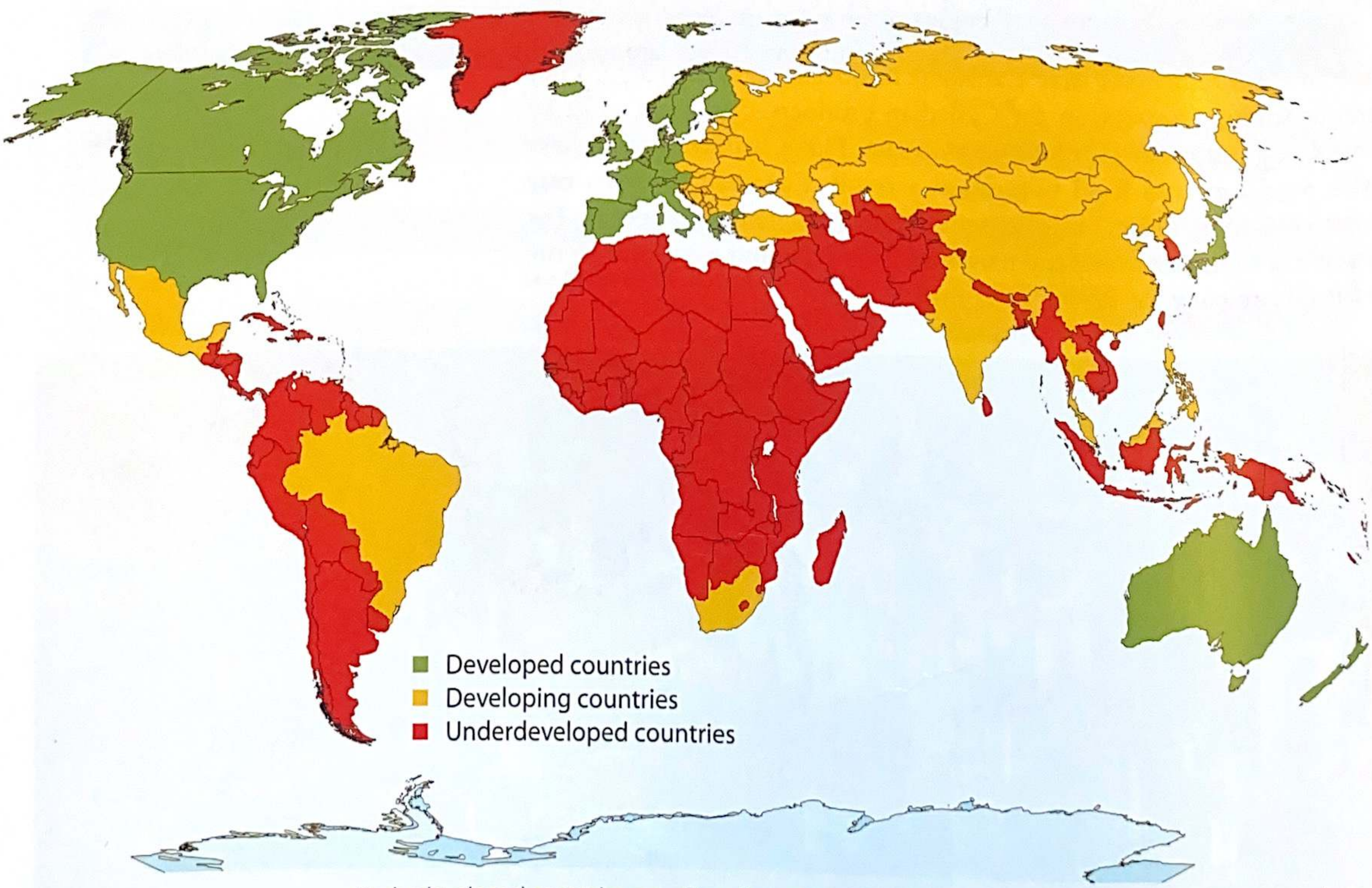
Yes: Worldwide environmental damage is so severe today that all countries must become environmentally friendly to prevent devastating fallout for the entire world.

No: Developed countries destroyed the environment as they became successful; it is not fair to hold underdeveloped countries to a different standard. Being environmentally friendly may impede the growth of these countries.

Developed Countries

Developed countries, also known as industrialized nations or first world countries, are characterized by a high per capita income or strong **gross domestic product (GDP),** the total goods and services produced in one country in one year. These nations have high standards of living and literacy rates, and make major advancements in health care and technology. They design and manufacture a diverse range of complex products, such as cellphones, computers, and hybrid cars. They have moved from a reliance on primary industries into secondary and predominantly tertiary industries.

Developed countries are world leaders in international business and have formed strong trade alliances and agreements. They have created international trade organizations, such as the G8. They are also competitors for one another's markets. There is a strong correlation between developed countries and democratic political systems. Examples of developed countries include Canada, the United States, Japan, Germany, Australia, and the United Kingdom.



Underdeveloped countries are often characterized by long-term political issues, such as war and corruption, while developed countries tend to have democratic political systems.

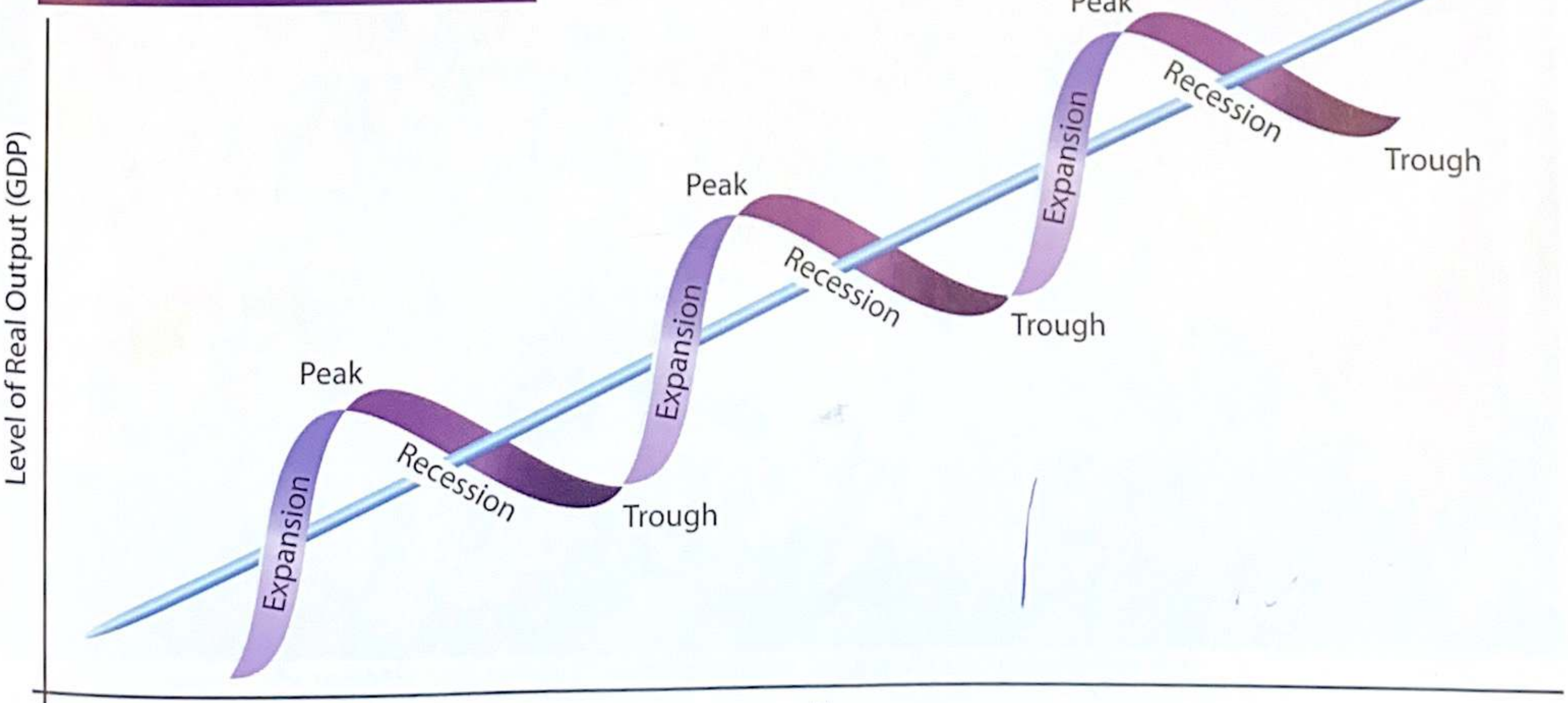
The Business Cycle

Soup kitchens provided hot meals for those who experienced poverty and unemployment during the Great Depression.

Over time, the economies of countries, and of the globe, contract and expand. This expansion and contraction is called the **business cycle**. It measures GDP, and is periodic and unpredictable. The business cycle is characterized by four stages:

- **Recession.** Sometimes referred to as a contraction. During this phase, the economy slows down. The definition of a recession is two consecutive quarters of negative GDP. Recession is characterized by a decline in consumer purchasing, which leads to an increase in unemployment, and results in businesses contracting or closing. Fewer taxes are collected during a recession, which means the government has less capital to provide social services. Some economic indicators are used as predictors of the economy as a whole; these are referred to as leading indicators. In Canada, these indicators are exports and construction contracts. A decline in exports and construction is a sign that a recession may occur.
- **Trough.** This is the bottom of the cycle. Production and employment reach their lowest levels. At this point, the economy completes the recession and turns towards prosperity. Sometimes an economy enters a deep trough known as a depression. This is a particularly difficult and sustained period of economic decline. However, the term depression is commonly reserved to describe the major economic slump that lasted for most of the 1930s.
- **Expansion.** Sometimes referred to as recovery or prosperity. At this stage the economy begins to grow again. Employment, wages, production, and profits all expand. Investments are strong, new businesses are created, and the economic climate is good. The period from 2001-2007 was one of expansion or prosperity.
- **Peak.** This is the top of the business cycle. At this point, the economy stops expanding and begins contracting.

Figure 4.1: The Business Cycle



Frank and Ernest

Economic Indicators of the Business Cycle

Economic indicators measure how well an economy is doing. There are three types of economic indicators—leading, lagging, and coincident—which are described below:

- Leading indicators predict where the economy is headed. These indicators adjust before the economy actually experiences the change. These indicators are critical because they help to guide investors, businesses, and governments to act according to what is about to happen. Housing starts (the number of new houses that construction is begun upon) are a leading indicator. People are unlikely to purchase a new house if they believe the economy will decline.
- Lagging indicators do not adjust until after the economy has experienced the change. It may take two or three quarters of economic change to influence a lagging indicator. An example of a lagging indicator is the unemployment rate. Once an economy starts to improve, it may take six months for the unemployment rate to decrease.
- Coincident indicators move in conjunction with the business cycle. An example is international trade. When economies are slumping, countries do not import as many goods and services. When the economy is strong, countries are able to purchase more goods from other countries.

Governments and the Business Cycle

The business cycle can influence an individual country's economy. For example, the recession of 2008–2009 deeply affected the United States and caused many Americans to lose their homes and major businesses to go bankrupt. Canada also suffered a recession in 2008–2009, but it was not as extreme as in the U.S. One reason that Canada entered a recession was that Americans no longer purchased Canadian exports, causing Canadian businesses to suffer. The 2008–2009 recession is covered in greater depth in Chapter 10.

In response, governments can influence the business cycle. In recessionary times, governments increase their spending to stimulate the economy. This provides employment, stability, and customers for businesses, and economic growth and job training for the unemployed. The funding for these programs comes from increased taxes or from budget deficits.

Canada's 2009 federal budget shows government influence on the business cycle. In Canada, the budget included $12 billion for infrastructure improvements (roads, Internet access, health records, border crossings), $7.8 billion to build quality homes, and $200 billion for consumers and businesses to provide financing for investing and creating new jobs. At the same time, the United States federal government allocated $190 billion of its $787-billion stimulus package to government agencies. This money was for infrastructure improvements, alternative energy programs, education, health care, technology improvements, and to help small businesses.

Democratic governments also affect the business cycle when an election is imminent. Controlling parties often spend money on various social programs to influence voters' decisions before an election.

Think About It!

4.15. What are the characteristics of an underdeveloped country? Name three underdeveloped countries.

4.16. What are the characteristics of a developing country? Name three developing countries.

4.17. What are the characteristics of a developed country? Name three developed countries.

4.18. State the characteristics of a recession.

4.19. State the characteristics of expansion.

4.20. Draw and label the business cycle.

The recession stage of the business cycle can cause companies both large and small to be forced out of business

Economics of Trade

There are many advantages to trading internationally, including an increase in jobs, markets, technology, variety of products, and competition. But is international trade really good for everyone? What about underdeveloped and developing nations? Can they really gain from trading with developed nations or are wealthy nations just taking advantage of them? These questions can be answered theoretically using the economic concepts of absolute and comparative advantage.

Absolute Advantage

One country has an **absolute advantage** if it makes a product or service more productively than other countries. The country uses its resources efficiently to manufacture more products or manufactures more products with the same amount of resources. The nation with an absolute advantage has better technology or labour, or higher quality resources. For example, Zambia has an absolute advantage in producing copper; Canada has an absolute advantage in producing forest products. Countries export products or services in which they have an absolute advantage, and import products or services in which other countries have an absolute advantage.

Let's use a hypothetical example. Assume that there are only two countries in the world: Canada and the United States. They can each produce apples and peaches, but if each country uses half of its resources to produce each product, they produce different amounts. This is illustrated in **Table 4.3**:

Table 4.3

	Apples	Peaches
Canada	1,000	600
United States	800	1,400
Total	1,800	2,000

It makes more sense for each country to specialize in products in which they have an absolute advantage. Each country would make twice as much of the product in which it has an absolute advantage and none of the other product. This can be seen in **Table 4.4** below:

Table 4.4

	Apples	Peaches
Canada	2,000	0
United States	0	2,800
Total	2,000	2,800

Overall, more apples and peaches are produced. Canada has an absolute advantage in apples and the United States has an absolute advantage in peaches. Canada and the United States will trade. Canada will trade apples for peaches and the United States will trade peaches for apples.

What if one of the countries is more productive at manufacturing both products? Is it beneficial to trade? In the following table, the United States has an absolute advantage in both apples and peaches.

Table 4.5

	Apples	Peaches
Canada	1,000	500
United States	1,200	800
Total	2,200	1,300

In this case, should the countries trade? Yes, they should. To understand why, you need to understand the concept of **opportunity cost**. An opportunity cost is the value of what is foregone. It is the cost of giving something up to get something else. For example, your opportunity cost of being in class is the money you could be making working at a job.

Comparative Advantage

Let's look at how efficient each country is at producing peaches. In this situation:

- In Canada, 1 peach costs 1,000/500 = 2 apples
- In the United States, 1 peach costs 1,200/800 = 1.5 apples

The opportunity cost of peaches is lowest in the United States; therefore, the United States should produce peaches.

Let's look at how efficient each country is at producing apples. In this situation:

- In Canada, 1 apple costs 500/1,000 = 0.5 peaches
- In the United States, 1 apple costs 800/1,200 = 0.667 peaches

The opportunity cost of apples is lowest in Canada; therefore, Canada should produce apples.

A country with an absolute advantage uses its resources efficiently to produce a greater amount of a specific product, such as apples.

In this case, Canada has a **comparative advantage** in apples and the United States has a comparative advantage in peaches. **Table 4.6** shows what happens if the countries trade.

Table 4.6

	Apples	Peaches
Canada	2,000	0
United States	0	1,600
Total	2,000	1,600

Trade is advantageous to both countries because the total number of apples and peaches has increased. Canada and the United States have given up 200 apples to gain 300 peaches. Production in both countries can be adjusted so that no apples are lost. This can be seen in **Table 4.7**.

Table 4.7

	Apples	Peaches
Canada	2,000	0
United States	200	1,467*
Total	2,200	1,467

*Note: 200 apples = 200 × 0.667 peaches = 133 peaches lost
1,600 peaches - 133 peaches = 1,467 peaches

If the countries traded after specializing, the same number of apples would be produced as before and 167 peaches would be gained.

Comparative advantage is the foundation for specialization and trade. If countries produce items in which they have a comparative advantage, and import from other countries the products in which those other countries have comparative advantage, both countries benefit. The lessons from absolute and comparative advantage are general and simplistic; however, they can be applied to the real world. Although world trade involves millions of products and many countries, the study of absolute and comparative advantage demonstrates that trade is beneficial to all countries.

A country with a comparative advantage in producing peaches can trade its peaches for other products.

Where Do We Get

Tea

Canada does not have the climate to grow tea; therefore, it imports bulk black tea from Sri Lanka, India, and Kenya, and bulk green tea from China and Japan. These countries have an absolute advantage over Canada in producing tea. Tea arrived in Canada with European settlers. It was first imported by the Hudson's Bay Company in 1716. It took one year to transport the tea across the ocean.

Tea plants are grown on large farms called tea gardens. When the plant is three to five years old and over a metre high, workers called tea pluckers pick the leaves. The leaves are then sent to a factory, where they are laid out on drying racks. Air is blown over the leaves to dry them out. After that, they are sent through rolling machines that extract the leaves' juices, then placed in a room for oxidation or fermentation. In the last step, the leaves are dried in an oven where they turn brownish-black. Green tea requires less processing than black.

The Tea Association of Canada states that tea consumption is growing in Canada. One of the main reasons is that Canadians are becoming aware of the health benefits of green and herbal teas. Black tea is still the largest imported type of tea; however, green and white are increasing in sales. Tea sales make up almost 10 percent of all beverages purchased by Canadians.

Tea consumption in Canada continues to increase, but the country's climate is not suitable for growing tea. Canada imports tea from countries such as Sri Lanka, India, and Kenya.

Think About It!

4.21. Define absolute advantage. Provide an example.

4.22. Provide an example of specialization.

4.23. Define opportunity cost.

4.24. Define comparative advantage.

The Role of Government in International Business

Every country's government plays a critical role in its international business and trading success. Some of the ways government affects international trade and business include:

- Establishing import and export laws
- Setting tariffs
- Maintaining membership in trade organizations and negotiating trade agreements
- Establishing immigration laws
- Determining monetary policy, including currency exchange rates
- Determining fiscal policy, including taxation laws
- Signing tax treaties with foreign governments
- Education
- Military systems
- Establishing environmental policies
- Building infrastructure, such as roads and sewer systems
- Ordering embargoes

The Canadian government can help international businesses that want to set up in Canada by providing incentives and tax breaks, but they can also impede international business through stiff regulations, licenses, and laws. Many laws affect businesses. These laws are meant to provide protection for workers and consumers. Standards are set to ensure safe working conditions and to guarantee that imports are not hazardous.

The Canadian government encourages and supports international business. The government makes the process of setting up a business in Canada relatively easy, with limited paperwork required.

Government Regulations

Governments set rules and regulations that affect businesses. If you have a job, you may have experienced many of these laws. You are paid at least minimum wage and work only limited hours because you are still in school. Your employer must follow established safety standards. These government regulations change over time and are different in each country. Businesses must be aware of all laws, and implement and comply with them.

All that is needed to start a business in Canada is a single online application.

To start up a business in Canada, a business owner needs to follow government regulations. This includes completing the paperwork necessary to register the business. After registering with the Canada Revenue Agency (CRA), the business will receive:

- A registration number
- A GST/HST number
- A corporate income tax account
- An import/export account
- Payroll deduction information

Canada has greatly reduced the procedures needed to start a business here; in fact, it is ranked as the second-easiest country in the world in which to start a business (see Chapter 9). In Canada, all that is needed for a Canadian to start a business is a single online application. It is also easy for non-Canadians to establish businesses in Canada. Invest in Canada is a government website that clearly explains the steps a foreign investor must take to establish a business in Canada. Chapter 9 explains how the Canadian government attracts foreign investment.

In other countries, the story is quite different. When American Apparel set up its business in China, it had to go through thirteen levels of government, and comply with requests to submit information, such as the CEO's electricity bill for his home in Los Angeles to prove that his address at home and on his passport were the same. Countries that have reduced the obstacles that must be overcome to start a business are seeing more businesses setting up and higher productivity. In July 2007, Senegal revised its start-up company registration process. By May 2008, 3,060 new companies were established, an 80 percent increase from the year before.

Trade Offices

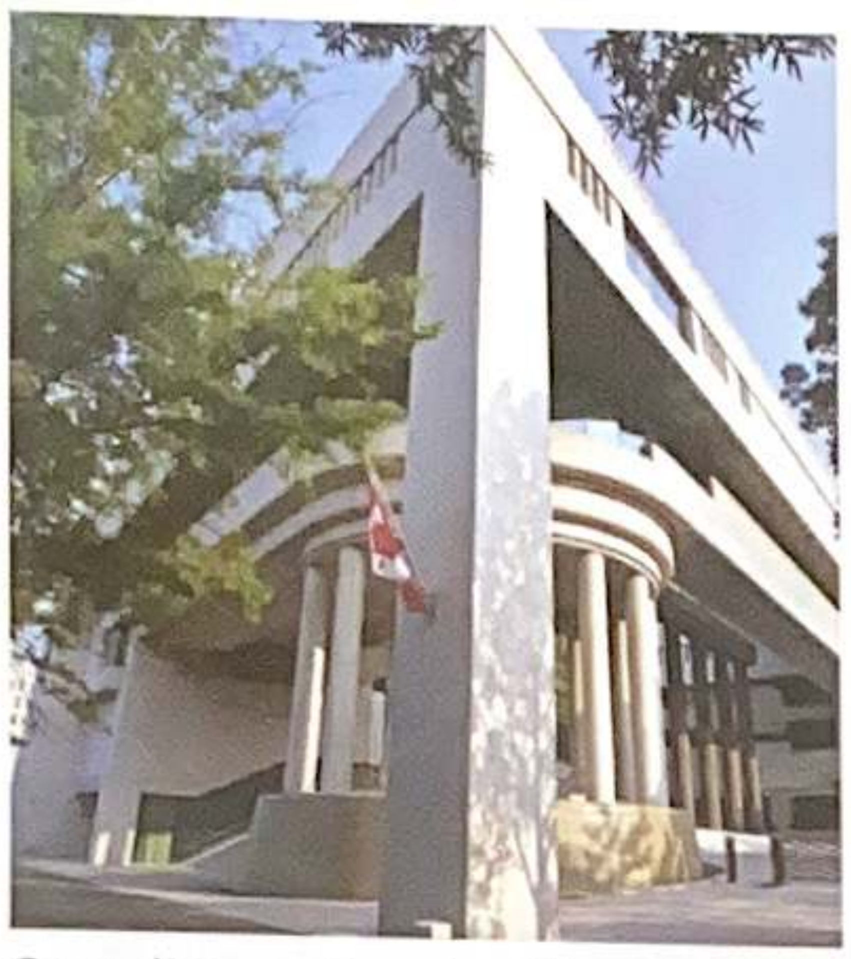
Governments establish a presence in foreign countries to help their businesses operate in those countries. For example, the Canadian government has trade offices in over 150 cities worldwide. These trade offices help Canadian businesses export products, invest outside of Canada, seek R & D and technological opportunities, and lower costs by providing market intelligence and expertise. This information is also available online through the Virtual Trade Commissioner.

Table 4.8: Where is it Easy—or Difficult—to Start a Business?

Easiest Rank		Most Difficult Rank	
1	New Zealand	172	Cameroon
2	Canada	173	Djibouti
3	Australia	174	Equatorial Guinea
4	Georgia	175	Iraq
5	Ireland	176	Haiti
6	United States	177	Guinea
7	Mauritius	178	Eritrea
8	United Kingdom	179	Togo
9	Puerto Rico	180	Chad
10	Singapore	181	Guinea-Bissau

Global Gaffes

Toyota ran into trouble with China's autocratic government when it began using the slogan, "Wherever there is a road, there is a Toyota." The government accused Toyota of false advertising because there was clearly not a Toyota on every road in China or on every road throughout the world. Toyota learned the difference between the standards of a strict communist society and a more lax market economy.



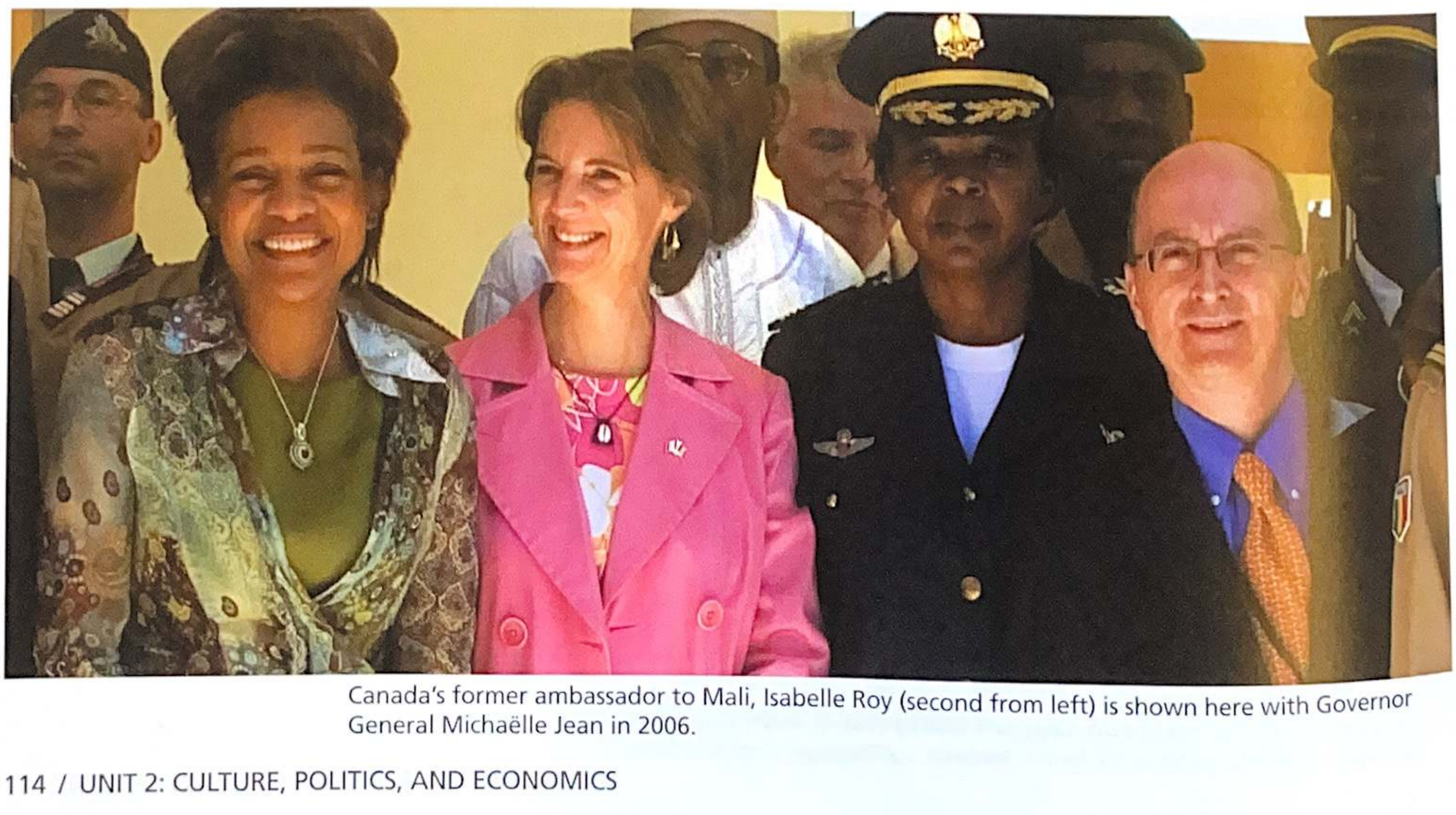
Canadian embassies, like the one pictured above in Washington D.C., offer services to Canadians living or travelling abroad.

Government Embassies, High Commissions, and Consulates

The Government of Canada provides a variety of consular services around the world for Canadians travelling, studying, living, or working abroad. These include emergency services; facilitating communication with family in Canada if an emergency occurs; help locating missing persons; passport services (for example, if you lose your passport while outside of Canada); information and advice on customs, taxes, social services, property and estate management, and claims against foreign states (including corporations). Consular services are available 24 hours a day at 260 offices in 150 countries. It is important that Canadians travelling outside of Canada, for business or pleasure, carry with them the consular information for each country they visit so they can quickly access help if necessary.

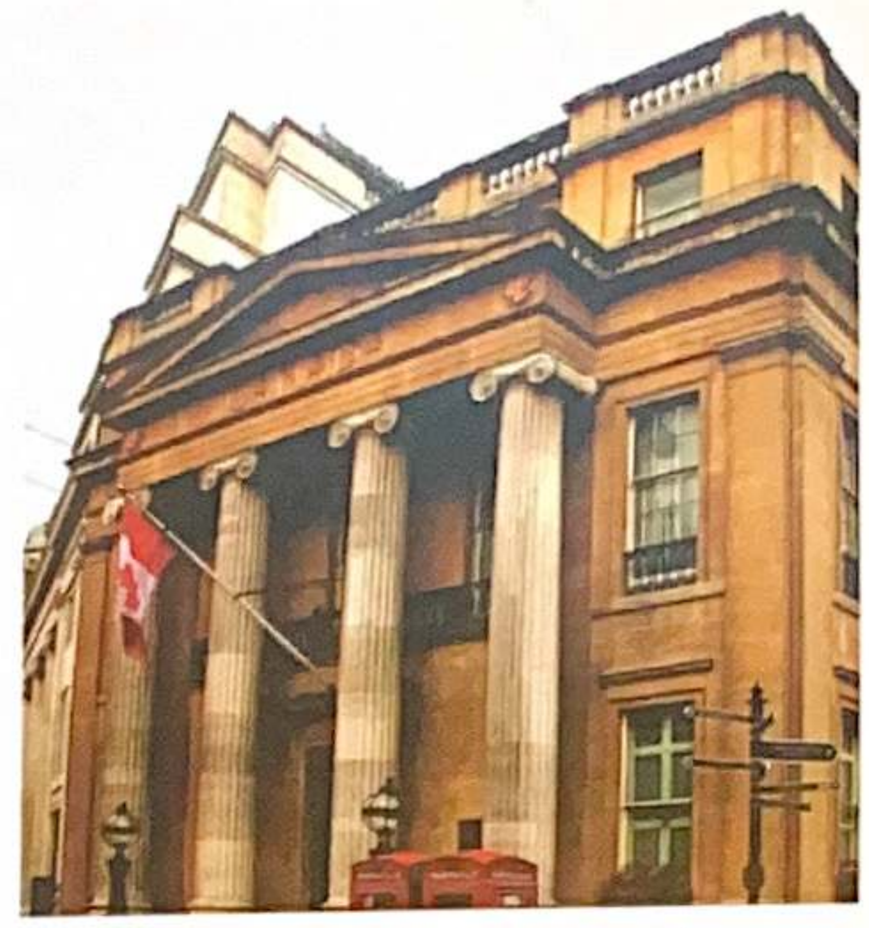
Canada's consular services take many forms:

- **Embassies.** These are located in the capital cities of countries and provide a full range of services. There are Canadian embassies in the United States, Mexico, and Japan, for example.
- **High commissions.** These provide the same services as embassies, but are located in Commonwealth countries, such as Great Britain and Australia.
- **Permanent missions.** These offices are located in major international organizations such as the United Nations, the WTO, and the EU. They do not usually provide consular services.
- **Consulates general.** These are located in major cities that are not capitals. There are offices in cities such as Los Angeles and Sao Paulo, Brazil.
- **Consulates.** These are located in major cities, but do not always provide a full range of services. For example, there are consulates in Munich, Germany, and Chongqing, China.



Canada's former ambassador to Mali, Isabelle Roy (second from left) is shown here with Governor General Michaëlle Jean in 2006.

- **Consulates headed by honorary consuls.** There are one hundred consulates in the world that are headed by persons designated as honorary consuls. Locations include Uganda and Paraguay.
- **Offices.** These may be found in capital and major cities. They are established to support Canada's foreign aid programs or specific projects. They usually provide limited consular services. Locations include Recife, Brazil, and Lilongwe, Malawi.


Canada House is the site of Canada's High Commission in London, England.

Canada and Australia have agreed to provide services for one another's citizens if an embassy for their own country is unavailable. Canadians may also call the British embassy in an emergency.

Trade Missions

The Canadian government promotes international business through trade missions to other countries. On these missions, which are organized through the Department of Foreign Affairs and International Trade (DFAIT), representatives of Canadian businesses accompany the prime minister, the Minister of International Trade and/or senior officials with DFAIT. The group that goes on the mission (commonly referred to as Team Canada) visits a particular country or region and focuses on a specific industry. In 2008, Team Canada visited Libya on an oil and gas mission and South Africa on an electricity mission. A trade mission provides Canadian business people with an opportunity to meet potential customers, suppliers, or other key contacts, and to gather market intelligence.

In addition to Team Canada, there is also Junior Team Canada. These Canadian youths meet with international businesses, gather cultural and business information, and make critical contacts. The team promotes Canadian culture and businesses in an effort to develop Canada's international identity, or "Brand Canada." The team creates a video and a series of reports at the completion of each trip. In August 2009, Junior Team Canada visited Ecuador and Panama on a mission that focused on agriculture, rural development, enhancing youth leadership, and social responsibility.


Stephen Harper is shown here on an official visit to Shanghai, China. The Canadian government encourages international business through trade missions and official state visits.

Corporate Influence on Governments

There are several ways for corporations to influence governments. Corporations often contribute large amounts to political campaigns, supporting politicians who will create legislation that is favourable to their businesses. Many companies support politicians who will endorse lower corporate tax rates. Companies may also influence governments by participating in Team Canada trade missions. For example, twelve companies from Alberta, Ontario, and Newfoundland and Labrador participated in the Canadian Oil and Gas Trade Mission to Libya in 2008. The Canadian representatives had the opportunity to meet potential buyers, network, and attend marketing briefings. Participants also have a chance to talk with the politicians accompanying the group.

At times, businesses take only concerns about profit, rather than the needs of society, into account when placing pressure on the government. For example, many Canadian companies believe that the implementation of emission controls will have a detrimental effect on their businesses and have expressed their concerns to the government. North American businesses that have to compete against companies based in countries such as China, which has limited emission controls, would be at a particular disadvantage, if these restrictions were implemented.

The goal of the Group of Twenty (G20) meeting on climate control in November 2009 was to set emissions targets for all G20 countries. This did not occur because China refuses to set targets before it has had a chance to grow economically. The G20's developed countries did not believe it was fair that they be asked to set and meet emission targets. If developed nations had agreed to limit their emissions, they would have been at an economic disadvantage to China, which could continue to grow its economy without regard for emission controls.

The National Rifle Association is an influential group that lobbies the American government on gun control issues.

One major way that companies influence governments is through **lobbying**. Lobbying is the process through which companies, special interest groups, or individuals attempt to influence government officials and persuade them to endorse public policy favourable to these groups. The term "lobbying" comes from the time when these groups would wait in the lobbies of legislatures in the hope of speaking to politicians. Lobbyists are experts in their areas and in the policy process. This makes them useful to politicians who do not always have the time, knowledge, or money to become experts on particular subjects.

Lobbyists work on specific projects rather than broad issues. This work may include taking part in government projects, attempting to influence policy changes, or obtaining grant money. The lobbying process is time-consuming and expensive. The *Lobbying Act of Canada* regulates the activities of lobbyists and government officials to ensure that no single group can obtain funding or influence government policy through access to lawmakers.

In Canada, lobbyists of the tobacco industry and health care have been attempting to influence the government for many years in favour of their opposing sides. Other lobby groups include the Retail Council of Canada, the Automotive Industries Association of Canada, and the Canadian Sugar Institute. Lobbyists have significant influence throughout the world. In the United States, lobby groups have had a tremendous effect on government policies. One of the strongest lobby groups in the United States is the NRA (National Rifle Association), which influences the government on gun-control issues. Other lobby groups work for the oil, tobacco, and pharmaceutical industries.

Think About It!

4.25. State six ways the government has a role in international trade.

4.26. What is the purpose of the Government of Canada trade offices found throughout the world?

4.27. What services does a consulate provide?

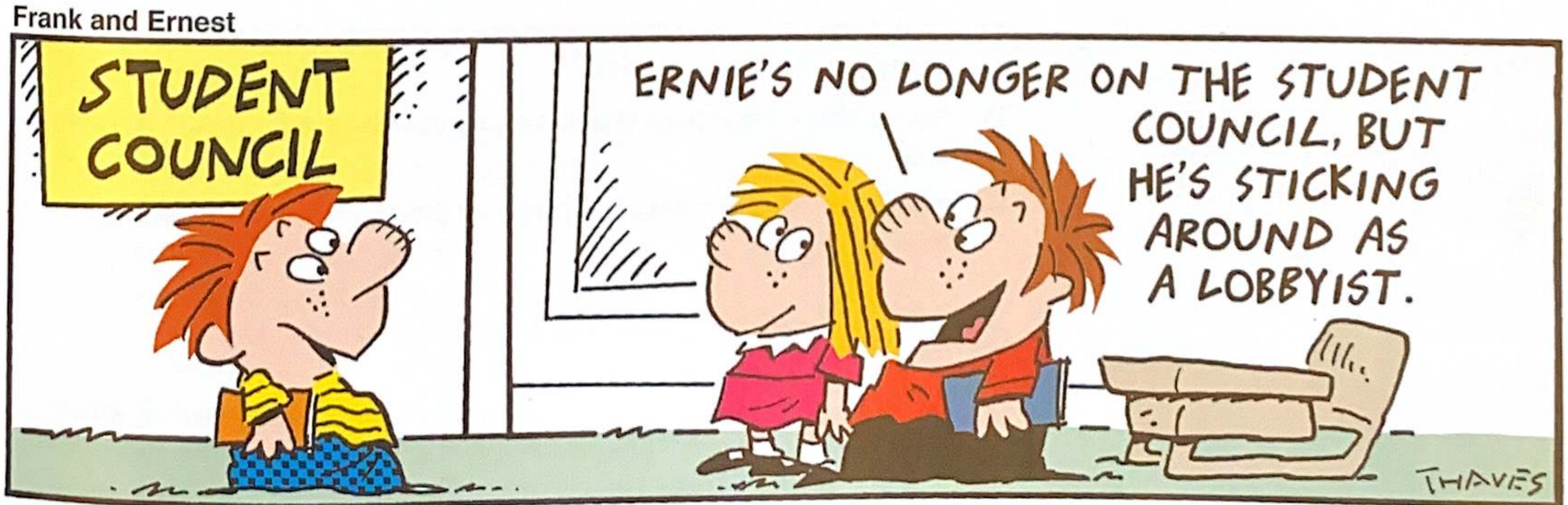
4.28. What is Team Canada?

4.29. What are the purposes of trade missions?

4.30. What does a lobbyist do?

4.31. State four examples of lobbyist groups in Canada.

Frank and Ernest



CHAPTER REVIEW

Chapter Questions

Knowledge

1. Compare and contrast democracy and autocracy.
2. What is the difference between an embassy, a high commission, and a general consulate?
3. How can businesses benefit if governments make starting a business easier?
4. Explain, using examples, why Canada is a mixed economy.
5. Explain how a recession in the United States can affect Canadian businesses.
6. In what products does Canada specialize?
7. What are the opportunity costs of a post-secondary education?
8. Using examples, prove that Canada meets the criteria of a developed country.

Thinking

9. Why are most democracies market economies?
10. Why are most autocracies command economies?
11. If you are in a country without a Canadian consulate, where can you go if you lose your Canadian passport?
12. Why do you think that Canadian and Australian consulates help one another's citizens?
13. Do you think the Canadian government should spend tax dollars on trade missions? Why or why not?
14. Name three companies operating in Canada that would prosper during recessionary times.
15. Name three countries that have an absolute advantage in labour costs.
16. Name three countries that have an absolute advantage in technology.

Communication

17. Winston Churchill, prime minister of Great Britain during World War II, once stated, "Democracy is the worst form of government in the world—except for all the other kinds." In your own words, what do you think he meant?
18. When you travel to other countries, why should you have the address and phone number for the Canadian embassy in that country?
19. Create an economic system continuum by drawing a line and putting the label "centrally planned economy" on the left and "market economy" on the right. Place the following countries on the continuum: Canada, United States, Ireland, China, Cuba, and Sweden.

20. Using the CIA World Factbook or another reliable online source, complete the following table and answer Question 21.

Criteria for Comparison	Bermuda	Cuba
Type of political system		
Type of economic system		
State of economic development		
GDP per capita		
GDP composition by sector		
Labour force by occupation		
Population below poverty line		
Literacy rate		

21. State four conclusions you can make from comparing these countries.

Application

22. Assume that there are two nations in the world, Ireland and Switzerland, and that they can produce only two products. Each country uses half of its resources on each product. They can produce the following:

	Wool	Chocolate
Ireland	4,000 kg	2,200 kg
Switzerland	2,500 kg	5,000 kg

a) If the two nations do not trade, how much wool and chocolate is produced?

b) Rewrite the following sentences and select the correct word in brackets:

i. Ireland has a(n) (absolute, comparative) advantage in the production of (wool, chocolate).

ii. Switzerland has a(n) (absolute, comparative) advantage in the production of (wool, chocolate).

c) The two countries decide to trade. Create a new table that shows what will happen if the countries trade.

d) Will the countries gain from trading? Explain.

23. Assume that there are two nations in the world, Italy and India, and that they can produce only two products. Each country uses half of its resources on each product. They can produce the following:

	Pairs of Shoes	Computers
Italy	8,000	2,000
India	10,000	20,000

a) If the two countries do not trade, how many pairs of shoes and computers will be produced?

b) India has an absolute advantage in both products. What does this mean?

c) Calculate the opportunity cost of producing a pair of shoes for both countries.

d) Calculate the opportunity cost of producing a computer for both countries.

e) Create and complete a new table that shows what will happen if the two countries specialize and trade.

f) Does the world gain if the two countries trade? Explain.

g) In this situation, how many pairs of shoes are lost to gain how many additional computers?

h) Create a chart to show that if India gives up some production of computers, no pairs of shoes are lost because of trading.