International Business
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Lecture – 22
Components of an Economy, Inflation, Unemployment, Debt

Welcome everyone to the course of International Business. In the last few classes, we have been discussing about you know the factors that affect the international business which every manager in a firm should understand and you know try to keep updated right. So, some of them being for example, we talked about the cultural factor, the political factor, the legal factor and then, we started about the economic factors right.

So, we discussed how economic factors affect the you know any firm for that right because economy of a country is one of the most important things it decides the living condition of the people ok. So, when we talked about the economic condition, we talked you know some of the terms like GDP Gross Domestic Product, GNP, the purchasing power parity and you know kind of terms which were used in the last class.

Then, we talked about how poverty and you know how inflation kind of things they also affect economic you know situation. We are going to do it in detail today. We also learned how human development index becomes one of the factors and how it influences the entire economy of a nation. So, as a whole, we have understood by now that economy has a very very vital role to play because just to start this lecture I would start with an example.

Let us assume in a famine, when there is a famine right people die of hunger. So, there was there is an argument why do people die of hunger? Is it because there is a shortage of food? Is it because there is a distribution problem? Is it because you know there is some other reason? What is the basic reason why people die? So, economists like Amartya Sen they finally, eventually they came to in conclusion and stated that it is not that food is not available, grains is not available. But what happens is peoples purchasing power comes down right. So, as a low purchasing power, they are unable to buy the grains and the food products.

So, as a result of it, there is a severe you know malnutrition and crisis which occurs in a country or a place. So, when we have understood economy and we are getting into it. Let us move further today with some of the other things for example, let us start with what are the components of an economy?

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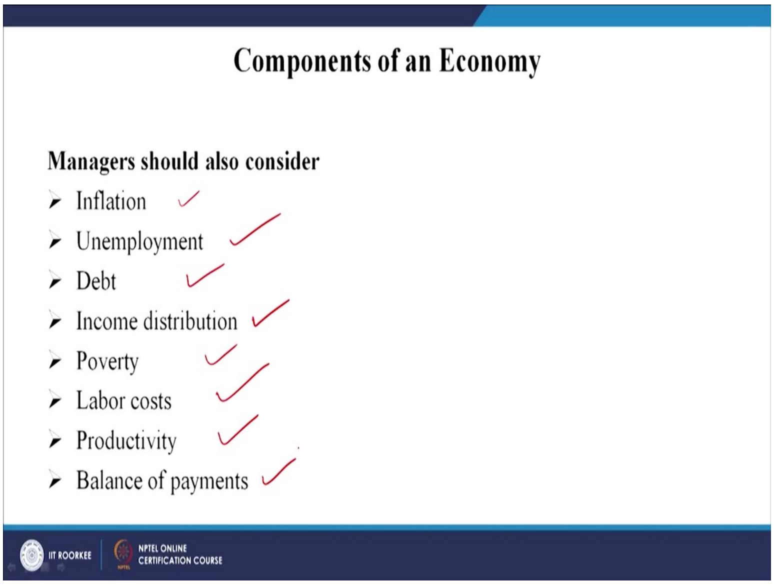

So, when we are saying the components of economy, there are certain factors which managers need to understand. For example, inflation: how inflation affects, what is inflation by the way and how it affects the economy right.

Unemployment or employment level in the country, level of debt a country goes through or has, how is what is the income distribution level, how is income being distributed in the country is it is there a serious heavy a large gap or it is equally distributed, what kind of a distribution system is there? What is the level of poverty? What is labor cost you know? What is the productivity of a nation and finally, the balance of payment. So, these are some of the components which we will understand, we will talk in detail today in this lecture.

So, let us start with inflation. So, what is inflation by the way? This word every day we when we will you know come across through the some economy, some news and we are finding we are talking about and we you know listen to that, that there is a growth in inflation or inflation has come down. So, what is this inflation all about?

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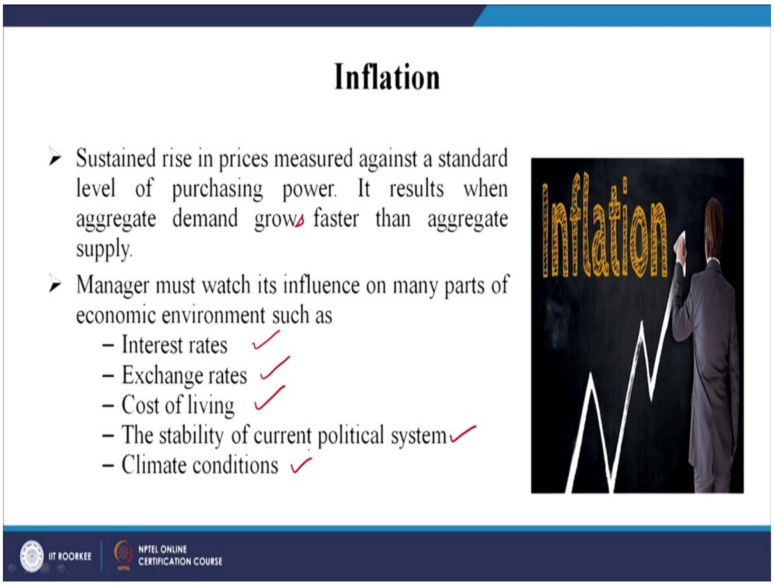

So, as it says in a layman's word inflation is nothing but a rise in prices of some basic commodities or basic products right which we use in our day to day life right. So, if you take this what says what it says is sustained rise in prices measured against a standard level of purchasing power. It results when aggregate demand grows faster than the supply. So, when there is a large amount of demand, but supply is less what happens the price of the commodities increases right as a result of it, inflation grows.

So, if there is sufficient amount of supply and you know there is a purchasing power with people, then inflation would be in controlled. A you know there is an argument whether inflation is good or bad. So, this argument has two places. Many a times we say or largely we understand inflation is to be a very dangerous thing and it is not very you know good for any country, but inflation a moderate inflation is always a healthy sign because a moderate inflation helps a country to grow right.

So, as a economist, one has to understand or you know a student of economics, one has to understand how much inflation is a bad inflation or up to what level can we sustain it and beyond that its dangerous right.

So, what is that good and the bad side of it? Managers must watch its influence on many parts of the economic environment such as interest rates, how inflation affects the interest rates, the exchange rate, the cost of living, the stability of the current political system and the climate condition.

So, inflation has an influence right on all these factors. Now, if the inflation grows that means, the country would like to you know ensure that there is less money in the market and to do that, they would increase the interest rate for that right.

So, with the interest increase in interest rate, they would ensure the liquidity in the market is lessened. So, that it would reduce the inflation. So, these kind of things inflation is connected with a lot number of factors and it drives the economy to a very large extent.

So, stability of a current political system; how if the inflation is large even governments topple, you know there is a change in government systems because people are not happy and there is an unrest and there is a very high chance of a civil unrest which can you know result in a you know change in the government also right. So, all of these things taken together inflation puts a very big plays a very big role.

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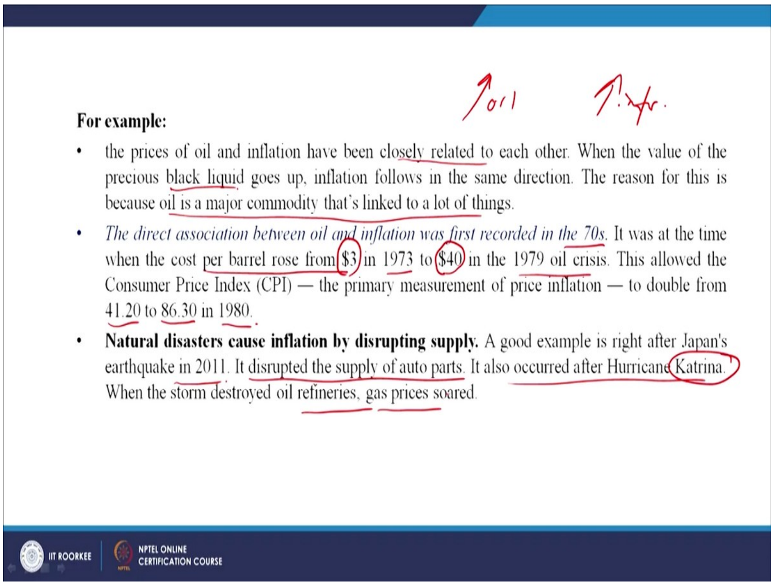

Let us take this example, the prices of oil and inflation have been always closely related right. So, if oil increases oil price, inflation tends to grow right why? Because whatever transportation happens, all these are happening through the vehicles which are using oil and now if the price of oil will increase, the prices of this transportation will increase which leads to a increase in the cost of the product right.

So, when the value of the precious black liquid or petroleum goes up, inflation follows in the same direction. So, if there is an rise in price of oil, inflation also will tend to grow up right. May not be in a you know linear fashion, but there is a growth right.

The reason for this is the because oil is a major commodity that is linked to a lot of things in our life ok. So, the direct association between oil and inflation was first recorded in this 1970’s. It was at the time when the cost per barrel rose from 3 dollar in 73 to 40 dollar in 79. So, you can understand how what was the rate of growth an extranomical growth rate.

This allowed the consumer price index, the primary measurement of inflation which is you know through which it is calculated to double from 41.2 to 86.3 in 1980. So, inflation grew rapidly because of an increase in the oil price. Even recently, we have seen in India, inflation was mildly controlled after when there was a change from one government to the other; because of that one big reason was that the oil prices came down, the price per barrel came down the oil prices.

Second is natural disasters cause inflation by disrupting the supply. So, this is the reason right. But we have very little control over this. Yes, a good optimizist optimized technique or a good governance can help it, but you cannot naturally control obviously, a natural disaster.

A good example is right after Japan’s earthquake in 2011. It disrupted the supply of auto parts. It also occurred after the Hurricane very famous Katrina right. When the storm destroyed the oil refineries, gas prices soared and as we have said when there was a soaring in the increase in the gas prices and oil prices, automatically inflation grew.

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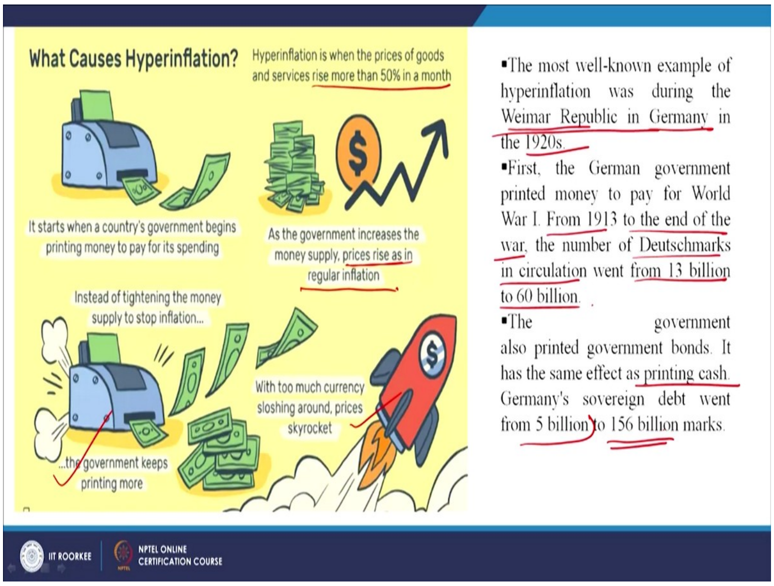

Now, let us see this case now hyperinflation is a situation where inflation has you know crossed you know its definition is there it is when the prices of the goods and services rise more than 50 percent in a month right. So, this is a very serious condition. So, this is nobody no country would want, but why does it happen right and let us take an example also. So, let us understand first what causes the hyperinflation.

So, as we said when the price of goods and services rise more than 50 percent in a month, it is a case of hyperinflation right. It starts when a country's government begins printing money to pay for its spending. So, it is not a very wise idea to print money right, but some of the governments have done it.

As the government increases the money supply so, more money is available with people. The rise of prices you know the commodities the there is a price rise in of the commodities right and as there is a price rise of the commodities because people have more money to spend so, they can pay.

So, that is why the prices also rise and as the price rises, regular inflation happens, or inflation raises. Why then, what is the problem? One needs to understand very as a student of you know social science and management that yes, money supply has increased, but money supply has not been distributed equally in everybody's hand. So, that is why the inflation cause is a major concern ok.

So, instead of tightening the supply to stop inflation, the money supply the governments keeps printing more. Now with too much currency prices skyrocket. So, this is a very beautiful diagrammatic representation which is you can understand.

So, the most well known example of hyperinflation was during the Weimar Republic in Germany in the 20's. First the German government printed money to pay for the World War I. From 1913 to the end of the war, the number of Deutschmarks in circulation went from 13 billion to 60 billion ok.

Now, the government also printed government bonds. So, which is again another kind of a you know tool which affects the inflation like the cash right. German sovereign debt went from 5 billion to 156 billion marks. So, all these resulted in a very hyperinflation situation for Germany ok.

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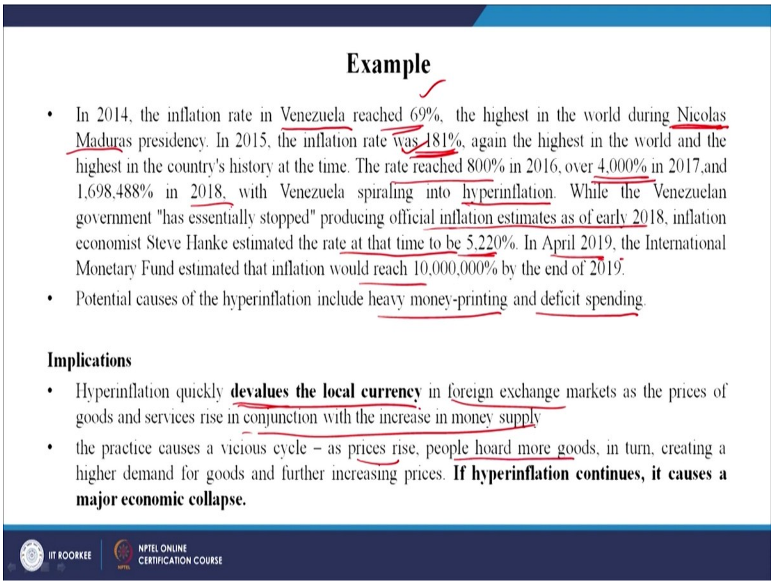

Another example very recent one, not very oldest Venezuela what happened in 2014, the inflation rate in Venezuela reached 69 percent which was the highest in the world right and who was the ruler at that time Nicolas Madura's and he was a president. In 2015, this rate was 181 percent. Now you see this is 69, now it has moved to 181 again it was the highest in the world and the highest in the country's history at that time. Now, that did not stop there.

The rate now reached 800 percent in 2016. So, 2014, 2015, 2016 from 69 to 800 percent and then, in 2017 over 4000 percent right and in 2018, it is 1,698,488 percent. So, you can see what has happened to the economy right, with Venezuela spiraling into hyperinflation right.

While the Venezuelan government has essentially stopped producing official inflation estimates after that, inflation economist Steve Hanke estimated the rate at that time to be 5220 percent. In April 2019, the IMF estimated that inflation would reach 10,000,000 by that percentage by the end of 2019 right.

So, you can understand; that means, there is a lot of money but the money has no value at all because the cost of goods is also skyrocketing right. So that means, what people will go with bags of money and maybe buy a loaf of bread that is the situation.

Potential causes of the hyperinflation include heavy money printing and deficit spending another bad thing. Now not only money printing, but again what you are doing is you are spending money by taking maybe loans right so, you do not have the money to spend, but you are still spending on what? On what basis will you spend? You take loans from somebody which you have to pay.

Today Pakistan is in a very bad state because he had taken, they have taken a lot of loan from China and today as of now, Pakistan is in a terrible situation. They have they do not even have money for left for more than 3 months.

Implications: Hyperinflation quickly devalues the local currency in foreign exchange markets as the prices of the goods and services in conjunction with the increase in money supply right. The practice causes a vicious cycle now. As prices rise, people hoard more goods. See all about economy is behavior. Economy is nothing more to me if I understand correctly. Economy is nothing but a way of human behavior you know understanding that human behavior that is in that is in connection with one tool which is called currency or money right.

How do humans behave with the tool called currency or money whatever you say, how do they behave with it? This entire behavior of human beings in relation to the currency to me is economic right. So, people would hoard more, they would try to save, they were try to keep. In turn, creating a higher demand for goods and further increasing prices. If hyper inflation continues, it causes a major economic collapse. So, such examples we have seen in Venezuela, we have seen in Argentina, we have seen in Zimbabwe so, there have been lot of examples.

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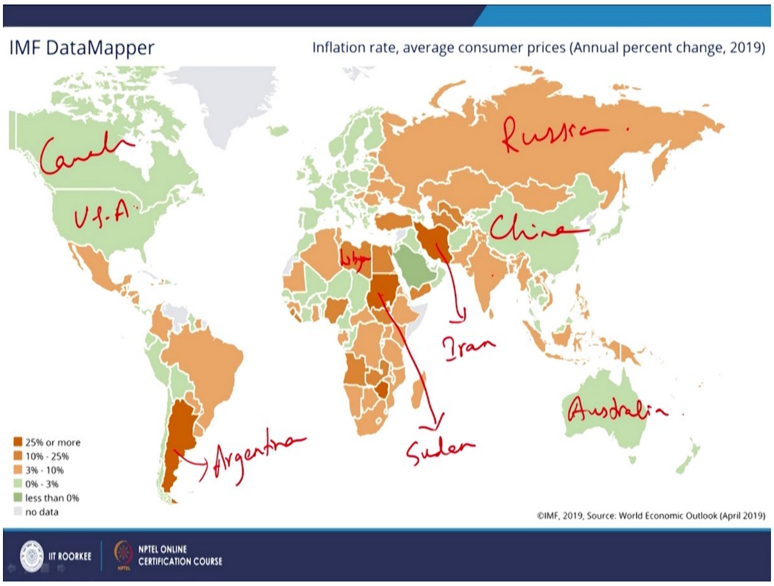

So, this is an example of you know we have taken from the IMF data. So, inflation rate if you can see, these are some of the indicators given to you. So, 25 percent or more right inflation rate average consumer prices of some countries has been given.

So, where it is if you see the red color so, these are like the reddish ones which has got 25 percent or more which have a 10 to 25 percent inflation rate is in slightly in the you know in the darkest region and then, it goes on, So, 0 to 3 percent is green and dark green is less than 0 percent.

So, let me show you some of the countries if you if I want to show you. So, for example, let us take this one, the red one right. So, in case I would not forget so, I have also brought it in writing so, for you. So, Argentina right. So, let us take some more red ones, let us say this one. So, this is Iran right. So, this one is I think Sudan right. So, this is Sudan. Then, you have here Libya. So, these are some of the economies which have a very high.

Where is India? India is somewhere here right; India is somewhere here. So, India comes and then a 3 to 10 percent condition right and if you see the good ones, the green ones for example, Australia right, this is Australia. Then, you have this one is if I am not wrong China right; China, this is Russia the Russian federation basically and then, you come this side let us say this is the US right Canada and US right. So, this is Canada so, this is the USA. So, so there are different kinds of conditions which I have mentioned. So, you can see all of them and this gives you an idea about the inflation rate and how they are varying in the different parts of the world right.

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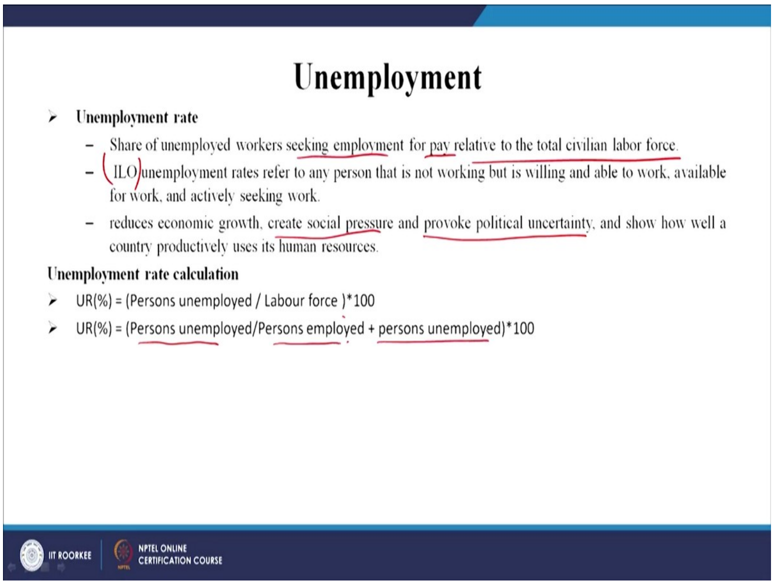

Unemployment also another indicator which affects the economic largely. Now what is this? Share of unemployed workers seeking employment for pay relative to the total civilian labor force right. So, I will explain it. ILO, the International Labor Organization unemployment rates refer to any person. According to ILO, it refers to any person that is not working, but is willing and able to work.

So, what does the ILO say? The ILO says that unemployment rates refers to any person that is not working, but he is willing to work, he is interested to work, they are interested to work, but they are not getting a work.

So, in that condition, it would only be categorized in the unemployed sector or category right and actively seeking work, they are looking for work. So, but if somebody is not looking for work, then he is not part of the labor force it is as simple as that. What it does? It reduces economic growth. Due to unemployment, economic growth is you know comes down. There is a social pressure right. Some somebody has money, somebody has do not have money. So, there is a chance of crime and all these things are getting larger. Provoking the political uncertainty and show how well a country productively uses its human resources.

So, unemployment is very important because the more unemployment and we will see later on that the more unemployment is there; that means, people do not have the power to you know purchase thing, they do not have money right and as they do not have money, then what will it happen? Then they will not be able to buy things and as they will not have you know money to buy things, automatically there will be a you know fall in the demand of the goods and as there is a demand of goods falls down, automatically there is a you know loss of job and again, when there is a loss of job so, there is a loss of money earning capacity. So, this is again a cycle, a vicious cycle right.

Unemployment rate is calculated as for example, persons unemployed divided by the total labor force right. Now what is this? Persons unemployed divided by labor forces person employed plus persons unemployed into 100. This is how it is calculated.

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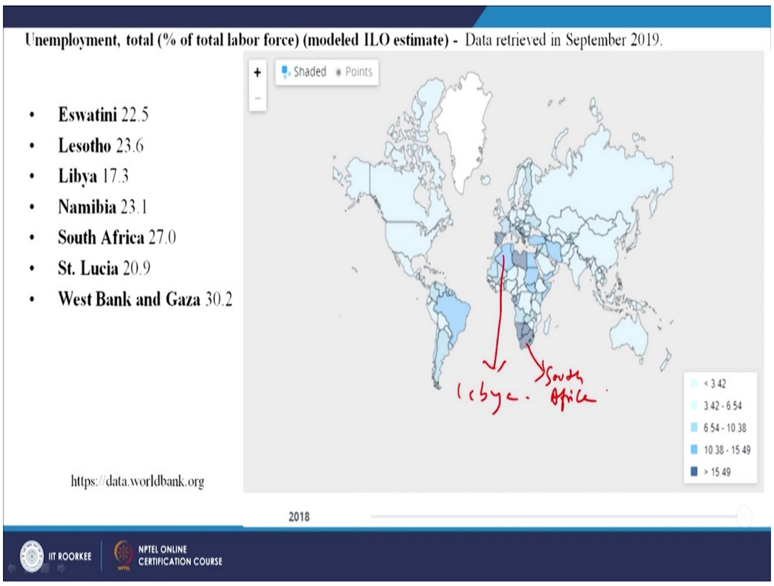

These are again some of the examples which I have shown you. So, for example, you can see some countries like Libya right. Libya is somewhere here right. If I am not wrong, Libya exactly this one is Libya right. So, this one is Libya right. then we have South Africa which is that you know end the tip I think yes, so, this is South Africa; South Africa. So, these are some of the countries which have got a high unemployment rate right. India has not got a much problem, but then that is a dicey to understand because how it is calculated sometimes unemployment calculation is a little confusing thing ok.

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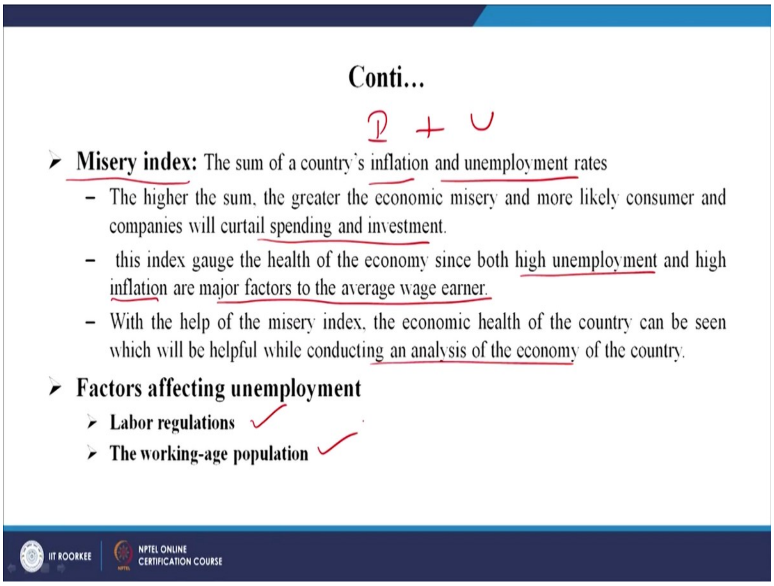

So, there is something called a misery index. Now what is this? What does it say? The sum of a country's inflation and unemployment rate taken together is called the misery index right. Higher the sum that means, the inflation plus the unemployment. Higher the sum, the greater the economic misery and more likely consumer and companies will curtail spending and investment.

If you remember during any recession, what happens is largely companies tend to stop their investments into marketing, promotion of goods and all right. But some companies have understood this is not a very wise way of you know addressing the problem of recession. If you do that, then again it is a spiral, it is a visual cycle which again reduces your chances of you know people buying your product.

So, some intelligent and good companies have always understood that even during the time of recession, there should be some money spent on you know marketing and branding of products right.

So, that when the good time comes, you are the most ready company. You are the company with the best condition. So, that you can people can automatically remember you and can try your products out. This index gauge the health of the economy since both high unemployment and high inflation are major factors to the average wage earner right.

With the help of the misery index, the economic health of the country can be seen which will be helpful while conducting an analysis of the economy. So, if you can understand the misery index, it helps you to understand the economic health of the nation.

Some other factors affecting unemployment are labor regulations and working age population which are for example, labor regulation is one which like in India, our labor laws are very archaic, very old right. So, hardly they had changed from the British times right. So, now many what happens is because of this very stringent norms where you cannot remove people, it is very difficult to remove even one person. What happens is the private companies now are in a problem.

So, now, there have been some changes in the recent past, but earlier days, there used to be lot of problems. So, they if they wanted some workers also, they would not hire it why because they were afraid, they have to keep those workers for lifelong.

So, now that is an too much of a burden for these companies. So, they wanted maybe for a time period 2 years, 3 years, 1 year whatever 6 months so, they could have hired. Now that would have been still an earning mechanism for the workers, but because of the fear, that these regulations will be you know will be legal regulations are very damaging, the companies do not hire.

So, now, not hiring creates a very difficult situation and what they do is they try to optimize with the existing labor, but the existing labor because it knows it is protected by the government to a very large degree as it happens I am; I am I feel I can openly say this. In the government sector in India, the people are protected.

So, as they feel protected so, then they what they do is they do not try to improve their productivity. They are happy doing whatever they like. So, that hampers the growth of a company right. So, at one end, you cannot hire good people, at the other end the people who are working they are not interested, and they are not very you know productive in nature right.

Second is the working age population with. Now, this is a natural condition which cannot be controlled a very largely it cannot be controlled because, now the working age population for example, in Japan is a very aged country that means, the average age of the people is high on the higher side. So, more people are growing old whereas, on the other side India is in a young country. So, when it is a young country, more people are coming to the job market every year.

So, if we cannot afford, if we cannot provide them jobs, then automatically the unemployment rate can grow tremendously right. But on the other hand, Japan the might be the unemployment rates the demand in the employment might not be very high because many people are getting old now right. So, this is a condition which affects it.

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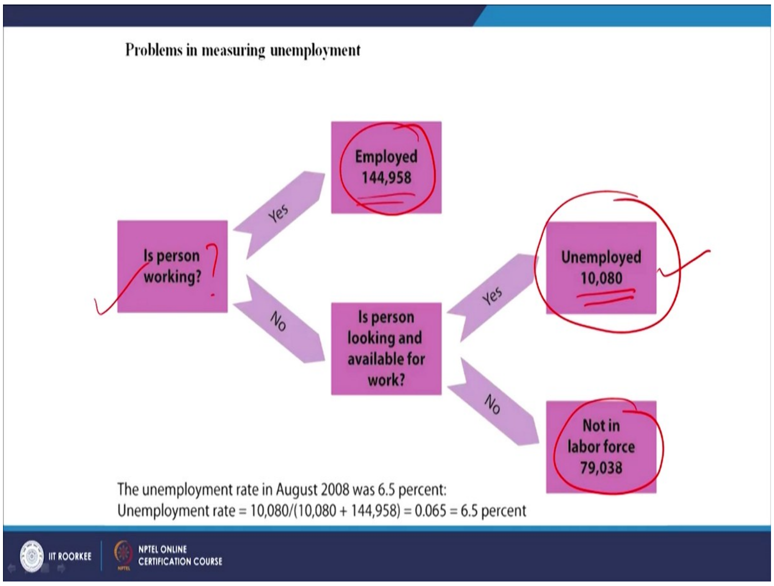

Let us see this example will understand unemployment. So, is a person working is one question right yes, there are two possibilities yes or no. If it is a yes, then let us say this is a number we have taken for a calculation, then these people are the employed people. So, in this case this is an example, we have taken 144,958 people are employed. Let us say not employed, is the person working? No.

So, is the person now there are two questions again. Is the person looking and available looking for work is he looking for work? If it is a yes, then he comes under the unemployed right which is let us say 10,080. If he is not looking for a work, then he comes in the not in the labor force which is in this case are let us say 79038 right. So, which can happen right for example, people working in their own farms, agricultural fields, they do not look for jobs many a times. Somebody has his own business; somebody does a handicraft. So, the government tries to, every government tries to increase the business you know climate of a country so that, people are self-employed, they do not mind, you know they are not looking for a job.

Though the unemployment rate in August is that is why you know our Prime Minister had given a statement which was a lot of hue and cry. When he said people could make some fry you know some items and sell it in the market, even that is a job, but then he meant here that is any job, it is creating job right.

So, if you are even having a stall where you know you are making food items and selling it to the public, still it is a job because you are creating more economical conditions, you are more you are hiring people, you are giving them wages. So, that is not to be looked at a negative side only, it has some positive connotations. But yes, you might define jobs in different manners that is a different story.

So, the unemployment rate in August 2008 was 6.5 percent. Now, how does it come you see. 10080 which is the unemployed rate unemployed divided by 10080 plus 144958. Now, if you this if you take this total this is 6.5 percent. If you would have added this one, then this scene would look very bad right.

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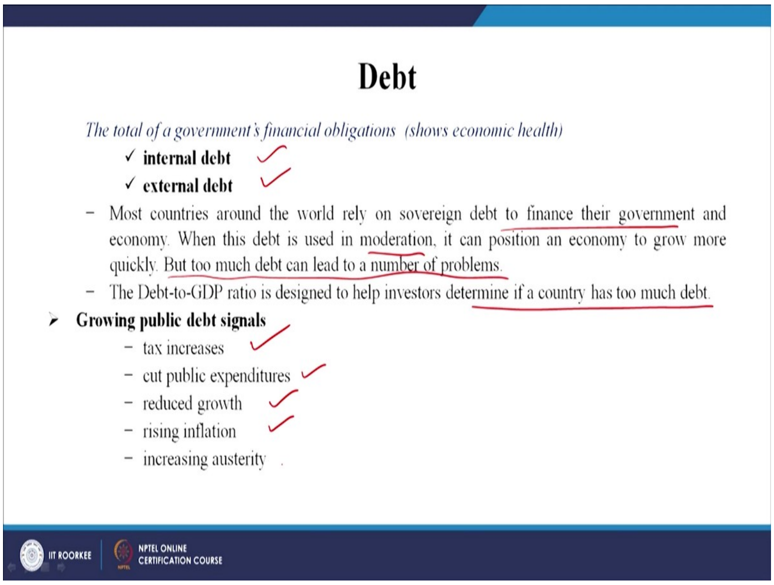

This another you know thing that comes into the discussion is debt. What is the relationship with debt and economy? Debt is basically the total of a government's financial obligations right so, financial obligations. So, there could be two kinds of you know when you talk about debts: internal debt and external debt. Debt is to be understand we have taking some money from borrowed some money or something so, that is a debt right.

Most countries around the world rely on sovereign debt to finance their government. So, they ask money from foreign players and foreign other countries and all to run their own economy. So, that is something we talk about we say is the debt right. When this debt is used in moderation, it is good. Suppose you want to you know for example, in finance also we have heard the debt you know way of going for generating revenue or the equity based system which is better. So, there are lot of arguments for it.

If you can use your debt properly, then it is always good. Having no debt does not mean that a company is always doing good because if you have taken debt, taken loan and you are using it for productive purposes for example, like more schools, more hospitals and all then it is good for the economy. But if you are not using it in that way and you are wasting your money for let us say other purposes which are not creating more jobs or more productivity, then that is a dangerous condition right.

So, to, but too much debt can lead to a number of problems because you will not be able to even pay the interest then what happens is the you know it goes on the principal plus interest goes on piling up and then you are in a position where you might not be able to pay at all right. So, the debt-to-GDP ratio is designed, is one of the indicators is designed to help investors determine if a country has too much debt or not.

So, for example, when a foreign investor would come to India, he would like to see the debt it could GDP ratio for India. Some of those signals for growing debt public debt is for example, then the government increases the tax right, he cuts the public expenditures so, basic expenditures which are important they are cut down, growth is reduced, inflation goes on rising and austerity measures again like you know cutting public expenditures is one of them is growing, is rising.

So, in these conditions we would say maybe the country is going in a debt condition and there is a lot of debt which to manage it, they are now using this kind of techniques, but they are may not be the wise techniques right.

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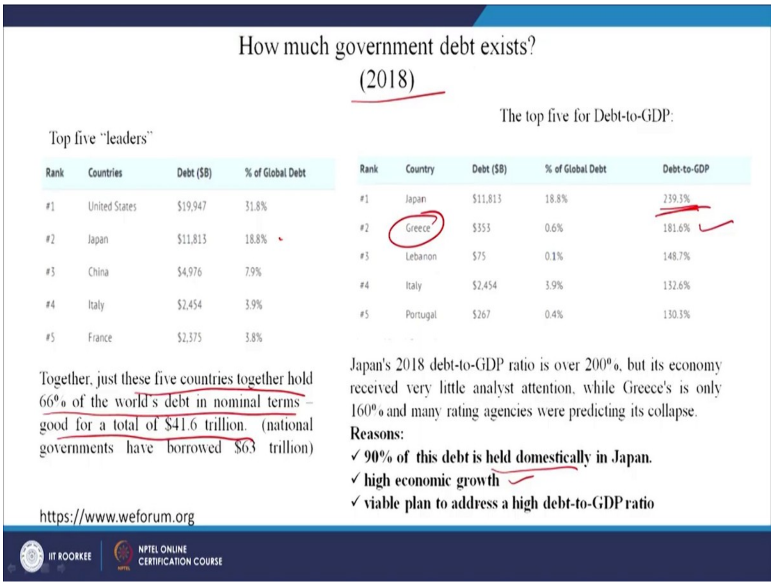

So, anyway we can understand now that how inflation and debt taken together right has this is yes, this is one thing which I wanted to show you. Some of the top you know the company countries how much government debt exists. For example of 2018, this value is taken.

So, they are ranked some countries with the top 5 leaders. United States has a debt of this much right in billions which is 31.8 percent of the global debt, Japan 18.8, China it goes on right together just these 5 countries together hold 66 percent of the worlds debt in nominal terms good for a total of 41.6 trillion right.

But if you can see interestingly, all these are economies which are growing. So, from here also if you do not understand anything, still you can say that all the time debt is not as bad as it looks ok. On the other side, if you look at the top 5 for debt-to-GDP, the number one country that comes from in debt-to-GDP is Japan right which has 18.8 percent of the global debt here and when you talk about the debt-to-GDP it is 239 240 percent right. Greece is 181.6 percent. Greece is in a bad condition right.

So, if you can see here, Japan’s 2018 debt-to-GDP ratio is over 200 percent, but its economy received very little analyst attention because they are still doing good. While Greece is only 160 percent and it has been on the verge of collapse why? Why did it happen? Reason 90 percent of the debt in Japan is held domestically. So, it is not from outside. High economic growth, they are using their money well. Viable plan to address. They have a good plan to address the GDP to debt ratio right. So, this is something which we have covered.

So, today we have understood how inflation and debt and all these things how they are affecting unemployment they are affecting the economy of a country right. In the coming lecture, we will carry on from here and understand some of the more components which are connected with economic factors and how they affect the international business right.

So, thank you for the day. Have a nice day.