

Case studies

THE ROLE OF GOVERNMENTS

ECONOMIC DEVELOPMENT AND DEVELOPMENT ECONOMICS

- ❖ Objective: transformation and economic development in undeveloped areas
- ❖ History: once succeed in past as parts of classical economics.

New opportunity:

- ❖ New development in other areas, such as game theory, public choice and economic history
- ❖ New economists from developing countries who observe and experience the process of development
- ❖ No institutional factors or variables in the model of mainstream, so no concerning on institutions in development economics,
- ❖ Not to say, concerning on the system of government
- ❖ In 1950s, overlook the market system, stress on capital, and on governments, but in distribute capital and technology rather than in supplying public goods. So no institutional change of governments, no advantage of governments in efficiency, no labor division and specialization in private and public goods between market and governments
- ❖ Maybe politician and elites don't like it
- ❖ In 1970s, governments failed, back to market,
- ❖ But, still no efficiency of governments, no market economy's efficiency
- ❖ No institutional change of public finance, no efficiency of governments
- ❖ The system of public finance is important, but be ignored.
- ❖ In 1990s, public finance or relationship between market and governments has been discussed (Stiglitz, 1999) in development economics.
- ❖ Popular of new institutional school
- ❖ Uncorporate equilibrium of group game theory(Auman and Shelling)
- ❖ Public budget system be still overlooked
- ❖ How to establish or initiate a new institution

A NEW MODEL OF ECONOMIC DEVELOPMENT

- ❖ Perfectly competitive markets are defined by two primary characteristics:
 - (1) The goods being offered for sale are all the same, and
 - (2) The buyers and sellers are so numerous that no single buyer or seller can influence the market price.

Problem of mainstream model:

- ❖ The price is an exogenous variable in the function of economic growth, and a base on which economic entities make their decisions.
- ❖ Information economics no use about information of prices, here, because consumers always change their ideas.

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Outcome:

- ❖ The efficiency of market economy missed:
- ❖ The role of entrepreneur: Guess the price of goods, even in a perfect competitive market
- ❖ The efficiency of public finance: Bargaining between taxpayers and governments for the price of public goods

Impacts:

- ❖ The model in mainstream just concerns production, which rely on labor, capital, technology, then innovation, but no any business
- ❖ Misunderstanding: capitalists' or entrepreneurs' market economy
- ❖ This misleading no influence on USA, but impact on developing countries which lack of entrepreneurs and institutions.

What is market economy?

- ❖ Distribute resources by market system?
- ❖ Maximum of profit by mathematics?
- ❖ If so, the planner will do it best
- ❖ But who knows the information in calculation?
- ❖ The advantage of market over plan: Run business and efficiency from the mechanism of prices
- ❖ Need a institution to permit entrepreneurs to guess and bargain the price with consumers, and governments do it with taxpayers.

Ways of economic development:

- ❖ Trade: entrepreneurs guess preferences of consumers, and raise the prices;
- ❖ Technology of trade to reduce transaction cost: invention of money;
- ❖ Institutional changes to reduce transaction cost: property right system;
- ❖ Technology of production to reduce costs: machines and organizations;
- ❖ Institutional changes in governments to reduce transaction cost: budget system;
- ❖ Capital and resources to replace labor: no save of cost, but bring us more leisure time- the objective of economic development
- ❖ All factors have been analyzed in past, but budget system. What is it? How to get it?

THE EFFICIENCY OF PUBLIC FINANCE AND THE ROLE OF GOVERNMENTS IN SOME CASES

- ❖ Is a state or government a trouble maker (like it in SA)? Or is it a solution (like it in EA) ?
- ❖ No answer just like private company, but we cannot ignored it
- ❖ The key points here are what kind of government it is, what it does as a government and how it does those works. - Efficiency

Efficiency of governments

- ❖ Come from the political structure or budget system
- ❖ The change of structure is slow and difficult
- ❖ However, not to plan or distribute resources, but to supply public goods efficiently

Three systems:

- ❖ the system to enforce laws and contracts with sovereignty,
- ❖ the system of making decisions and supervising the actions of governments by taxpayers,
- ❖ the system of showing and coordinating the preference of taxpayers on public goods and negotiating between taxpayers and governments

The hardness of economic development

- ❖ We cannot copy a system; they are a consequence of political struggle or cooperate game.
- ❖ The system change will be influenced heavily by culture, history and old system.
- ❖ Mass democracy is not a good way; the important point is taxpayer participating in the system. keep small group for cost and equilibrium

EXTERNALITIES

Adam Smith's "invisible hand" of the marketplace leads self-interested buyers and sellers in a market to maximize the total benefit that society can derive from a market.

1. An *externality* refers to the uncompensated impact of one person's actions on the wellbeing of a bystander.
2. Externalities cause markets to be inefficient, and thus fail to maximize total surplus. When a person engages in an activity that influences the well-being of a bystander and yet neither pays nor receives any compensation for that effect.
3. When the impact on the bystander is adverse, the externality is called a negative externality.
4. When the impact on the bystander is beneficial, the externality is called a positive externality.

Externality: a by-product of a transaction that affects someone not immediately involved in the transaction.

- Imply that the competitive equilibrium will not result in the social optimum
- Imply that the competitive equilibrium will result in a dead weight loss
- Create a role for government intervention

Negative Externalities

- Automobile exhaust
- Cigarette smoking
- Barking dogs (loud pets)
- Loud stereos in an apartment building

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Positive Externalities

- Immunizations
- Restored historic buildings
- Research into new technologies

Negative externalities lead markets to produce a larger quantity than is socially desirable.

- Positive externalities lead markets to produce a smaller quantity than is socially desirable.

Externalities, which occur in cases where the "market does not take into account the impact of an economic activity on outsiders." There are positive externalities and negative externalities. Positive externalities occur in cases such as when a television program on family health improves the public's health. Negative externalities occur in cases such as when a company's process pollutes air or waterways. Negative externalities can be reduced by using government regulations, taxes, or subsidies, or by using property rights to force companies and individuals to take the impacts of their economic activity into account.

EXTERNALITIES: impacts on third parties besides the buyer and seller.

Consumption Externalities: impacts on third parties as a result of the consumption of a good. Eg. Each infected person who takes Drugs eliminates disease helps all of society, not Just the drug company which provides the medicine.

Production Externalities: impacts on third parties as a result of the production of a good. Eg. New discoveries & innovations impact all of Society, not just the scientist who discovers them and the firm who employs the Scientist (streptomycin patent problem)

Market Power: The power of a single Company to change the price of a good or service in the market place. Includes: MONOPOLY, MONOPOLISTIC COMPETITION, And BILATERAL MONOPOLY. Examples: Drug Companies while they have Patents.

Inequities: any economic, social or political mechanism that systematically causes one part of the population to be worse off than another part of a population through time without the possibility of correction. Examples: Poor Populations have greater vulnerability to TB due to their economic and social conditions.

Dynamic Market Failure: the failure through time to achieve technological change and the failure of the market to achieve stable, equilibrium outcomes. Examples: As a disease disappears in a given locale:

- lack of incentives for new drug development
- Lack of treatment for those who are diseased

Both in the area and in other areas where pandemics may occur

Indivisibilities: a problem cannot be sub- divided into smaller pieces for the purpose of Solving the problem or marketing the solution Example: even one remaining infected person means no cure has been achieved. Any plan to wipe out a disease means that a comprehensive worldwide plan must be undertaken.

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Information Asymmetry: decision makers do not have access to the same information which leads to different definitions, boundaries, and solutions to problems to be solved and social outcomes. Examples: indifference to disease, lack of education about how to treat diseases, and failure to understand the tradeoff between private rights and public goods.

ECONOMIC ANALYSES FOR BUSINESS

MARKET

A **market** is any one of a variety of different systems, institutions, procedures, social relations and infrastructures whereby person's trade, and goods and services are exchanged, forming part of the economy. It is an arrangement that allows buyers and sellers to exchange things. Markets vary in size, range, geographic scale, location, types and variety of human communities, as well as the types of goods and services traded.

Some examples include local farmers' markets held in town squares or parking lots, shopping centers and shopping malls, international currency and commodity markets, legally created markets such as for pollution permits, and illegal markets such as the market for illicit drugs.

In mainstream economics, the concept of a **market** is any structure that allows buyers and sellers to exchange any type of goods, services and information. The exchange of goods or services for money is a transaction. Market participants consist of all the buyers and sellers of a good who influence its price.

This influence is a major study of economics and has given rise to several theories and models concerning the basic market forces of supply and demand. There are two roles in markets, buyers and sellers. The market facilitates trade and enables the distribution and allocation of resources in a society.

Markets allow any tradable item to be evaluated and priced. A market emerges more or less spontaneously or is constructed deliberately by human interaction in order to enable the exchange of rights (cf. ownership) of services and goods.

Historically, markets originated in physical marketplaces which would often develop into or from small communities, towns and cities.

TYPES OF MARKETS

Although many markets exist in the traditional sense such as a marketplace there are various other types of markets and various organizational structures to assist their functions. The nature of business transactions could define markets.

Financial markets

Financial markets facilitate the exchange of liquid assets. Most investors prefer investing in two markets, the stock markets and the bond markets. NYSE, AMEX, and the NASDAQ are the most common stock markets in the US. Futures markets, where contracts are exchanged regarding the future delivery of goods are often an outgrowth of general commodity markets.

Currency markets are used to trade one currency for another, and are often used for speculation on currency exchange rates. The money market is the name for the global market for lending and borrowing.

Prediction markets

Prediction markets are a type of speculative market in which the goods exchanged are futures on the occurrence of certain events. They apply the market dynamics to facilitate information aggregation.

Organization of markets

A market can be organized as an auction, as a private electronic market, as a commodity wholesale market, as a shopping center, as a complex institution such as a stock market, and as an informal discussion between two individuals.

Markets of varying types can spontaneously arise whenever a party has interest in a good or service that some other party can provide. Hence there can be a market for cigarettes in correctional facilities, another for chewing gum in a playground, and yet another for contracts for the future delivery of a commodity. There can be black markets, where a good is exchanged illegally and virtual markets, such as eBay, in which buyers and sellers do not physically interact during negotiation. There can also be markets for goods under a command economy despite pressure to repress them.

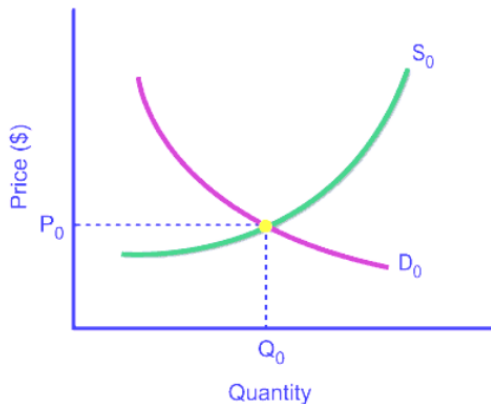
Mechanisms of markets

In economics, a market that runs under laissez-faire policies is a free market. It is "free" in the sense that the government makes no attempt to intervene through taxes, subsidies, minimum, price ceilings, etc. Market prices may be distorted by a seller or sellers with monopoly power, or a buyer with monopsony power.

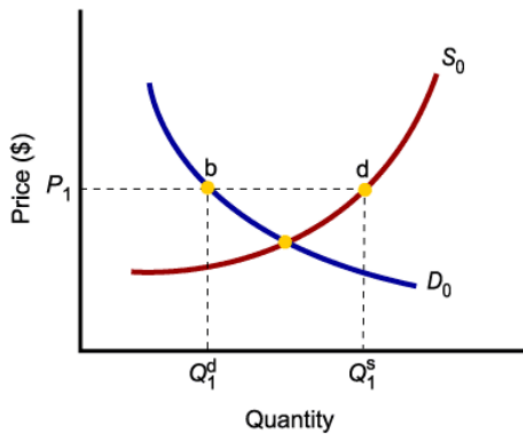
Such price distortions can have an adverse effect on market participant's welfare and reduce the efficiency of market outcomes. Also, the level of organization or negotiation power of buyers, markedly affects the functioning of the market. Markets where price negotiations meet equilibrium though still do not arrive at desired outcomes for both sides are said to experience market failure.

Market Equilibrium

- The operation of the market depends on the interaction between buyers and sellers.
- Equilibrium is the condition that exists when quantity supplied and quantity demanded are equal.
- At equilibrium, there is no tendency for the market price to change.



Market Equilibrium

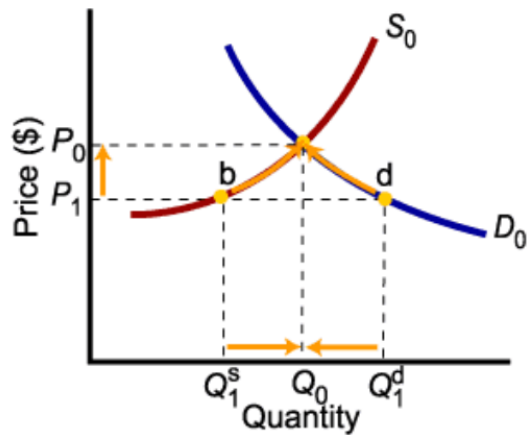


- Only in equilibrium is **quantity supplied equal to quantity demanded**.

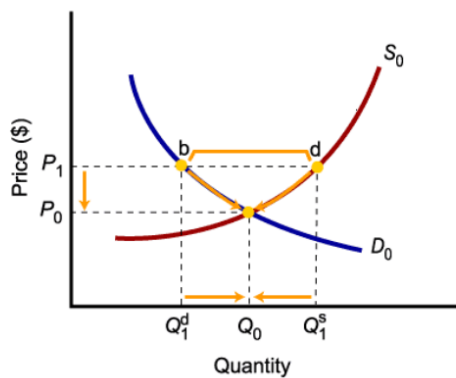
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- At any price level other than P_0 , the wishes of buyers and sellers do not coincide.

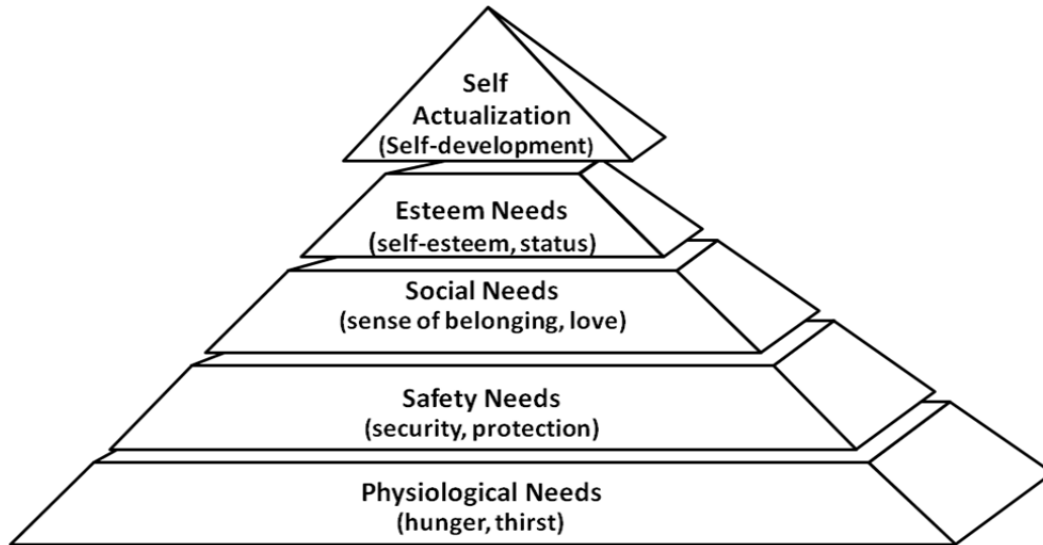
Market Disequilibria



- *Excess demand*, or shortage, is the condition that exists when quantity demanded exceeds quantity supplied at the current price.
- When quantity demanded exceeds quantity supplied, price tends to rise until equilibrium is restored.
- *Excess supply*, or surplus, is the condition that exists when quantity supplied exceeds quantity demanded at the current price.
- When quantity supplied exceeds quantity demanded, price tends to fall until equilibrium is restored.



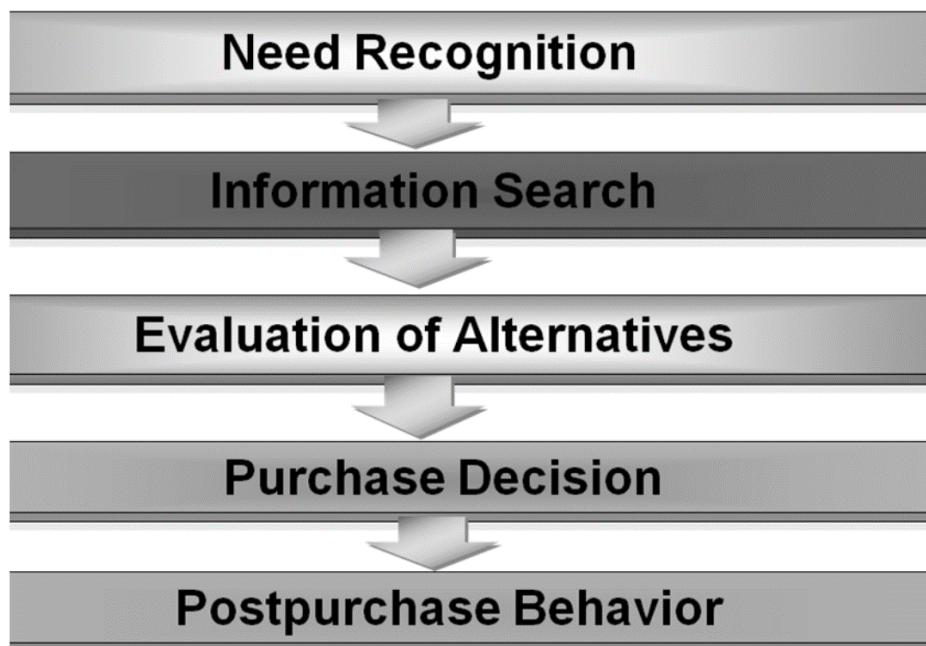
Maslow's Hierarchy of Needs



Types of Buying Decisions

	High Involvement	Low Involvement
Significant differences between brands	Complex Buying Behavior	Variety-Seeking Behavior
Few differences between brands	Dissonance-Reducing Buying Behavior	Habitual Buying Behavior

The Buyer Decision Process



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The Buyer Decision Process Step 1. Need Recognition

Need Recognition

Difference between an *actual* state and a *desired* state

Internal Stimuli

- Hunger
- Thirst
- A person's normal needs

External Stimuli

- TV advertising
- Magazine ad
- Radio slogan
- Stimuli in the environment

The Buyer Decision Process Step 2. Information Search

Personal Sources

- Family, friends, neighbors
- Most influential source of information

Commercial Sources

- Advertising, salespeople
- Receives most information from these sources

Public Sources

- Mass Media
- Consumer-rating groups

Experiential Sources

- Handling the product
- Examining the product
- Using the product

The Buyer Decision Process Step 3. Evaluation of Alternatives

Product Attributes
Evaluation of Quality, Price, & Features

Degree of Importance
Which attributes matter most to me?

Brand Beliefs
What do I believe about each available brand?

Total Product Satisfaction
Based on what I'm looking for, how satisfied would I be with each product?

Evaluation Procedures
Choosing a product (and brand) based on one or more attributes.

The Buyer Decision Process Step 4. Purchase Decision

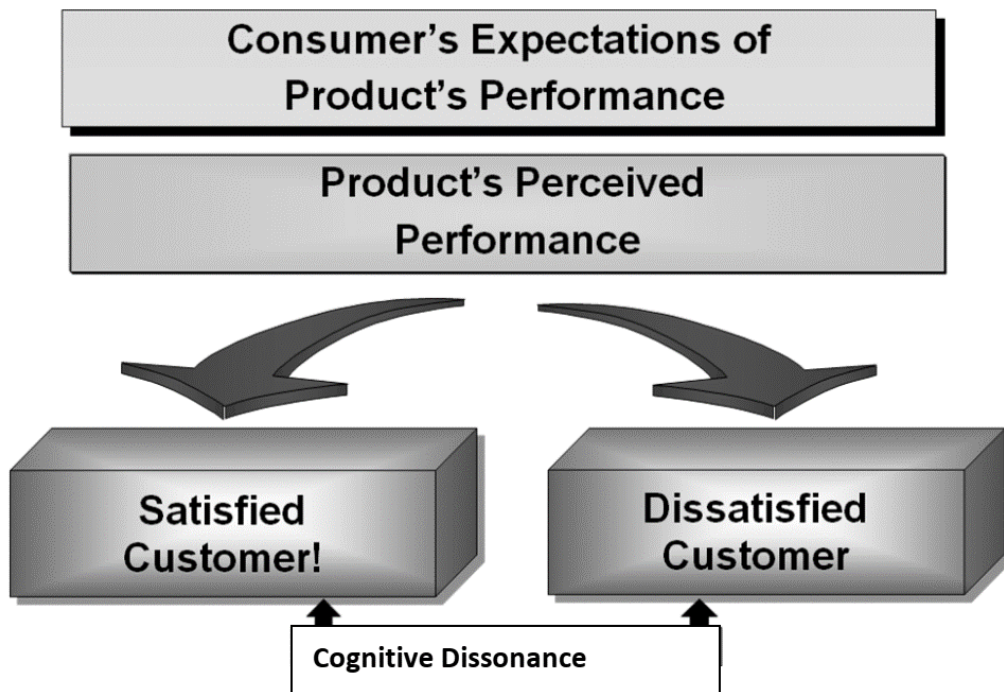
Purchase Intention
Desire to buy the most preferred brand

Attitudes
of others

Unexpected
situational
factors

Purchase Decision

The Buyer Decision Process Step 5. Post purchase Behavior



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