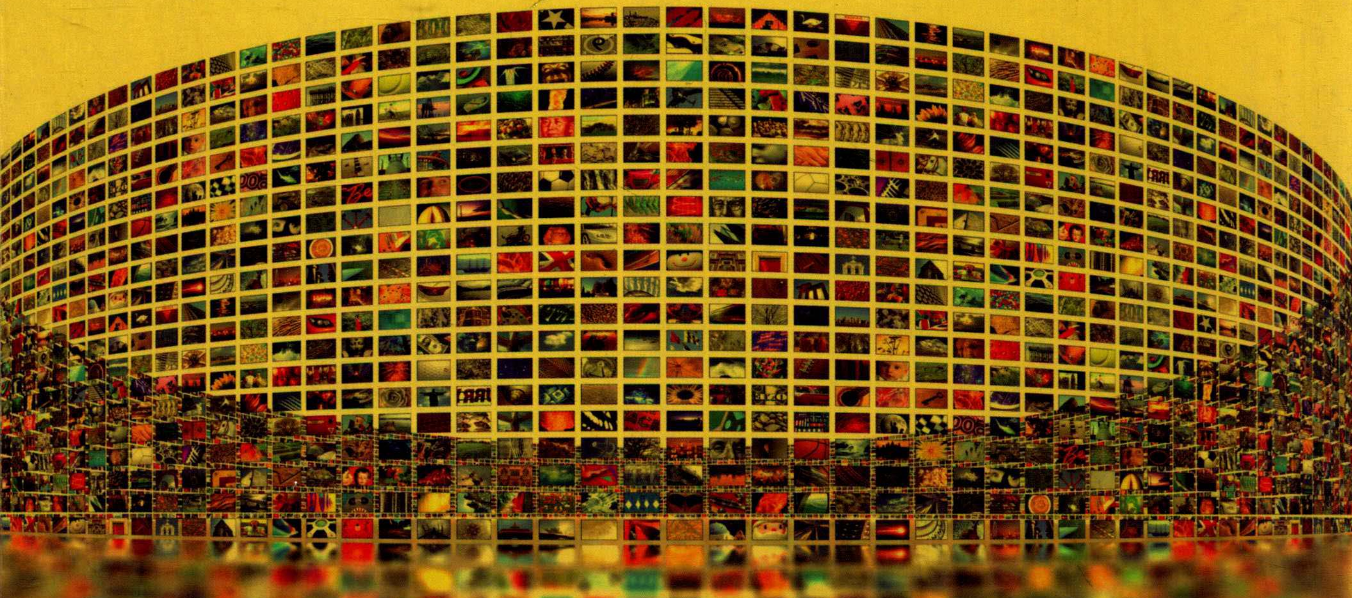
Henk Jager &
Catrinus Jepma

Second Edition



Introduction to International Economics

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Preface

The idea of producing a new introductory course on International Economics emerged from an initiative taken at the Open University of the Netherlands in the early 1990s to develop a one-year distance teaching programme in the field of International Business. As one of the introductory elements of the programme, a 100-hour course on International Economics was needed. Such a book, covering the whole area of International Economics, was difficult to find: relevant textbooks were either too long or written from the perspective of Economics rather than Business students. This prompted us to write such a book.

So the book was developed for use by students who are interested in International Economic Relations primarily from a practical, business-oriented point of view. Bearing this target group in mind, the use of mathematics was kept to a minimum, with some equations, but no mathematical derivations. Instead, a wealth of supporting figures was used to clarify the text, particularly in the section on international trade. The subject matter was often cross-disciplinary, exploring the adjacent areas of Industrial Organization and International Finance.

The book was published in 1996, both in Dutch and English. The Dutch edition, *Wereldeconomie in beeld – Inzichten in de internationale economie*, was published by Academic Service and the English edition, *Introduction to International Economics*, was published by Pearson Education. Both books were published in cooperation with the Open University of the Netherlands, in Heerlen. Over the course of the next ten years over 10,000 copies of the two books were sold.

This second edition, published by Palgrave Macmillan, has maintained all the features of the first, but tables, figures and indeed the entire text have been substantially updated and new topics added, such as currency crises, and the introduction of the euro and Euro area in 1999 and their subsequent development. Moreover, we have accepted the preferences of many readers of the previous edition to discuss the balance of payments not before but after the treatment of international trade. Compared with the first edition, the size of the book has somewhat increased, and so, while most of the chapters can be read independently of each other, this edition can be used for 100–150 hour courses.

We gratefully acknowledge the support of several people. While writing the first edition we received valuable suggestions, comments and even preliminary texts from Walter Vanthielen, Wytze van der Gaast, Alexander Mollerus and, above all, Elise Kamphuis, our co-author of that edition. Their input has also contributed to the present, second edition. The current edition has also benefitted from the indispensable work of Marius Popescu, especially in relation to the section on trade.

Finally, we would like to thank the staff of Palgrave Macmillan for their constructive support, in particular the book's editors, Jaime Marshall and Aléta Bezuidenhout, for their effective guidance and patience with us as well as their prolonged trust in this project; and Nick Brock and Elizabeth Stone for all their useful suggestions to improve the language and clarity of the text.

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Henk Jager and Catrinus J. Jepma

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Contents

List of Tables

List of Figures

CHAPTER 1

Aspects of International Economics

1.1 Introduction

Almost everyone involved in business needs to study international economics and to be aware of developments in international economic relations. Managers need to appreciate how the internationalization of economic activities can affect their companies, leading to success or failure, and students need to learn how developments on foreign markets, through processes of internationalization, can have a substantial influence on domestic markets.

Despite the impact of internationalization, domestic and international market conditions remain separate. One powerful factor is national economic identity: national governments still have a certain amount of sovereignty to carry out their own economic policies. International economics is thus a battlefield in which the forces of internationalized markets compete with national policies and/or the practice of individual businesses. On the one hand, the increasing integration of world markets tends to make national borders less significant, and this process is strengthened by international policy coordination initiatives that tend to reduce national autonomy, such as the European Union, the General Agreement on Trade in Services (GATS), the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), the Kyoto Protocol, the Association of Southeast Asian Nations (ASEAN), the North American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT)/World Trade Organization (WTO). On the other hand, many national governments are still motivated to retain as much control as possible, preferring to direct the economy using the instruments available to them, such as national policy action and the regulation of a national currency. This desire to preserve at least some national autonomy inhibits the development of a truly and completely integrated global economy.

Since the Second World War, economic relationships between regions, countries and companies have grown much closer. Internationalization has occurred in the physical world, for example in international commodity markets, in the international transfer of technology, and via the international mobility of factors of production. It has also occurred in the financial world, on the international money and capital markets. Internationalization is being supported by the progressive elimination of many kinds of barriers to trade between countries: in goods, in services and, most recently, in the international mobility of capital.

One direct result of internationalization is that entrepreneurs are increasingly aware of the opportunities of international trade and are expanding their operations outside their national borders, supported by improving transport links and communication networks. As companies establish foreign subsidiaries, form joint ventures and enter other forms of international cooperation, the level of internationalization continues growing even more.

This introductory chapter presents a detailed case study (Section 1.2) of one company, demonstrating how liberalization and deregulation increase the company's competition in its home market and examining how this company responds to these developments. In the following discussion (Section 1.3), we consider various questions of international economics that arise from the case study and illustrate the issues that are central to this book. Later chapters consider these questions in greater depth.

1.2 The company and its international environment

Globalization affects everyone, not only entrepreneurs involved in international trade who face international competition, whether directly or indirectly. Entrepreneurs who trade only in their domestic markets are undoubtedly also influenced by globalization's competitive consequences. For example, a businessman whose purchases and sales are exclusively concentrated in the home market has to take account of potential foreign competition or domestic competitors in their efforts to try to strengthen their market position by internationalization.

The following real-life case study illustrates how consumers can benefit from the processes of internationalization, while also demonstrating that internationalization and, of course, globalization, poses both threats and opportunities to the enterprise. The case study describes a business that had enjoyed a monopoly position in its home market and had been protected by government regulations, but then it lost its non-competitive position when a new government regime that favoured liberalization and internationalization came to power. Subsequently, the company faced increasing competition from foreign-owned companies. The case discusses some of the aspects of internationalization that a company is likely to encounter, and serves as a practical tool to explain the theory. The discussion here is intended as an outline only: later chapters will tackle the same questions in greater depth. After studying all the material in this book, we advise that you re-read the case study to see how your knowledge and understanding have developed.

This case study looks at the Dutch telecoms company KPN, based in The Hague. In 1995, most western telecommunication companies were still (state-owned) monopolies in their home markets. In several countries, however, governments started to challenge these telecom monopolies. Two distinct approaches were adopted: the creation of a rival to the existing company, or the fostering of competition between several companies. By 1998, very few telecom monopolies still remained in Organisation for Economic Co-operation and Development (OECD) countries, and in most countries telecom companies were facing serious competition from foreign competitors.

The case study shows how KPN, through a subsidiary called KPN Mobile, reacted to these changes, first by reorganizing itself to face increased international competition, and then taking even more aggressive strategic steps to establish itself as a major European player in the market for mobile telecoms.