

CHAPTER 2

COUNTRY DIFFERENCES IN POLITICAL ECONOMY

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Learning Objectives

1. Give examples of how the political systems of countries differ.
2. Distinguish how the economic systems of countries differ.
3. Explain how the legal systems of countries differ.
4. Explain what determines the level of economic development of a nation.
5. Summarize the main changes that are currently reshaping the political, economic, and legal systems, worldwide.
6. Describe how transition economies are moving towards market-based systems.
7. Explain the implications of changes in political economies.

Chapter Summary

This chapter focuses on how political, economic, and legal systems collectively influence a country's ability to achieve meaningful economic progress. The first half of the chapter focuses on the different political,

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economic, and legal systems that are influential in the world. It is made clear to the reader that these differences are significant, and must be clearly understood by the managers of international firms. The section that focuses on legal systems includes a discussion of intellectual property, including patents, copyrights, and trademarks. Protecting intellectual property is a particularly problematic issue in international trade. The second half of the chapter focuses on the determinants of economic development. The author makes the point that a country's political, economic, and legal systems have a direct impact on its economic potential. The importance of innovation, along with the types of systems that facilitate innovation, is discussed. Next, the author discusses the parts of the world that are transition from one political-economic ideology to another, and the implications of this changing political economy. Finally, the chapter ends with a brief discussion of ethical issues.

OPENING CASE: Ghana: An African Dynamo

Summary

The opening case describes the positive economic changes in Ghana that result from economic liberalization policies. The opening case tracks the changes within Ghana since gaining its independence from Britain in 1957 and through its progression of military coups and corruption over the ensuing decades. Political liberalization began in 1992 and from that point onwards, and up to 2010, measures were put in place to advance Ghana to its next phase of prosperity, being derived from its oil boom. Norway and Thailand's revenues laws were used as an example of ensuring that oil profits would go into a national fund as opposed to be siphoned off in corrupt practices. Part of the new development that followed these progressive measures was to embark on a national public works initiative that included a national road construction and airport on projects, and to double the country's electricity supply between 2010 and 2015.. Even though Ghana's economy is still primarily commodity-based in cocoa exports, its economy shows promise thanks to these new measures put in place.

A discussion of the case can evolve around the following questions.

1) What was the most important change since Ghana's independence that allowed it to chart long term economic success?

2)

The student can cite the political liberalization measure that came into effect in 1992 and then further discuss other areas mentioned in the case such as privatization and market-based reforms.

2) What models for a national trust did Ghana use?

The student would cite the Norwegian and Thailand models.

3) What role did Jerry Rawlings play in initiating anti-corruption measures?

The student would cite the 1982 and Jerry Rawlings popularity with the common people

because he was so anti-corruption.

Chapter Outline with Lecture Notes and Teaching Tips

INTRODUCTION

A) Different countries have different political systems, economic systems, and legal systems. Cultural practices can vary dramatically from country to country, as can the education and skill level of the population. All of these differences have major implications for the practice of international business.

B) This chapter explores how the political, economic, and legal systems of countries differ. Together these systems are known as the **political economy** of a country.

C) The opening case on changes in the political and economic systems of Ghana shows how economic reforms make a country a more attractive location for international businesses, yet problems such as poverty and inequalities of wealth may persist.

POLITICAL SYSTEMS

A) By **political system** we mean the system of government in a nation. Political systems can be assessed according to two related dimensions. The first is the degree to which they emphasize collectivism as opposed to individualism. The second dimension is the degree to which they are democratic or totalitarian.

Collectivism and Individualism

B) **Collectivism** refers to a political system that stresses the primacy of collective goals over individual goals. The modern day roots of collectivism can be traced to Marx, yet the foundations can be found in Plato's *Republic*. The general premise of collectivism is that the state must manage enterprises if they are to benefit society as a whole rather than individual capitalists.

Socialism

C) **Communists** generally believed that socialism could only be achieved through revolution and totalitarian dictatorship, while **social democrats** worked to achieve the same goals by democratic means.

D) While state owned firms might have been intended to promote the public interest, experience suggests that this isn't always the case. In many countries the performance of state owned companies has been poor. Protected from significant competition by their monopoly position, and guaranteed governmental financial assistance, many state owned enterprises have become increasingly inefficient. Thus both in former communist and Western European countries,

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previously state owned enterprises are being privatized.

Individualism

E) **Individualism** refers to a political philosophy that an individual should have freedom over his or her economic and political pursuits. In contrast to collectivism, individualism stresses that the interests of the individual should take precedence over the interests of the state.

F) Individualism, while advocated by Aristotle, in modern days was encouraged by David Hume, Adam Smith, John Stuart Mill, and most recently, Hayek and Milton Friedman. Individualism focuses on i) guaranteeing individual freedom and self-expression, and ii) letting people pursue their own self-interest in order to achieve the best overall good for society. The Canadian Charter of Rights and Freedoms or the US Declaration of Independence and the Bill of Rights embody the spirit of individualism.

G) While collectivism asserts the primacy of the collective over the individual, individualism asserts the opposite. This ideological difference shapes much of recent history and the Cold War.

Democracy and Totalitarianism

H) **Democracy** and **totalitarianism** are at different ends of a political dimension. Democracy refers to a political system in which government is by the people, exercised either directly or through elected representatives. Totalitarianism is a form of government in which one person or political party exercises absolute control over all spheres of human life, and opposing political parties are prohibited. There are four major forms of totalitarianism in the world today.

Democracy

I) Democracy in its pure state, with each individual voting on every issue, has generally been replaced by **representative democracy**, where elected representatives vote on behalf of constituents.

Totalitarianism

J) Under totalitarianism, a single political party, individual, or group of individuals monopolize the political power and do not permit opposition. There are four major forms of totalitarianism: **communist totalitarianism** (form of totalitarianism that advocates achieving socialism through totalitarian dictatorship), **theocratic totalitarianism** (form of totalitarianism in which political power is monopolized by a party, group, or individual that governs according to religious principles), **tribal totalitarianism** (form of totalitarianism found mainly in Africa in which a political party that represents the interests of a particular tribe monopolizes power), and **right wing totalitarianism** (form of totalitarianism in which individual economic freedom is allowed but individual political freedom is restricted in the belief that it could lead to communism). There has been a general trend away from communist and right wing totalitarianism and towards democracy beginning in the 1980s through the 1990s and into this decade. Issues relating to theocratic and tribal totalitarianism are presently at the root of some unrest in Asia and Africa.

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K) The political environment of a country matters because 1) when economic freedoms are restricted, so may be the ability of an international business to operate in the most efficient manner, and 2) when political freedoms are restricted there are both ethical and risk concerns that have to be considered.

ECONOMIC SYSTEMS

A) There are three broad types of economic systems: market, command, and mixed. In reality almost all are mixed to some extent, for even the most market oriented have some governmental controls on business and even the most command based either explicitly allow some free markets to exist or have black markets for some goods and services. Yet all countries can be considered to be at some point on a continuum between pure market and pure command.

Market Economy

B) In a pure **market economy**, the goods and services that a country produces, and the quantity in which they are produced, is not planned by anyone. Rather price and quantity are determined by supply and demand. For a market economy to work there must be no restrictions on either supply or demand - no monopolistic sellers or buyers.

Command Economy

C) In a pure **command economy** the goods and services that a country produces, the quantity in which they are produced, and the price at which they are sold are all planned by the government. Resources are allocated "for the good of society". The government owns most, if not all, businesses.

Mixed Economy

D) A **mixed economy** includes some elements of each. In Canada, for example, while most business is privately owned and operated under market principles, health care, electrical power, and liquor distribution are run by state owned enterprises in most provinces. Over the past few decades France has chosen to inefficiently operate many business enterprises "for the good of workers and the country," and complains vigorously to the EU when more efficient private firms from other EU countries seek to encroach on the markets these enterprises poorly serve.

LEGAL SYSTEMS

A) The **legal system** of a country refers to the rules, or laws, that regulate behaviour, along with the processes by which the laws of a country are enforced and through which redress for grievances is

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obtained.

B) The legal environment of a country is of immense importance to international business because a country's laws regulate business practice, define the manner in which business transactions are to be executed, and set down the rights and obligations of those involved in business transactions. Differences in the structure of law can have an important impact upon the attractiveness of a country as an investment site and/or market.

Teaching Tip: The Encyclopedia of Corporate Governance is an older site that contains a broad base of information about international law and the legal systems of the countries of the world. This site is available at <http://e.viaminvest.com/>

Different Legal Systems

C) The **common law** system (based on tradition, precedent, and custom) evolved in England over hundreds of years. It is now found in most of Great Britain's former colonies, including Canada (outside of Quebec) and the United States.

D) A **civil law** system is based on a very detailed set of laws organized into codes. Over 80 countries, including Canada (Quebec), Germany, France, Japan, and Russia, operate with a civil law system.

E) Islamic law is the most widely practiced **theocratic law** system (based on religious teachings) in the modern world. Many Muslim countries have legal systems that are a blend of Islamic law and a common or civil law system.

Differences in Contract Law

F) **Contract law** is the body of law that governs contract enforcement. A **contract** is a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved. The **United Nations Convention in Contracts for the International Sales of Goods (CISG)** establishes a uniform set of rules governing certain aspects of the making and performance of everyday commercial contracts between sellers and buyers who have their places of business in different nations. By adopting CISG, a nation's signals to other nations that it will treat the convention's rules as part of its law.

Property Rights

G) Control over **property rights** (the bundle of legal rights over the use to which a resource is put and over the use made of any income that may be derived from that resource) are very important for the functioning of business. Property rights can be violated by either private action (theft, piracy, blackmail, Mafia or other organized crime group) or public action (governmental bribery and corruption, nationalization).

Private Action

H) Private action refers to theft, piracy, blackmail, and the like, by private individuals or groups.

Teaching Tip: Ask your students how they would act if they were employed in the situations described in this section.

Public Action and Corruption

I) Public action to violate property rights occurs when public officials extort income or resources from property holders using various legal mechanisms including levying excessive taxation, requiring expensive licenses or permits from property holders, or taking assets into state ownership without compensating the owners.

Lecture Note: For more information visit <http://www.transparency.org/>

J) In some countries, corruption is kept to a minimum while in other corruption is rampant.

The American Foreign Corrupt Practices Act and Canadian Bill S-21

K) The **Foreign Corrupt Practices Act** makes it a violation of United States law to bribe a foreign government official in order to obtain or maintain business over which the foreign official has authority, and requires all publicly traded companies to keep detailed records so that it is clear whether a violation of the act has occurred or not. Canada's Bill S-21 makes bribery of a foreign official by a Canadian business person a criminal offence.

The Protection of Intellectual Property

L) **Intellectual property** refers to property, such as computer software, a screenplay, or the chemical formula for a new drug that is the product of intellectual activity. Intellectual Property rights include **patents** (documents giving the inventor of a new product or process exclusive rights to the manufacture, use, or sale of that invention); **copyrights** (exclusive legal rights of authors, composers, playwrights, artists, and publishers to publish and dispose of their work as they see fit); and **trademarks** (designs and names, often officially registered, by which merchants or manufacturers designate and differentiate their products).

M) The protection of intellectual property rights differs greatly from country to country. While many countries have stringent intellectual property regulations on their books, the enforcement of these regulations has often been lax. In addition to lobbying their governments, firms may want to stay out of countries where intellectual property laws are lax rather than risk having their ideas stolen by local entrepreneurs .

Teaching Tip: Lead a discussion on song and file sharing and other instances of violations of intellectual property. Is sharing a song, or piece of software with one person okay? How about with a group of friends? How about reselling these files for profit?

N) An International agreement signed by 187 countries to protect intellectual property rights is known as the **Paris Convention for the Protection of Industrial Property**. In addition, a new agreement known as the Trade Related Aspects of Intellectual Property Rights (**TRIPS**) requires WTO members to grant and enforce patents lasting at least 20 years and copyrights lasting 50 years.

Teaching Tip: The World Intellectual Property Organization's web site contains extensive information on various treaties and agreements between countries regarding the protection of intellectual property. The site is <http://www.wipo.int/about-wipo/en/what>

Product Safety and Product Liability

O) Different countries have different product safety and liability laws (safety standards to which a product must adhere). In some cases businesses must customize products to adhere to local standards if they are to do business in a country, whether these standards are higher or just different.

P) When product standards are lower in other countries, firms face an important ethical dilemma. Should they produce products only of the highest standards even if this puts them at a competitive disadvantage relative other producers and results in not maximizing value to shareholders? Or should they produce products that respond to local differences, even if that means that consumers may not be assured of the same levels of safety in different countries?

THE DETERMINANTS OF ECONOMIC DEVELOPMENT

A) One reason for looking at the different political, economic, and legal systems in the world is that collectively these different systems can have a profound impact on the level of a country's economic development, and hence on the attractiveness of a country as a possible market and/or production location for a firm.

Differences in Economic Development

B) Different countries have dramatically different levels of economic development, which can be measured in different ways.

Broader Conceptions of Development: Amartya Sen

C) Nobel prize-winning economist Amartya Sen has argued that development should be assessed less by material output and more by the capabilities and opportunities that people enjoy. Sen's ideas have been picked up by the United Nations and are reflected in the **Human Development Index (HDI)** (a United Nations developed index based on life expectancy, education attainment, and whether average incomes are sufficient to meet the basic needs of life in a country). The index was developed to gauge a country's economic development and likely future growth rate.

Political Economy and Economic Progress

D) What is the relationship between political economy and economic progress? This question has been the subject of a vigorous debate among academics and policy makers for some time.

Innovation and Entrepreneurship Are the Engines of Growth

E) Innovation is the process through which people create new products, new processes, new organizations, new management practices, and new strategies. There is broad agreement that innovation and entrepreneurship are the engines of long-run economic growth.

Innovation and Entrepreneurship Require a Market Economy

F) It has also been argued that the economic freedom associated with a market economy creates greater incentives for innovation and entrepreneurship than either a planned or mixed economy.

Innovation and Entrepreneurship Require Strong Property Rights

G) Strong legal protection of property rights is another requirement for a business environment conducive to innovation, entrepreneurship, and economic growth.

The Required Political System

H) In the West, it is often argued that democracy is good for economic growth. However, there are examples of totalitarian regimes that have fostered a market economy and strong property rights protection and experienced rapid economic growth. However, given all the facts, it seems likely that democratic regimes are far more conducive to long-term economic growth than a dictatorship, even one of the benevolent kinds.

Economic Progress Begets Democracy

I) While it is possible to argue that democracy is not a necessary precondition for the establishment of a free market economy in which property rights are protected, it seems evident that subsequent economic growth leads to establishment of democratic regimes.

Geography, Education, and Economic Development

J) Geography can also affect economic development. A landlocked country with an inhospitable climate, poor soil, few natural resources, and terrible diseases is unlikely to develop economically as fast as country with the opposite characteristics on each of these attributes.

K) While it can be hard to do much about unfavourable geography, education is something that governments can affect. Numerous studies suggest that countries that invest more in the education of their young people develop faster economically.

STATES IN TRANSITION

The Spread of Democracy

A) Since the late 1980s and early 1990s there have been two major changes in the political economy of many of the world's nations. First, a wave of democratic revolutions swept the world, and many of the previous totalitarian regimes collapsed. Secondly, there has been a move away from centrally planned and mixed economies towards free markets.

The New World Order

B) The revolutions in the USSR and Eastern Europe have (in general) moved these countries towards democracy (away from totalitarianism), towards individualism (away from collectivism), and towards mixed economies (away from command). Author Francis Fukuyama argues that we may be in a time where there is a universalization of Western liberal democracy. Political scientist Samuel Huntington argues that there is no "universal" civilization—that while societies may be modernizing, they are not becoming more Western.

The Spread of Market-Based Systems

C) There are three main reasons for the spread of democracy. First, many totalitarian regimes failed to deliver economic progress to the vast bulk of their populations. Secondly, improved information technology limited the ability of the government to control citizens' access to information. Thirdly, increases in wealth and the standard of living have encouraged citizens to push for democratic reforms.

D) In Western Europe, Asia, and Mexico there has been a general trend towards privatization of state owned companies and deregulation of industry beginning in the 1980s and extending through the 1990s and into the current decade.

Teaching Tip: A number of countries and regions maintain an international "Chamber of Commerce" to disseminate current information about their respective country or region of the world. These Chambers of Commerce are an excellent "first stop" when conducting research on the market potential of a particular country or area. Information can be found at <http://www.iccwbo.org/>

THE NATURE OF ECONOMIC TRANSFORMATION

Deregulation

A) **Deregulation** involves removing restrictions on the free operation of markets.

Privatization

B) **Privatization** transfers the ownership of state property into the hands of private investors. In order to attract investment and protect the interests of the private enterprise encouraged by the first two activities, changes typically need to be made to legal systems to protect the property rights of investors and entrepreneurs.

Legal Systems

C) Laws protecting private property rights and providing mechanisms for contract enforcement are required for a well functioning market economy. Without a **legal system** that protects property rights, and without the machinery to enforce that system, the incentive to engage in economic activity can be reduced substantially by private and public entities that expropriate the profits generated by the efforts of private sector entrepreneurs.

D) The road that must be travelled to reach a market-based economy has often turned out to be rocky. Those states that have been most successful at transforming their economies have followed a policy of “shock therapy” in which prices and trade were liberated quickly, inflation was held in check by tight monetary policy, and the privatization of state-owned industries was implemented rapidly.

IMPLICATIONS OF CHANGING POLITICAL ECONOMY

A) The shift toward market-based economies has significant implications for international business including bigger markets, but also greater risks.

IMPLICATIONS FOR BUSINESS

Attractiveness

A) The overall attractiveness of a country as a market and/or investment site depends on balancing the likely long-term benefits of doing business in that country against the likely costs and risks.

Benefits

B) The long run monetary benefits of doing business in a country are a function of the size of the market, the present wealth (purchasing power) of consumers, and the likely future wealth of consumers. By identifying and investing early in a potential future economic star, firms may be able to gain **first mover advantages** (advantages that accrue to early entrants into a market) by establishing loyalty and gaining experience in a country. Two factors that are reasonably good predictors of a country’s future economic prospects are its economic system and property rights regime.

Costs

C) The costs of doing business in a country are determined by a number of political, economic, and legal factors. Political costs can involve the cost of paying bribes or lobbying for favourable or fair treatment. Economic costs relate primarily to the sophistication of the economic system, including the infrastructure and supporting businesses. Regarding legal factors, it can be more costly to do

business in countries with dramatically different product, workplace, and pollution standards, or where there is poor legal protection for property rights.

Risks

D) As with costs, the risks of doing business in a country are determined by a number of political, economic, and legal factors. **Political risk** is the likelihood that political forces will cause drastic changes in a country's business environment that adversely affects the profit and other goals of a business enterprise. Canada has had its unified political stability tested at times over the past four decades. **Economic risk** is the likelihood that economic mismanagement will cause drastic changes in a country's business environment that adversely affects the profit and other goals of a business enterprise. **Legal risk** is the likelihood that a trading partner will opportunistically break a contract or expropriate property rights.

Overall Attractiveness

E) The overall attractiveness of a country as a potential market and/or investment site for an international business depends on balancing the benefits, costs, and risks associated with doing business in that country.

Ethics and Regulations

Ethics and Human Rights

F) One ethical concern regards whether firms should invest in countries where the government represses its citizens in political and/or economic freedom. While some argue that investing in these countries is implicitly supporting the repression, others argue that the best way to encourage change is from within, and that increasing economic development of the country will lead to greater political and economic freedoms.

Ethics and Regulations

G) A second ethical concern regards whether an international firm should adopt consistent and high levels of product safety, worker safety, and environmental protection worldwide, or whether they should focus only on meeting local regulations. If they adopt high standards, and subsequently lose business to other competitors with lower standards, was this an ethically correct position for it to take in light its requirements to act in the best interest of shareholders and provide advancement opportunities for its personnel?

Ethics and Corruption

H) Another ethical concern regards whether firms should pay bribes to governmental officials or business partners in exchange for business access. Should paying bribes be completely avoided, or are bribes just another cost of doing business that "greases the wheels" and leads to benefits for both the firm and consumers. If bribes are an integral part of business transactions in a country, is a firm being culturally insensitive and elitist if it finds bribes repulsive and refuses to pay them? Are

large campaign contributions in the USA any different than bribes in reality?

Teaching Tip: The Carnegie Council for Ethics and International Affairs maintains a very substantive and thought-provoking website at <http://www.carnegiecouncil.org/index.html>. This site contains publications that comments on many of the ethical issues that surround globalization and international business.

LEARNING OBJECTIVES SUMMARY

1. Political systems can be assessed according to two dimensions: the degree to which they emphasize collectivism vs individualism, and the degree to which they are democratic or totalitarian.
2. There are three broad types of economic systems: a market economy, a command economy, and a mixed economy.
3. Differences in the structure of law between countries has implications for international businesses. This includes the degree to which property rights are protected, product safety and liability laws, and the nature of contract law.
4. Countries differ in their level of development. Economic progress is tied to a well-functioning market economy that protects property rights.
5. Many countries are now in a transition state. There has been a shift away from totalitarian governments and command or mixed economic systems towards democracy and free market economic systems.
6. The shift to market economies needs deregulation, privatization, and the creation of a legal system that protects property rights.
7. A country's attractiveness depends on balancing the likely long-run benefits of doing business there against the likely costs and risks.

Critical Thinking and Discussion Questions

1. "Free market economies stimulate greater economic growth, whereas command economies stifle growth". Evaluate this statement.

Answer: In a market economy, private individuals and corporations are allowed to own property and other assets. This right of ownership provides a powerful incentive for people to work hard, introduce new products, develop better advertising campaigns, invent new products, etc., all in the hopes of accumulating additional personal capital and wealth. In turn, the constant search on the part of individuals and corporation to accumulate wealth enriches the entire economy and creates economic growth. In contrast, in a command economy, private individuals and corporations are not allowed to own substantial quantities of property and other assets. The objective of a command economy is for everyone to work for "the good of the society." Although this sounds like a noble ideal, a system that asks individuals to work for the good of society rather than allowing individuals to build personal wealth does not provide a great incentive for people to invent new products, develop better advertising campaigns, find ways to be more efficient, etc.

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As a result, command economies typically generate less innovation and are less efficient than market economies.

2. "A democratic political system is an essential condition for sustained economic progress". Evaluate this statement.

Answer: This question has no clear-cut answer. In Canada and the United States, we tend to argue that democracy is good for economic progress. This argument is largely predicated upon the idea that innovation is the engine of economic growth, and a democratic political system encourages rather than stifles innovation. However, there are examples of totalitarian regimes that have fostered a market economy and strong property rights protection and experienced rapid economic growth. The examples include four of the fastest growing economies of the past 30 years – South Korea, Taiwan, Singapore, and Hong Kong – all of which have grown faster than Western economies. However, while it is possible to argue that democracy is not a necessary precondition for the establishment of a free market economy, it seems evident that subsequent economic growth leads to establishment of democratic regimes. Several of the fastest-growing Asian economies have recently adopted more democratic governments.

3. What is the relationship between corruption in a country (i.e., bribe taking by government officials) and economic growth? Is corruption always bad?

Answer: Economic evidence suggests that high levels of corruption significantly reduce the economic growth rate in a country. By siphoning off profits, corrupt politicians and bureaucrats reduce the returns to business investment, and hence, reduce the incentive that both domestic and foreign businesses have to invest in that country. The lower level of investment that results has a negative impact on economic growth. However, while most students will probably agree that corruption is bad, some may point out that the Canadian Bill S-21 and the U.S. Foreign Corrupt Practices Act, does allow “grease payments” to expedite or secure the performance of a routine governmental action. These “grease payments”, while technically bribes, are not being used to obtain or maintain business, but rather are simply made to facilitate performance of duties that the recipients are already obligated to perform.

4. The Nobel prize-winning economist Amartya Sen argues that the concept of development should be broadened to include more than just economic development. What other factors does Sen think should be included in an assessment of development? How might adoption of Sen’s views influence government policy? Do you think Sen is correct that development is about more than just economic development? Explain.

Answer: Sen has argued that development be assessed less by material output measures such as GNP per capita, and more by the capabilities and opportunities that people enjoy. Sen suggests that development be seen as a process of expanding real freedoms that people experience, and as such, that development requires the removal of major impediments to freedom. Governments influenced by Sen might ensure that basic health care and education programs are available especially for women. Many students will agree with Sen and the notion that development is not just an economic process, but a political one too, and that to succeed citizens must be given a voice in the important decisions made for the country.

5. During the late 1980s and early 1990s China was routinely cited by various international organizations such as Amnesty International and Freedom Watch for major human rights violations, including torture, beatings, imprisonment and executions of political dissidents. Despite this, in the mid-1990s China received record levels of foreign direct investment, mainly from firms based in democratic societies such as the United States, Japan, and Germany. Evaluate this trend from an ethical perspective. If you were the CEO of a firm that had the option of making a potentially very profitable investment in China, what would you do?

Answer: While there are those who argue that investing in totalitarian countries provides comfort to dictators and can help prop-up repressive regimes, in the case of China these arguments appear to have been ineffective. Western firms have continued to invest in spite of these concerns, either out of opportunism or a belief in a different ethical perspective. The alternate ethical perspective suggests that investment by a Western firm, by raising the level of economic development of a totalitarian country, can help change it from within. Since economic well-being and political freedoms often go hand in hand, and investment creates jobs and provides needed goods for individuals, an investment may be good for the people both in the short and the long run. As the CEO of a firm that had the option of making a potentially very profitable investment in China, not only should this ethical tradeoff be considered, but also so should the importance of the opportunity and the ethical responsibility one has to shareholders. If there are opportunities in China, passing these up may simply be allowing a competitor to gain a first mover advantage that will be difficult to overcome. Unless all potential competitors from all countries have the same ethical principles, it is likely that some firm will decide to undertake the investment in spite of the ethical concerns. (Investment withholding, like any other form of collusion or sanction adherence, requires compliance by all parties if it is to be effective.) Hence the CEO must consider the ethical responsibility to shareholders to maximize the value of the firm. In the end the decision must rest on both ethical concerns about doing business in China and ethical concerns about what is in the best interest of shareholders. There is no right or wrong decision, as each involves different tradeoffs.

6. You are the CEO of a company that has to choose between making a \$100 million investment in either Russia or the Czech Republic. Both investments promise the same long-run return, so your choice of which investment to make is driven by considerations of risk. Assess the various risks of doing business in each of these nations. Which investment would you favour and why?

Answer: When assessing the risks of investment, one should consider the political, economic, and legal risks of doing business in either Russia or the Czech Republic. The risk in Russia would probably be considered higher than the risk in the Czech Republic. The Czech Republic has been accepted as a member of the EU, and as such gains the benefits and stability offered by the EU. Russia, by contrast, is still many years away from even being in a position to be considered by the EU for membership. However, the political situation in these countries is ever-changing, so depending on when you use this text, this situation could be different.

(You also may want to substitute other countries into this question depending on current events and the countries with which you feel your students will be most familiar.)

CLOSING CASE:

The Polish Surprise

This case explains the success of Poland in the post-communist era with the help of its inclusion into the European Union and the Polish Government's recognition of the importance of creating favourable tax laws and providing people with various incentives including the possibility for Poles to exchange old cars for new cars, and thus help the growing Polish automotive industry. Throughout the worldwide debt crisis of 2008-2009, Poland stayed the course and stuck to fiscal austerity measures, thus creating confidence in its economy both at home and abroad. By adhering to its tight monetary policy, Poland avoided many of the economic pitfalls felt by other nations around the world who spent, instead of reined in spending. Also, tax reductions are being implemented along with various laws such as the Entrepreneurship Law of March, 2009 that encourages business startups.

Case Discussion Questions

1. How was Poland able to avoid the worst effects of the economic crisis that gripped most of Europe during 2008–2009?

Through measures of austerity complemented by favourable tax laws providing incentives.

2. What lessons can be derived from the Polish experience during 2008–2009?

The general idea is the spending does not boost confidence in the economy. In Poland's case, austerity is what kept its growth intact.

3. From the perspective of international business, what is attractive about the Polish economy? What are the weaknesses and risks associated with doing business there?

Its stability is a major positive factor. The student can consult numerous web sites to further discuss this, such as www.doingbusiness.org. Some weaknesses that have surfaced in 2014 and yet that have only worried Poland – but not impacted it, are old concerns about Soviet hegemony, that has split apart Ukraine.

4. Even though Poland has been committed to liberalizing its economy since the collapse of communism in 1989, significant vestiges of the old system still remain. Why do you think it has taken Poland so long to transform its economic, political and legal system?

The “old guard” might still be reticent to change. The student can also site historical differences between capitalism and communism and the difficulty in purging communism to make way for capitalism.

COUNTRY FOCUS

Venezuela After Chavez

Venezuela watchers often lamented over the state of Venezuela under Chavez until they realized how much worse the current president, Maduro is than Chavez was. It initially appeared that Maduro was toning down anti American Rhetoric, but in some circles, many fear that he is more anti-American than was Chavez.

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State run policies have run from socialism to extreme socialism under the stewardship of Maduro. Venezuela being an oil producing country coupled with a communist style state run economy was unable to weather the economic storm created by and was severely impacted by a collapse in world oil prices in the early 2000s. Chavez had set the ground work for further socialization when he sought to strengthen presidential powers and Maduro has gone even further. Freedom House, which assesses political and civil liberties worldwide, concluded that Venezuela was only partly free with its freedoms being increasingly curtailed as it moved towards further totalitarianism. In spite of government rhetoric of openness, Transparency International, which ranks nations according to the extent of their public corruption, has noted an increase under Maduro and Venezuela is ranked in the 160th out of 177 ranked nations, as the most corrupt nation in the world.

QUESTIONS;

1. What do you think will happen if oil prices continue to stay below the \$100 a barrel mark?
 2. The student should hone in on the logic that as Venezuela's mismanaged economy is mostly dependent on oil exports, lower prices will exacerbate already extreme social problems in Venezuela.
2. What are the broader implications to the country's economy, and its people, of having such a highly regulated economy for over 15 years?

One could infer that entrepreneurial initiatives for business startups will be squelched through heavy-handed socialist mentality policies that are anti-business. Poverty, corruption and crime will likely rise as poverty increases.

Management Focus: Governments Growing to Love and Hate Gambling

Summary

For many years, gambling was illegal in North America, outside of Nevada. Beginning in the 1970s, governments became attracted to the potential revenue from legal gambling. While casino gambling grew in Canada and the United States in the late 1980s and 1990s, the rise of the Internet created some new issues around the legality of on-line gaming that is offered to Canadians by a company that is located somewhere else. CryptoLogic Inc. is a Canadian company that until very recently software for the Internet gambling industry. While the market for on-line gambling certainly exists, the company faces issues of an evolving regulatory environment, especially with legal changes that severely limited on-line gaming in the United States in 2006. The company moved its headquarters to gaming-friendly Ireland, but it continued to struggle and was bought out in 2013.

Questions

1. Laws that change or are unclear are always a problem for companies, especially laws that strike at the very legality of the company doing business, as is the case here. Obviously, getting legal opinions for legal firms operating in the country in which the firm will be dealing is important. The students may also note the importance of keeping up to date on political and public opinion, in

order to gauge whether any new laws may be implemented or changed. Businesses can also lobby governments for laws that are favourable to their operations.

2. Governments would have shifting laws about gambling because public opinion is so divided/has changed so much in the past. Gambling was once seen as a vice, and was therefore outlawed, except for certain jurisdictions. It was then promoted by governments as a way to raise tax revenue, and public opinion shifted. It can be argued by the students, that public opinion is shifting again against gambling, as jurisdictions (such as Toronto) vote against the construction of a new casino, as the economic benefits of gambling are questioned and as the social costs are more readily understood.

Management Focus: Starbucks Wins Key Trademark Case in China

Summary

When Starbucks expanded into China it was faced with copycat firms that duplicated the company's name and its format. Starbucks sued in Chinese court, and in 2006 A Shanghai court ruled in Starbucks favour. This ruling came as a (good) surprise to Starbucks because foreign companies oftentimes felt that Chinese law was a farce in these matters. The outcome of this judicial ruling reassured foreign businesses and proved to the world that China is a serious and law abiding member of the WTO, at least in this matter.

Questions

1. Such a ruling is likely to be beneficial to the Chinese economy, as it stresses the importance of the rule of law in the country. This lessens political risk for all existing and future companies in China.
2. Students may give many examples of logos that define a company, such as the Nike "Swish", McDonalds "Golden Arches" and the logos of clothing companies such as Polo and Lacoste.

Additional Readings and Sources of Information

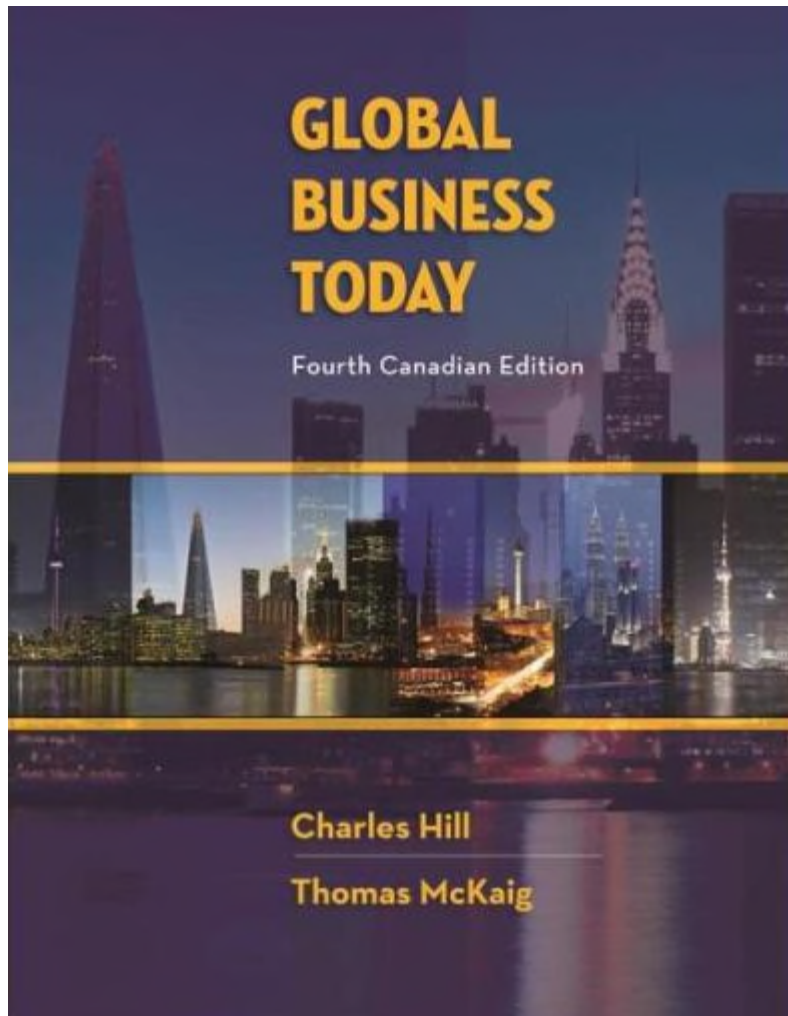
Fairtrade Canada:
<http://fairtrade.ca/>

Index of Economic Freedom
<http://www.heritage.org/index/>

World News Report

http://world.einnews.com/all_countries

World Economic Forum:
<http://www.weforum.org/>



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Country Differences in Political Economy



Chapter 2



Country Differences



International business is much more complicated than domestic business because countries differ in many ways

Country Differences



Countries have different

- political,
- economic,
- and legal systems.

Cultural practices can vary dramatically from country to country, as can the education and skill level of the population.

Countries are at different stages of economic development.

Country Differences



- This chapter focuses on how the political, economic, and legal systems of countries differ.
- Collectively we refer to these systems as constituting the political economy of a country.

Country Differences

interact
economy
economic
influence
independent
political

- We use the term political economy to stress that the political, economic, and legal systems of a country are not independent of each other.
- They interact and influence each other, and in doing so, they affect the level of economic wellbeing in a country.

Political Systems

- **Collectivism**

Political system that stresses the primacy of collective goals over individuals goals.

Plato (427–347 BC) – *Individual rights should be sacrificed for the good of society.*

Socialism :

1. Communism – revolution and totalitarian dictatorships
2. Social Democrats – socialism by democratic means



Political Systems

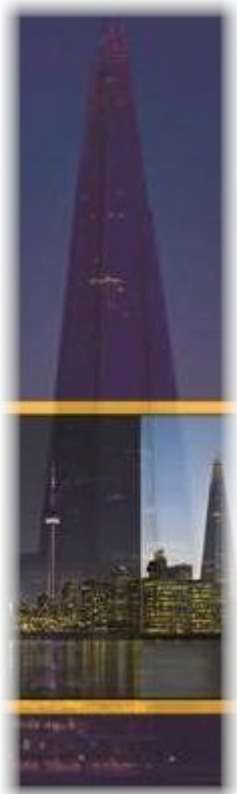
- **Individualism**

Political system that focuses on the interests of the individual over the interests of the state.

Aristotle (384 – 322 BC) – *Private property is more highly productive than communal property and will thus stimulate progress*

Individualism has two central tenets:

1. Individual Freedom and self-expression – John Stuart Mill
2. Let people pursue their own economic self interest – Adam Smith



Democracy and Totalitarianism



- **Democracy**

Political system in which the people elect representatives to form the government .

Democracy demands:

1. Freedom of expression
2. Free media
3. Regular elections
4. Limited terms for representatives
5. Fair court system
6. Non political – police and army

Democracy and Totalitarianism

- **Totalitarianism**

Political system based on collectivism, which advocates that socialism can be achieved only through a totalitarian dictatorship.



Economic Systems

- **Market Economy**

Economic system in which the interaction of supply and demand determines price and production

- **Command Economy**

Economic system in which the government determines the allocation of resources including the determination of production and prices

- **Mixed Economy**

Economic system in which certain sectors are left to private ownership and free market mechanism, while other sectors are owned and managed by the government

Legal Systems

Legal systems refers to the rules or laws that regulate people's behavior and business practices.

Types of legal systems:

1. Common Law
2. Civil Law
3. Theocratic Law



City Hall, Toronto, with the author of these ppt slides, Tim Richardson

Contracts



Definition of Contract:

Contract is a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved.

- **Contract Law**
- **International Trade and Contract Disputes**

United Nations Convention of Contracts for the International Sale of Goods (CISG)

By adopting the CISG, a nation accepts to treat the convention rules as part of its law.

Property Rights



Property

Refers to a resource over which an individual or business holds a legal title, meaning it owns the resource.

Resources include:

- Land & real estate
- Equipment
- Capital
- Mineral rights
- Businesses
- Intellectual property

Property Rights



Property Rights

Bundle of legal rights over the use to which a resource is put and over the use made of any income that may be derived from that resource.

Actions against Property Rights



1. Private Action

Private Action is an action by private individuals or groups against property holders including actions such as:

- Theft
- Piracy
- Blackmail
- Any criminal activity against property rights

Actions against Property Rights



2. Public Action and Corruption

Public Action violates property rights when public officials extort income from property holders, including actions such as:

- Bribes
- Levying excessive taxation
- Requiring expensive licenses or permits from property holders

Corruption Perceptions Index 2013

RANK	COUNTRY	SCORE	SURVEYS USED	CI: LOWER	CI: UPPER	2012 SCORE
1	Denmark	91	7	87	95	90
1	New Zealand	91	7	87	95	90
3	Finland	89	7	86	92	90
3	Sweden	89	7	85	93	88
5	Norway	86	7	82	90	85
5	Singapore	86	9	82	90	87
7	Switzerland	85	6	81	89	86
8	Netherlands	83	7	80	86	84
9	Australia	81	8	79	83	85
9	Canada	81	7	77	85	84
11	Luxembourg	80	6	75	85	80
12	Germany	78	8	74	82	79
12	Iceland	78	6	73	83	82
14	United Kingdom	76	8	74	78	74
15	Barbados	75	3	63	87	76
15	Belgium	75	7	71	79	75
15	Hong Kong	75	8	71	79	77



Source: Data taken from 2013 Corruption Perceptions Index. © Transparency International. All rights reserved. For more information, please see <http://www.transparency.org/>

Corruption

- Canada's Bill S-21
 - Otherwise known as the Corruption of Foreign Public Officials Act that entered into force in 1999
- It has long been illegal to bribe officials in Canada
- Now it is illegal for Canadian officials to bribe officials in another country

Corruption

- Canada's Bill S-21
- The Canadian Bill S-21 does have “loophole” provisions to cover for those instances in which a bribe might be solely a perception, due to cultural considerations of gift giving, in other countries
- Bill S-21 sets out a lawful exception that an accused could use as a defence. Namely, that the payment was lawful in the foreign state or public international organization for which the foreign public official performs duties or functions

The Protection of Intellectual Property

Intellectual Property

Refers to property that is the product of intellectual activity such as computer software, music, formulas etc.

Ownership rights are establish through:

1. Patents
2. Copyrights
3. Trademarks

Paris Convention for the Protection of Industrial Property

International agreement signed by 96 nations to protect intellectual property

Trade Related Aspects of Intellectual Property Rights (TRIPS)

TRIPS Agreement (1995)

Agreement amongst member states of the World Trade Organization (WTO) to oversee the enforcement of stricter intellectual property regulations.



A security guard stands near a pile of pirated CDs and DVDs before they were destroyed at a ceremony in Beijing on Saturday, February 26, 2005. Thousands of pirated items were destroyed in the event, one of a number of activities, including an antipiracy pop concert later Saturday, that were staged by China's government to publicize its antipiracy efforts. © ChinaPhotoPress/Getty Images

Product Safety and Product Liability

- **Product Safety Laws** set safety standards to which products must adhere, where it is going to be commercialized.
- **Product Liability** involves holding a firm and its officers responsible when a product causes injury, death or damage

Determinants of Economic Development

The political, economic, and legal systems can have a profound impact on a country's economic development.

Gross National Income (GNI) Total income of all citizens of a country.

Purchasing Power Parity (PPP) Adjustment in gross domestic product per capita for a comparison of living standards in different countries.

Gross national income per capita 2012, Atlas method and PPP

RANKING	ECONOMY	ATLAS METHODOLOGY		RANKING	ECONOMY	PURCHASING POWER PARITY (INTERNATIONAL DOLLARS)
		(US DOLLARS)				
1	Monaco	— ^a		3	Qatar	84 670 ^a
2	Liechtenstein	— ^a		5	Macao SAR, China	68 710 ^a
3	Bermuda	106 920 ^a		6	Norway	64 030
4	Norway	98 860		7	Luxembourg	63 000
5	Switzerland	82 730		8	Singapore	61 100
6	Qatar	78 720 ^a		10	Switzerland	54 870
7	Luxembourg	76 960		12	Hong Kong SAR, China	53 050
8	Isle of Man	— ^a		15	United States	50 610
9	Channel Islands	— ^a		16	Kuwait	49 230 ^a
10	Denmark	59 770		20	Netherlands	43 360
11	Australia	59 570		21	Austria	43 220
12	San Marino	—		22	Australia	43 170
13	Macao SAR, China	55 720 ^a		23	Sweden	43 160
14	Sweden	56 210		24	United Arab Emirates	42 380 ^{a, b}
15	Cayman Islands	— ^a		25	Canada	42 690
16	Faeroe Islands	— ^a		26	Denmark	42 620
17	Canada	50 970		28	Germany	41 370

Human Development Index (HDI)

Human Development Index (HDI) measures the quality of human life in different countries in terms of:

1. Life expectancy
2. Education attainment
3. Average incomes

based on three measures:

- Life expectancy at birth (which is a function of health care)
- Educational attainment (which is measured by a combination of the adult literacy rate and enrolment in primary, secondary, and tertiary education), and whether
- Average incomes, based on PPP estimates, are sufficient to meet the basic needs of life in a country (adequate food, shelter, and health care).

Innovation and Entrepreneurship

- Innovation and entrepreneurial activity are the engines of long-run economic growth
- Innovation is also seen as the product of entrepreneurial activity



Innovation and Entrepreneurship

- Innovation and entrepreneurial activity require strong property rights
 - If you invent something, people should not be able to copy it and make money off of you
- Without strong property rights protection, businesses and individuals run the risk that the profits from their innovative efforts will be expropriated

Political Economy and Economic Progress



Innovation and Entrepreneurship are the engines of growth. For this purpose, these are needed:

- 1. Market economy**
- 2. Strong property rights**
- 3. Political system**

The Spread of Democracy

Criteria to determine political freedom:

- Free and fair elections of the head of state and legislative representatives.
- Fair electoral laws, equal campaigning opportunities, and fair polling.
- The right to organize into different political parties.
- A parliament with effective power.
- A significant opposition that has a realistic chance of gaining power.
- Freedom from domination by the military, foreign powers, totalitarian parties, religious hierarchies, or any other powerful group.
- A reasonable amount of self-determination for cultural, ethnic, and religious minorities.

Source:
Freedom House, Freedom in the World, 2008,

The Spread of Democracy



Source: www.freedomhouse.org

The Spread of Market-Based Systems

Paralleling the spread of democracy since the 1980s has been the transformation from centrally planned command economies to market-based economies.



More than 30 countries that were in the former Soviet Union or the Eastern European communist bloc are now changing their economic systems.

Global Economic Freedom

2014 Index of Global Economic Freedom

RANK	COUNTRY	OVERALL	CHANGE
FREE (100–80)			
1	<i>Hong Kong</i>	90.1	+0.8 ^
2	<i>Singapore</i>	89.4	+1.4 ^
3	<i>Australia</i>	82.0	-0.6 v
4	<i>Switzerland</i>	81.6	+0.6 ^
5	<i>New Zealand</i>	81.2	-0.2 v
6	<i>Canada</i>	80.2	+0.8 ^
MOSTLY FREE (79.9–70)			
7	<i>Chile</i>	78.7	-0.3 v
8	<i>Mauritius</i>	76.5	-0.4 v
9	<i>Ireland</i>	76.2	+0.5 ^
10	<i>Denmark</i>	76.1	0.0 —
11	<i>Estonia</i>	75.9	+0.6 ^
12	<i>United States</i>	75.5	-0.5 v
13	<i>Bahrain</i>	75.1	-0.4 v
14	<i>United Kingdom</i>	74.9	+0.1 ^
15	<i>The Netherlands</i>	74.2	+0.7 ^
REPRESSED (49.9–0)			
163	<i>Uzbekistan</i>	46.5	+0.5 ^
164	<i>Kiribati</i>	46.3	+0.4 ^
165	<i>Solomon Islands</i>	46.2	+1.2 ^
166	<i>Argentina</i>	44.6	-2.1 v
167	<i>Chad</i>	44.5	-0.7 v
168	<i>Equatorial Guinea</i>	44.4	+2.1 ^
169	<i>Republic of Congo</i>	43.7	+0.2 ^

Source: <http://www.heritage.org/research/>

The Spread of Market-Based Systems

Deregulation involves removing legal restrictions to the free play of markets, the establishment of private enterprises, and the manner in which private enterprises operate.



The Spread of Market-Based Systems

Hand in hand with deregulation has come a sharp increase in privatization. Privatization transfers the ownership of state property into the hands of private individuals, frequently by the sale of state assets through an auction



The Spread of Market-Based Systems

Legal Systems

Laws protecting private property rights are required for a well-functioning market economy.



The Spread of Market-Based Systems

Paralleling the spread of democracy since the 1980s has been the transformation from centrally planned command economies to market-based economies.



More than 30 countries that were in the former Soviet Union or the Eastern European communist bloc are now changing their economic systems.



The overall attractiveness of a country as a market and/or investment site depends on balancing the likely long-term benefits of doing business in that country against the likely costs and risks.



In the following slides we consider the
determinants of
benefits,
costs,
and risks.

Benefits

In the most general sense, the long-run monetary benefits of doing business in a country are a function of the

- size of the market,
- the present wealth (purchasing power) of consumers in that market,
- and the likely future wealth of consumers



Benefits

- First-mover advantages are the advantages that accrue to early entrants into a market.
- Late-mover disadvantages are the handicap that late entrants might suffer



Costs

- A number of political, economic, and legal factors determine the costs of doing business in a country.
- With regard to political factors, the costs of doing business in a country can be increased by a need to pay off the politically powerful to be allowed by the government to do business.



Costs

- One of the most important variables is the sophistication of a country's economy.
- It may be more costly to do business in relatively primitive or undeveloped economies because of the lack of infrastructure and supporting businesses.



Risks

- Risks of doing business in a country are determined by a number of
 - political,
 - economic,
 - and legal factors.

Political risk has been defined as the likelihood that political forces will cause drastic changes in a country's business environment that adversely affect the profit and other goals of a particular business enterprise.

Risks

Economic risk can be defined as the likelihood that economic mismanagement will cause drastic changes in a country's business environment that adversely affect the profit and other goals of a particular business enterprise

Risks

Legal risk might be defined as the likelihood that a trading partner will opportunistically break a contract or expropriate property rights

The overall attractiveness of a country as a potential market and/or investment site for an international business depends on balancing the benefits, costs, and risks associated with doing business in that country.

Country Differences – Ethics

Country differences give rise to some important and contentious ethical issues.

Three important issues that have been the focus of much debate in recent years are

- (1) the ethics of doing business in nations that violate human rights;
- (2) the ethics of doing business in countries with very lax labour and environmental regulations; and
- (3) the ethics of corruption





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Slide 6 “Wordle” created by Tim Richardson

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