

# International Business 7e

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## Chapter 2

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# National Differences in Political Economy

# Political Systems

❖ The **political economy** of a nation refers to how the political, economic, and legal systems of a country are interdependent; they interact and influence each other, and in doing so they affect the level of economic well-being

# Political Systems

❖ **Political system** refers to the system of government in a nation

Political systems can be assessed according to two dimensions

❖ the degree to which they emphasize collectivism as opposed to individualism

❖ the degree to which they are democratic or totalitarian

# Collectivism And Individualism

- ❖ **Collectivism** refers to a political system that stresses the primacy of collective goals over individual goals
- ❖ Collectivism can be traced back to the Greek philosopher, Plato (427-347 BC), but in modern times, collectivism is equated with socialists

# Collectivism And Individualism

- ❖ **Socialists** advocate state ownership of the basic means of production, distribution, and exchange
- ❖ State-owned enterprises are managed to benefit society as a whole, rather than individual capitalists

In the early 20<sup>th</sup> century, socialism split into:

- ❖ **Communism** – socialism can only be achieved through violent revolution and totalitarian dictatorship
- ❖ **Social democrats** – socialism is achieved through democratic means

# Classroom Performance System

A political system that stresses the primacy of collective goals over individual goals is called

- a) individualism
- b) collectivism
- c) a democracy
- d) a market economy

# Collectivism And Individualism

- ❖ By the mid-1990s, communism was in retreat worldwide
- ❖ Social democracy is also retreating as many countries move toward free market economies
- ❖ State-owned enterprises have been privatized



# Classroom Performance System

\_\_\_\_\_ believe (s) that socialism can only be achieved through violent revolution and totalitarian dictatorship.

- a) communists
- b) social democrats
- c) social republicans
- d) Plato

# Collectivism And Individualism

- ❖ **Individualism** refers to philosophy that an individual should have freedom in his own economic and political pursuits
- ❖ Individualism can be traced to Greek philosopher, Aristotle (384-322 BC), who argued that individual diversity and private ownership are desirable
- ❖ Under individualism, individual economic and political freedoms are the ground rules on which a society should be based
- ❖ More practically, individualism means democratic political systems and free market economies

# Democracy And Totalitarianism

- ❖ **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 prohibits opposing political parties
- ❖ Democracy is usually associated with individualism and communism is usually associated with collectivism and totalitarianism

# Democracy And Totalitarianism

- ❖ Pure democracy is based on the belief that citizens should be directly involved in decision making
- ❖ Most modern democratic states practice **representative democracy** where citizens periodically elect individuals to represent them

# Classroom Performance System

A form of government in which one person or political party exercises complete control over all spheres of human life and prohibits opposing political parties is

- a) a democracy
- b) a representative democracy
- c) totalitarianism
- d) socialism

# Democracy And Totalitarianism

There are four major forms of totalitarianism:

- ❖ **Communist totalitarianism** – found in states where the communist party monopolizes power
- ❖ **Theocratic totalitarianism** - found in states where political power is monopolized by a party, group, or individual that governs according to religious principles
- ❖ **Tribal totalitarianism** - found in states where a political party that represents the interests of a particular tribe monopolizes power
- ❖ **Right-wing totalitarianism** - permits some individual economic freedom, but restricts individual political freedom

# Classroom Performance System

\_\_\_\_\_ is found in states where political power is monopolized by a party according to religious principles.

- a) tribal totalitarianism
- b) right-wing totalitarianism
- c) theocratic totalitarianism
- d) communist totalitarianism

# Economic Systems

- ❖ Political ideology and economic systems are connected
- ❖ In countries where individual goals are emphasized free market economies are likely

There are three types of economic systems:

- ❖ market economies
- ❖ command economies
- ❖ mixed economies



# Market Economy

- ❖ In a **market economy** all productive activities are privately owned and production is determined by the interaction of supply and demand
- ❖ The role of government is to encourage free and fair competition between private producers

# Command Economy

- ❖ In a **command economy**, the government plans the goods and services that a country produces, the quantity that is produced, and the prices as which they are sold
- ❖ All businesses are state-owned, and governments allocate resources for “the good of society”
- ❖ However, because there is little incentive to control costs and be efficient, command economies tend to stagnate

# Mixed Economy

- ❖ In a **mixed economy**, certain sectors of the economy are left to private ownership and free market mechanisms while other sectors have significant state ownership and government planning
- ❖ Governments tend to own firms that are considered important to national security

# Classroom Performance System

In which type of economic system are all productive activities privately owned?

- a) a mixed economy
- b) a command economy
- c) a representative economy
- d) a market economy

# Legal Systems

❖ The **legal system** of a country refers to the rules that regulate behavior along with the processes by which the laws are enforced and through which redress for grievances is obtained

There are three types of legal systems:

- ❖ **Common law** - based on tradition, precedent, and custom
- ❖ **Civic law** - based on detailed set of laws organized into codes
- ❖ **Theocratic law** - law is based on religious teachings

# Classroom Performance System

Which type of law is based on tradition, precedent, and custom?

- a) civil law
- b) common law
- c) theocratic law
- d) contract law

# Differences In Contract Law

- ❖ Depending on the legal system, contracts are approached in different ways
- ❖ 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
- ❖ **Contract law** is the body of law that governs contract enforcement

# Differences In Contract Law

- ❖ Under a common law system, contracts tend to be very detailed with all contingencies spelled out
- ❖ Under a civil law system, contracts tend to be much shorter and less specific because many issues are already covered in the civil code



# Differences In Contract Law

❖ Many countries have ratified the **United Nations Convention on Contracts for the International Sale of Goods (CIGS)** which establishes a uniform set of rules governing certain aspects of the making and performance of everyday commercial contracts between buyers and sellers who have their places of business in different nations

# Property Rights And Corruption

- ❖ **Property rights** refer to the 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
- ❖ Countries differ in terms of how their legal systems define and protect property rights

Property rights can be violated through:

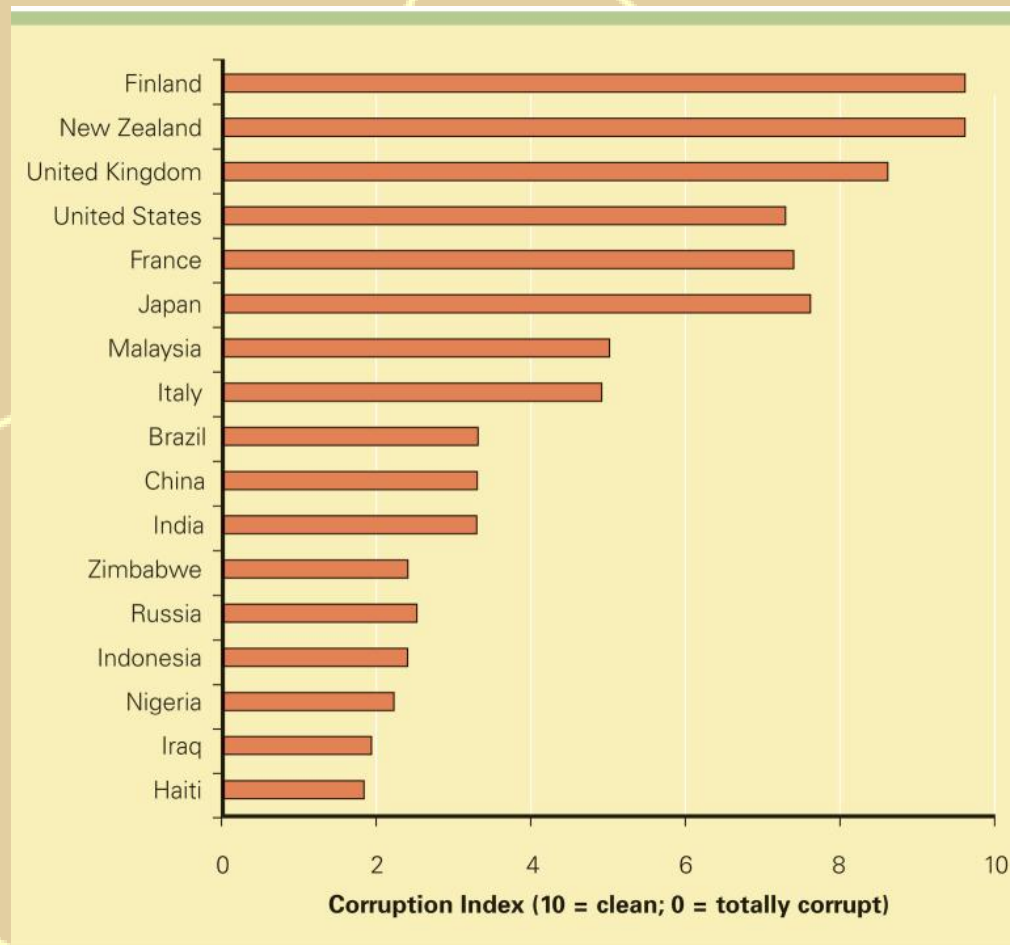
- ❖ private action
- ❖ public action

# Property Rights And Corruption

- ❖ **Public action** and **private action** to violate property rights occurs when public officials extort income, resources, or the property itself from property holders
- ❖ This can be done legally through mechanisms like excessive taxation or illegally through corrupt mechanisms like demanding bribes or blackmailing
- ❖ High levels of corruption reduce foreign direct investment, the level of international trade, and the economic growth rate in a country

# Property Rights And Corruption

Figure 2.1: Rankings of Corruption by Country 2006



# Property Rights And Corruption

- ❖ The **Foreign Corrupt Practices Act** makes it illegal for U.S. companies to bribe foreign government officials to obtain or maintain business over which that foreign official has authority
- ❖ The OECD has also adopted a convention that obliges member states to make the bribery of foreign public officials a criminal offense

# Classroom Performance System

Which country is *not* among the most corrupt countries in the world?

- a) Haiti
- b) Indonesia
- c) Malaysia
- d) Nigeria

# The Protection Of Intellectual Property Rights

❖ **Intellectual property** refers to property that is the product of intellectual activity

Intellectual property can be protected using:

❖ **Patents** – exclusive rights for a defined period to the manufacture, use, or sale of that invention

❖ **Copyrights** – the exclusive legal rights of authors, composers, playwrights, artists, and publishers to publish and disperse their work as they see fit

❖ **Trademarks** – design and names by which merchants or manufacturers designate and differentiate their products

# The Protection Of Intellectual Property Rights

- ❖ Protection of intellectual property rights differs from country to country – when intellectual property protection is lax, piracy is common
- ❖ Many countries are members of the **World Intellectual Property Organization** and have signed international treaties to protect intellectual property including the **Paris Convention for the Protection of Industrial Property**
- ❖ To avoid piracy, firms can stay away from countries where intellectual property laws are lax, file lawsuits, and lobby governments for international property rights agreements and enforcement



# Classroom Performance System

Design and names by which merchants or manufacturers designate and differentiate their products are called

- a) trademarks
- b) copyrights
- c) patents
- d) name brands

# Product Safety And Product Liability

- ❖ **Property safety** laws set certain standards to which a product must adhere
- ❖ **Product liability** involves holding a firm and its officers responsible when a product causes injury, death, or damage
- ❖ When product safety laws are stricter in a firm's home country than in a foreign country, or when liability laws are more lax, the firm has to decide whether to adhere to home country or host country standards

# The Determinants Of Economic Development

- ❖ Countries have different levels of economic development
- ❖ **Gross national income (GNI)** per person is a common measure of economic development
- ❖ **Purchasing power parity (PPP)** involves adjusting GNI by purchasing power

# Differences In Economic Development

Table 2.1: Economic Data for Select Countries

<b>Country</b>	<b>GNI per Capita, 2005 (\$)</b>	<b>GNI PPP per Capita, 2005 (\$)</b>	<b>GDP Growth Rate, 1996–2005 (%)</b>	<b>Size of Economy GDP, 2005 (\$ billions)</b>
Brazil	3,460	8,230	2.2	794
China	1,740	6,600	9.1	2,229
Germany	34,580	29,210	1.4	2,782
India	720	3,460	6.3	785
Japan	38,950	31,410	1.3	4,560
Nigeria	560	1,040	4.3	99
Poland	7,110	13,490	4.2	299
Russia	4,460	10,640	4.0	764
Switzerland	54,930	37,080	1.5	366
United Kingdom	37,600	32,690	2.7	2,193
United States	43,740	41,950	3.4	12,455

# Broader Conceptions Of Development: Amartya Sen

- ❖ Nobel Prize winning economist Amartya Sen argues that development should be seen as a process of expanding the real freedoms that people experience
- ❖ So, development requires the removal of major impediments to freedom like poverty, tyranny, and neglect of public facilities
- ❖ Sen emphasizes basic health care and basic education
- ❖ The United Nations used Sen's ideas to develop the **Human Development Index (HDI)** which is based on three measures: life expectancy at birth, educational attainment, and whether average incomes are sufficient to meet the basic needs of life in a country

# Political Economy And Economic Progress

What is the relationship between political economy and economic progress? Experts agree that:

- ❖ Innovation and entrepreneurship are the engines of long-run economic growth
- ❖ Innovation and entrepreneurship require a market economy
- ❖ Innovation and entrepreneurship require strong property rights
- ❖ It seems likely that democratic regimes are more conducive to long-term economic growth than a dictatorship, even one of the benevolent kind
- ❖ Subsequent economic growth leads to establishment of democratic regimes

# Geography, Education, And Economic Development

- ❖ In addition to political and economic systems, geography and education are also important determinants of economic development
- ❖ Countries with favorable geography are more likely to engage in trade, and so, be more open to market-based economic systems, and the economic growth they promote
- ❖ Countries that invest in education have higher growth rates because the workforce is more productive

# Classroom Performance System

Which is not a primary determinant of a nation's rate of economic development?

- a) its political system
- b) its economic system
- c) its geography
- d) its currency



# States In Transition

Since the late 1980s, two trends have emerged in the political economy:

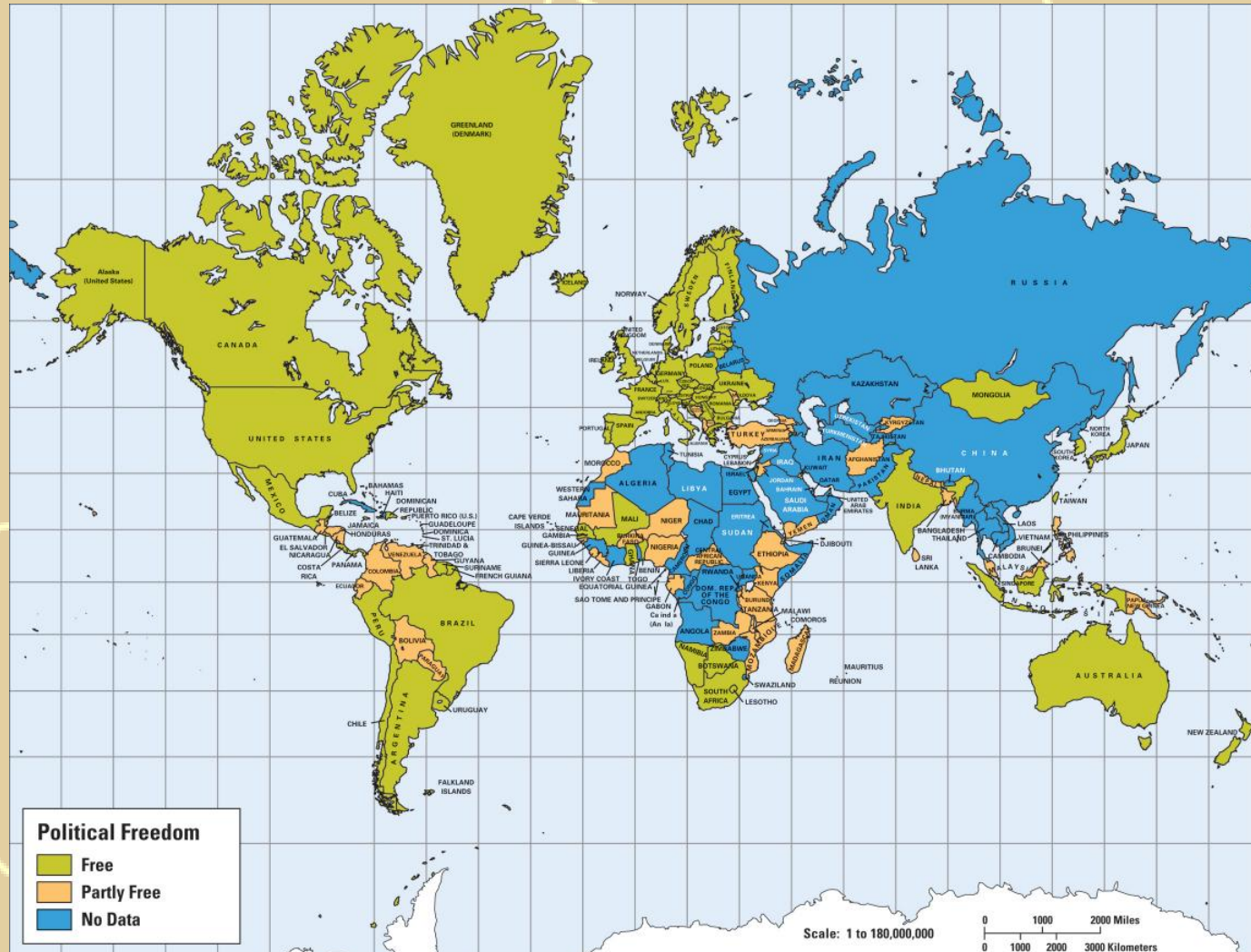
- ❖ A wave of democratic revolutions swept the world in the late 1980s and early 1990s
- ❖ There has been a move away from centrally planned and mixed economies and toward a more free market economic model

# The Spread Of Democracy

There are three main reasons for the spread of democracy:

- ❖ Many totalitarian regimes failed to deliver economic progress to the vast bulk of their populations
- ❖ New information and communication technologies, have broken down the ability of the state to control access to uncensored information
- ❖ The economic advances of the past quarter century have led to the emergence of increasingly prosperous middle and working classes who have pushed for democratic reforms

## Map 2.5: Political Freedom in 2006



# The New World Order And Global Terrorism

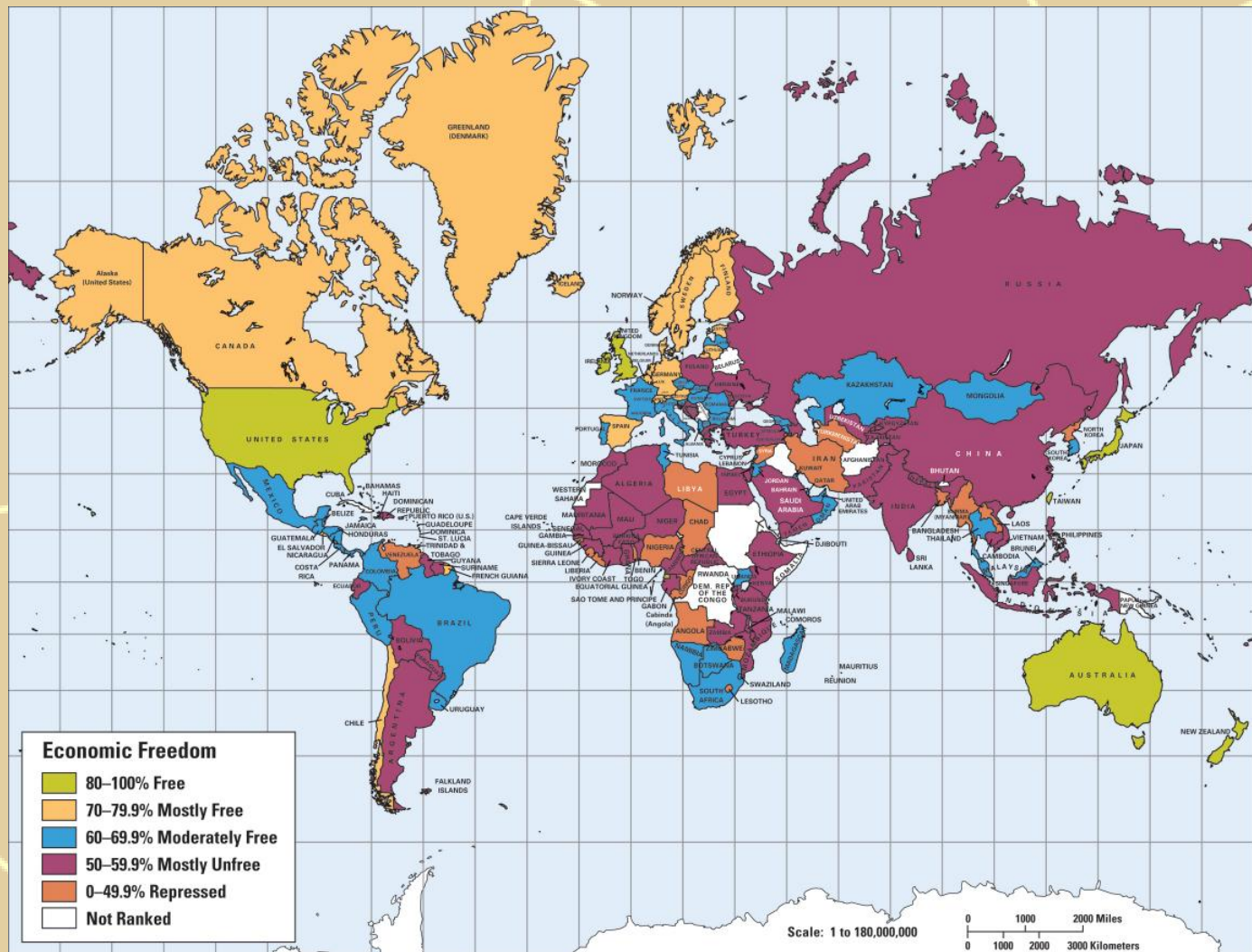
- ❖ Many countries may be increasingly difficult places in which to do business, either because of their inherent violent conflict, or because they are part of a civilization that is in conflict with an enterprise's home country
- ❖ Terrorism represents one of the major threats to world peace and economic progress in the 21<sup>st</sup> century

# The Spread Of Market-Based Systems

- ❖ Command and mixed-economies failed to deliver the kind of sustained economic performance that was achieved by countries adopting market-based systems
- ❖ As a result, more countries have shifted toward the market-based model

# The Spread Of Market-Based Systems

Map 2.6: Distribution of Economic Freedom in 2007



# The Nature Of Economic Transformation

The shift toward a market-based system involves:

- ❖ **Deregulation** – removing legal restrictions to the free play of markets, the establishment of private enterprises, and the manner in which private enterprises operate
- ❖ **Privatization** - transfers the ownership of state property into the hands of private investors
- ❖ The creation of a **legal system** to safeguard property rights



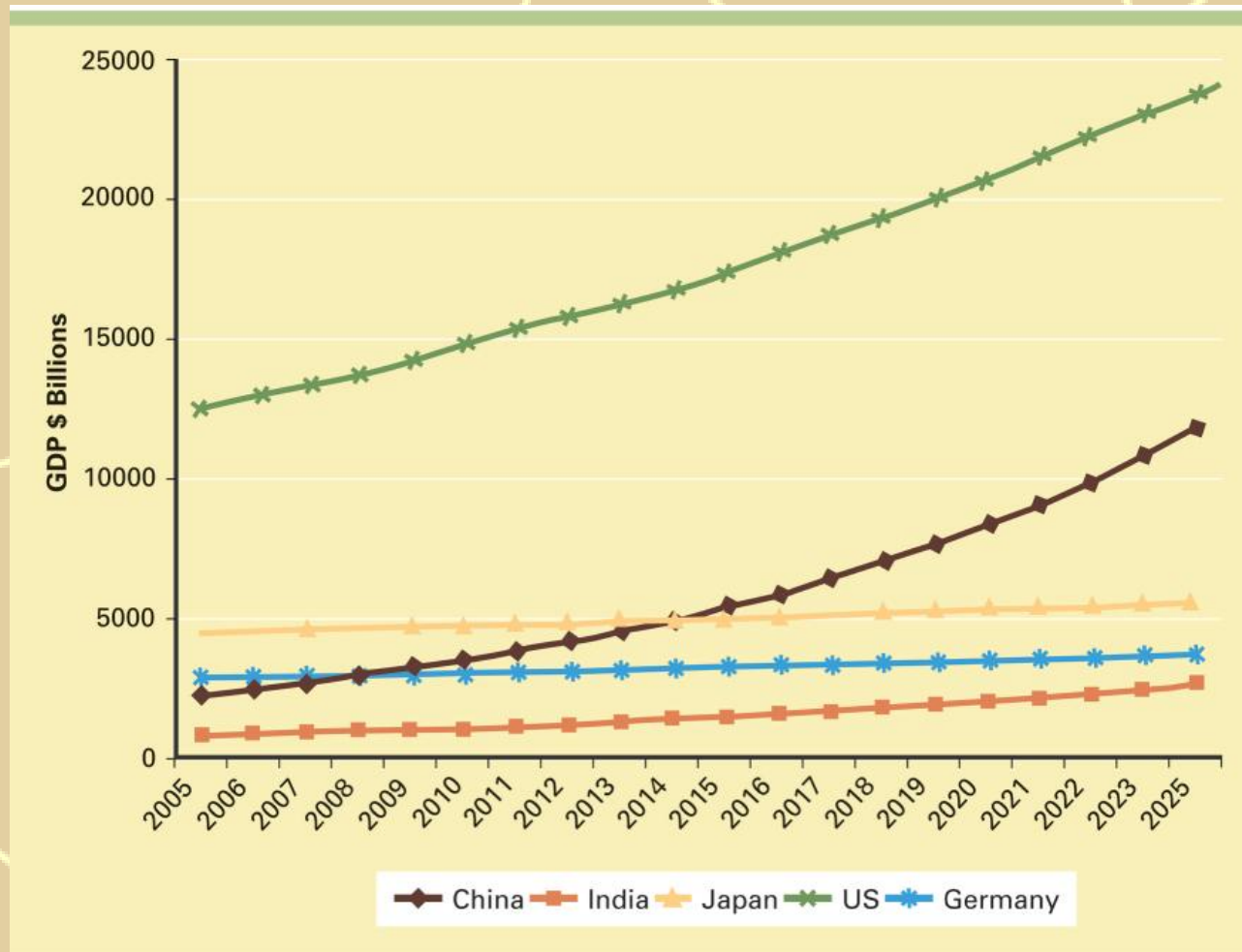
# Implications Of Changing Economy

- ❖ Markets that were formerly off-limits to Western business are now open
- ❖ China with its 1.2 billion people and India with its population of almost 1 billion are especially important
- ❖ However, just as the potential gains are large, so are the risks
- ❖ Democracy may not thrive in some countries



# Implications Of Changing Political Economy

Figure 2.3: The World's Largest National Economies, 2005-2025 (GDP \$ billions)



# Implications For Managers

There are two broad implications for managers:

- ❖ the political, economic, and legal systems of a country raise important ethical issues that have implications for the practice of international business
- ❖ the political, economic, and legal environment of a country clearly influences the attractiveness of that country as a market and/or investment site

# Benefits

- ❖ The long-run benefits of doing business in a country are a function of the size of the market, the present wealth of consumers in that market, and the likely future wealth of consumers
- ❖ By identifying and investing early in a potential future economic stars, firms may be able to gain **first mover advantages** (advantages that accrue to early entrants into a market) and establish loyalty and experience in a country

# Costs

The costs of doing business in a country are influenced by political, economic, and legal factors:

- ❖ Political costs include the cost of paying bribes or lobbying for favorable or fair treatment
- ❖ Economic costs relate primarily to the sophistication of the economic system, including the infrastructure and supporting businesses
- ❖ 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

The risks of doing business 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

❖ **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

- ❖ 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
- ❖ Other things being equal, the benefit-cost-risk trade-off is likely to be most favorable in politically stable developed and developing nations that have free market systems and no dramatic upsurge in either inflation rates or private sector debt