Chapter Two

National Differences in Political Economy
Political Economy

- A term that stresses that 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

• System of government in a nation
• Political systems can be assessed according to two dimensions
  - Degree to which they emphasize collectivism as opposed to individualism
  - Degree to which they are democratic or totalitarian
Collectivism and Individualism

**Collectivism**
- Collective goals are more important than individual goals
- Individual rights are sacrificed for the good of the majority
- In the modern world collectivism is expressed through **socialism**

**Individualism**
- Is the direct opposite of collectivism
- Central tenet is that individual economic and political freedoms are the ground rules on which society is based
Democracy versus totalitarianism

• **Democracy**
  - Government is by the people, exercised either directly or through elected representatives (representative democracy)
  - Elected representatives are held accountable through safeguards

• **Totalitarianism**
  - One person/party exercises absolute control over all spheres of human life (competing political parties are banned)
  - [Communist totalitarianism](#)
  - [Theocratic totalitarianism](#)
  - [Tribal totalitarianism](#)
  - [Right wing totalitarianism](#)
Economic Systems

- Connection between political ideology and economic systems
  - Countries where individual goals are given primacy free market economic systems are fostered
  - Countries where collective goals are given primacy there is marked state control of markets
Economic Systems

- **Market economy:** what is produced & in what quantity is determined by supply/demand and signaled to producers through a price system
- **Command economy:** planned by government
- **Mixed economy:** a balance of both of the above
Legal Systems

- Rules - laws - that regulate behavior
  - Processes through which laws are enforced & grievances are redressed
- Three main types of legal systems – in use around the world:
  - Common law
  - Civil law
  - Theocratic law
Contract Law

- Contract law is the body of law that enforces a contract
  - Specifies conditions under which an exchange is to occur
  - Details rights and obligations of parties
- Dispute resolution is often complex
  - Where to arbitrate and whose laws apply?
  - Validity of contracts and decisions
Property Rights

- A bundle of legal rights over the use to which a resource is put and over the use made of any income from that resource
- Can be violated through
  - Private action
  - Public action and corruption
Corruption as of 2004

Figure 2.1: Rankings of Corruption by Country 2004

![Bar chart showing the rankings of corruption by country as of 2004. Countries are ranked from least corrupt (Finland) to most corrupt (Bangladesh).]
Foreign Corrupt Practices Act

- The act was passed during the 1970s following revelations that U.S. companies had bribed government officials in foreign countries in an attempt to win lucrative contracts.
- This law makes it illegal to bribe a foreign government official in order to obtain or maintain business.
- The act allows facilitating or expediting payments to secure the performance of a routine governmental action.
Intellectual Property Rights

- Intellectual property refers to property that is the product of intellectual activity
- Intellectual property laws are a very important stimulus to innovation and creative work
- Protection of intellectual property rights differs greatly from country to country
Piracy of Intellectual Property

Figure 2.2: Regional Piracy Rates for Software

- Eastern Europe: 70%
- Asia Pacific: 55%
- Latin America: 65%
- Middle East and Africa: 60%
- Western Europe: 40%
- North America: 20%

Percentage of Software that is Pirated
Product Safety and Liability

- Product safety laws set safety standards for products and manufacturing processes
- Product liability laws hold the firm and its officers responsible for product safety standards
- Criminal laws/civil liability laws
  - Civil laws call for payment and monetary damages
  - Criminal liability laws result in fines or imprisonment
Differences in Economic Development

- Different countries have dramatically different levels of economic development
- Two common measurements of economic development
  - Gross National Income (GNI) superseded Gross National Product or GNP
  - Purchasing Power Parity (PPP) which accounts for differences in the cost of living
Differences in Economic Development: Gross National Income

Map showing GNI per capita in U.S. Dollars with different income categories:
- Low Income: $765 or less
- Lower Middle Income: $765–$3,035
- Upper Middle Income: $3,035–$9,385
- Lower High Income: $9,385–$20,000
- Upper High Income: $20,001 or more

Legend:
- No data

The values for the class intervals above are taken from the World Bank's current figures for high-income, upper-middle-income, lower-middle-income, and low-income economies.

Scale: 1 to 100,000,000

McGraw-Hill/Irwin
International Business, 6/e

### Differences in Economic Development: Purchasing Power Parity

<table>
<thead>
<tr>
<th>Country</th>
<th>GNI per Capita</th>
<th>GNI PPP per Capita</th>
<th>GDP Growth Rate 1993-2003(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>$2,710</td>
<td>$7,480</td>
<td>2.6%</td>
</tr>
<tr>
<td>China</td>
<td>$1,100</td>
<td>$4,990</td>
<td>9.3%</td>
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<td>Germany</td>
<td>$25,250</td>
<td>$27,460</td>
<td>1.2%</td>
</tr>
<tr>
<td>India</td>
<td>$530</td>
<td>$2,880</td>
<td>6.1%</td>
</tr>
<tr>
<td>Japan</td>
<td>$34,510</td>
<td>$28,620</td>
<td>1.2%</td>
</tr>
<tr>
<td>Nigeria</td>
<td>$320</td>
<td>$900</td>
<td>3.1%</td>
</tr>
<tr>
<td>Poland</td>
<td>$5,270</td>
<td>$11,450</td>
<td>4.8%</td>
</tr>
<tr>
<td>Russia</td>
<td>$2,610</td>
<td>$8,920</td>
<td>0.1%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>$39,880</td>
<td>$32,030</td>
<td>0.9%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>$28,350</td>
<td>$27,650</td>
<td>2.8%</td>
</tr>
<tr>
<td>United States</td>
<td>$37,610</td>
<td>$37,500</td>
<td>3.2%</td>
</tr>
</tbody>
</table>
Differences in Economic Development: Gross National Product
Broader Conceptions of Development: Amartya Sen

- Development should be measured less by material output measures, such as GNP, per capita and more by the capabilities and opportunities that people enjoy.
- HDI measures quality of life in different nations
- Based on life expectancy, educational attainment, and PPP based average incomes
Broader Conceptions of Development: Amartya Sen
Political Economy and Economic Progress

- It has been argued that a country’s economic development is a function of its economic and political systems.
- Generalizations regarding the nature of the relationship between political economy and economic progress:
  - Innovation and Entrepreneurship are the engines of growth.
  - Innovation and Entrepreneurship require a market economy.
  - Innovation and Entrepreneurship require strong property rights.
  - The required political system is in place.
  - Economic progress begets democracy.
States in Transition

- The political economy of the world has changed radically since the late 1980’s.
- Two trends have been evident:
  - A wave of democratic revolutions swept the world.
  - There has been a strong move away from centrally planned and mixed economies toward a free market economic model.
The Spread of Democracy
The Spread of Democracy

- Three main reasons account 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, including shortwave radio, satellite television, fax machines, desktop publishing, and most importantly, the Internet, 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
“We may be witnessing . . . the end of history as such: that is, the end point of mankind’s ideological evolution and the universalization of Western liberal democracy as the final form of human government.”

The Islamic resurgence is both a product of and an effort to come to grips with modernization. Its underlying causes are those generally responsible for indigenization trends in non-Western societies: urbanization, social mobilization, higher levels of literacy and education, intensified communication and media consumption, and expanded interaction with Western and other cultures. These developments undermine traditional village and clan ties and create alienation and an identity crisis. Islamist symbols, commitments, and beliefs meet these psychological needs, and Islamist welfare organizations, the social, cultural, and economic needs of Muslims caught in the process of modernization. Muslims feel a need to return to Islamic ideas, practices, and institutions to provide the compass and the motor of modernization.

The New World Order and Global Terrorism

Figure 2.3: Total International Terrorist Attacks, 1981-2003
The Spread of Market-Based Systems
The Nature of Economic Transformation

- **Deregulation**
  - Removal of legal restriction to the free play of market systems
  - Allowing establishment and operations of private enterprises

- **Privatization**
  - Transfer of ownership of state owned enterprise to private individuals

- **Legal systems**
  - Laws that support a market economy
Managerial Implications

- Two broad implications for international business
  - 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
Looking Ahead to Chapter 3

- Differences in Culture
  - What is culture?
  - Social Structure
  - Religious and Ethical Systems
  - Language
  - Education
  - Culture and the Workplace
  - Cultural Change
Socialism

Socialist ideology is split into 2 broad camps

- **Communism**
  - Communists believe that socialism can only be achieved through violent revolution and totalitarian dictatorship

- **Social Democracy**
  - Marxist roots. State owned enterprises run for public good rather than private profit
Safeguards of Representative Democracy

- Individual’s right to freedom of expression, opinion and organization
- Free media
- Regular elections
- Adult suffrage
- Limited terms for elected representatives
- A fair court system that is independent from the political system
- A non-political state bureaucracy
- Non-political force and armed service
- Relatively free access to state information
Communist Totalitarianism

- Advocates that socialism can be achieved only through totalitarian dictatorship
- Has been in decline worldwide since 1989
- Communist Totalitarian states deny many basic civil liberties to their populations
- Exceptions to this trend are China, Vietnam, Laos, North Korea, and Cuba
Theocratic Totalitarianism

- Found in states where political power is monopolized by a party, group, or individual that governs according to religious principles
- Most common form of theocratic totalitarianism is based on Islam
- State limits freedom of political and religious expression while the laws of the state are based on Islamic principles
Tribal Totalitarianism

- Tribal totalitarianism occurs when a political party that represents the interests of a particular tribe (and not always the majority tribe) monopolizes power.
- Tribal totalitarianism has arisen from time to time in African countries such as Zimbabwe, Tanzania, Uganda, and Kenya.
Right Wing Totalitarianism

- Generally permits some individual economic freedom but restricts individual political freedom, frequently on the grounds that it would lead to the rise of communism.
- Many right-wing totalitarian governments are backed by the military, and in some cases the government may be made up of military officers.
- Since the early 1980s this form of government has been in retreat.
Common Law

- Evolved in England over hundreds of years
- Based upon tradition, precedent, and custom
- Judges have the power to interpret the law so that it applies to the unique circumstances of an individual case
Civil Law

- Based upon a very detailed set of laws organized into codes
- Courts interpret civil law with regard to codes
- More than 80 countries operate with a civil law system; these include Germany, France, Japan, and Russia
- Judges have less flexibility than those in a common law system
Theocratic Law

- Based upon religious teachings
- Islamic law is the most widely practiced theocratic legal system in the modern world, although both Hindu and Jewish law are still practiced
- Based upon moral behavior
Figure 2.1: Country Attractiveness

**Benefits**
- Size of Economy
- Likely Economic Growth

**Costs**
- Corruption
- Lack of Infrastructure
- Legal Costs

**Risks**
- Political Risks: Social Unrest/Anti-Business Trends
- Economic Risks: Economic Mismanagement
- Legal Risks: Failure to Safeguard Property Rights