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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.

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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, 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: Putin's Russia

Summary

The opening case describes the modern Russia state after the dramatic collapse of the Soviet Union. Early in the post-Soviet era, Russia embraced ambitious policies designed to transform a communist dictatorship with a centrally planned economy into democratic state with a market-based economic system. The policies, however, were imperfectly implemented.

Today Russia still has a long way to go before it resembles a modern democracy with a functioning free market–based economic system. The economy is overly dependent upon commodities, particularly oil and gas. When prices fell, Russia's GDP fell with it. Russian private enterprises are also hamstrung by bureaucratic red tape and endemic corruption. The World Bank ranks Russia 92nd in the world in terms of the ease of doing business and 88th when it comes to starting a business (for comparison, the United States is ranked 4th and 20th, respectively).

On the political front, Russia is, at best, a highly imperfect pseudo-democracy. Since 1999, Vladimir Putin has exerted increasingly tight control over Russian politics, either as president or as prime minister. Under Putin, potential opponents have been sidelined, civil liberties have been progressively reduced, and the freedom of the press has been diminished. In late 2013, Russia's

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parliament, which is dominated by Putin supporters, gave the president more power to appoint and fire prosecutors, thereby diminishing the independence of the legal system.

If oil and gas prices return to previous high levels, Putin will probably be able to remain in control of Russia. However, the state has expanded public spending to such an extent over the last decade that should oil and gas prices fall significantly, or stay at their current rates of around $50 a barrel for oil, Russia could very quickly be enveloped in a financial crisis. A discussion of the case can revolve around the following questions:

QUESTION 1: How stable is an economy driven by the resource sector?

ANSWER 1: While a diversified economy can ride out many economic storms, a resource-based economy is not necessarily a source of instability. Reference can be made to Canada, and the continued importance of the resource sector, including oil and gas, in Canada.

QUESTION 2: From the perspective of international business, what is attractive about the Russian economy? What are the weaknesses and risks associated with doing business there?

ANSWER 2: The Russian economy is a large marketplace with a certain degree of capitalism and freedom. However potential instability is a major factor. The student can consult numerous web sites to further discuss this, such as www.doingbusiness.org.

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

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economic reforms make a country a more attractive location for international businesses, yet problems such as poverty and inequalities of wealth may persist.

LO 1 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 though 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, 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

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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.

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.

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LO 2 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.

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LO 3 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 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 corporate governance for businesses. 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.

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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 the 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 countries 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

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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 music 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 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/ .

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?

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LO 4 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.

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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.

LO 5 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 more away from centrally planned and mixed economies towards free markets.

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The New World Order

B) The revolutions in the former 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 to current.

Teaching Tip: A number of countries and regions maintain an international "Chamber of Commerce" to disseminate current information about their respective country or regional 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 https://iccwbo.org/.

LO 6 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

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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.

LO 7 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

B) Large parts of the globe that were formerly off-limits to western businesses are now open. There is a large upside potential here, but also risks that democracy will not continue to flourish (see the Opening Case).

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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.

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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 https://www.carnegiecouncil.org/ 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.

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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. 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.

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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.

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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 (until very recently)

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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: Ghana: An African Dynamo

Summary

The closing 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. 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.

Case Discussion Questions

QUESTION 1. After gaining independence from Britain, Ghana's economy languished for three decades. Why was this the case? What does the Ghana experience teach you about the connection between economic and political systems and economic growth?

ANSWER 1. A combination of military coups, corruption, inflation and the imposition of socialism affected the country. In this case, these factors are tied to the lack of economic growth.

QUESTION 2. What where the main changes that Jerry Rawlings made in the Ghanaian political and economic systems? What were the consequences of these changes? What are the lessons here?

ANSWER 2. He instituted democratic reforms and economic liberalization. This lead to the period of economic growth beginning in the late 1990s.

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QUESTION 3. What external forces helped to persuade Rawlings to change political and economic practices in Ghana? Do you think he would have made the changes he did without these external forces?

ANSWER 3. The IMF and Western governments applied pressure to Rawlings. While we will never know what would have happened without this pressure, and the broader economic liberalization of countries throughout the world, they did act to either change Rawling's practices or hurry them along.

QUESTION 4. If Ghana had discovered large oil reserves in the 1980s instead of the 2000s, do you think things might have played out differently? Why?

ANSWER 4. It can be argued that if Ghana had become richer earlier on, the existing socialist system may have continued for longer than it did. However, given the level of corruption in the country at the time, it can also be argued that such a discovery would have had little impact on the country as a whole.

QUESTION 5. What is the difference between the approach of Nigeria toward oil revenues and that of Ghana (the Nigerian experience is documented in the Country Focus feature in this chapter)? Which approach is in the best long-run interests of the country?

ANSWER 5. Ghana's open, liberal and democratic system appears to serve the country better than the dictatorial, corrupt system of Nigeria, which is only now slowly changing.

QUESTION 6. What does Ghana need to do to remain on its current track of sustained economic growth?

ANSWER 6. It needs to continue to follow the path of privatization, economic reforms and liberalism.

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COUNTRY FOCUS: CORRUPTION IN NIGERIA

Summary

When Nigeria gained independence from Great Britain in 1960, there were hopes that the country might emerge as an economic heavyweight in Africa. Not only was Nigeria Africa's most populous country, but it also was blessed with abundant natural resources, particularly oil. Despite this, Nigeria remains one of the poorest countries in the world. A number of factors seem to have conspired to damage economic activity in Nigeria. The country is composed of several competing ethnic, tribal, and religious groups, and the conflict among them has limited political stability and led to political strife, including a brutal civil war in the 1970s. With the legitimacy of the government always in question, political leaders often purchased support by legitimizing bribes and by raiding the national treasury to reward allies. Civilian rule after independence was followed by a series of military dictatorships, each of which seemed more corrupt and inept than the last (the country returned to civilian rule in 1999).

Has the situation in Nigeria improved since the country returned to civilian rule in 1999? In 2003, Olusegun Obasanjo was elected president on a platform that included a promise to fight corruption. By some accounts, progress has been seen. His anticorruption chief, Nuhu Ribadu, claimed that whereas 70 percent of the country's oil revenues were being stolen or wasted in 2002, by the mid-2000s the figure was "only" 40 percent. But in its most recent survey (2016), Transparency International still ranked Nigeria 136th out of 167, suggesting that the country still has a long way to go.

Questions

1. Companies can operate in other countries in the same way that they would operate at home. They can also have codified rules about how they apply their rules and regulations regardless of the country they operate in.

2.Companies can always lead by example, acting in an ethical fashion. However, there is no guarantee that such a program will lead to the implementation of widespread anti-corruption actions by governments.

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COUNTRY FOCUS: Venezuela under Hugo Chávez, 1999–2013

Summary

On March 5, 2013, Hugo Chávez, the president of Venezuela, died after losing a battle against cancer. Chávez had been president of Venezuela since 1999. A former military officer who was once jailed for engineering a failed coup attempt, Chávez was a self-styled democratic socialist who won the presidential election by campaigning against corruption, economic mismanagement, and the "harsh realities" of global capitalism. When he took office in February 1999, Chávez claimed he had inherited the worst economic situation in the country's recent history. A collapse in the price of oil, which accounted for 70 percent of the country's exports, left Venezuela with a large budget deficit and forced the economy into a deep recession.

Soon after taking office, Chávez worked to consolidate his hold over the apparatus of government. By 2012, Freedom House, which annually assesses political and civil liberties worldwide, concluded Venezuela was only "partly free" and that freedoms were being progressively curtailed.

On the economic front, things remained rough. The economy shrank in the early 2000s, while unemployment remained persistently high (at 15 to 17 percent) and the poverty rate rose to more than 50 percent of the population. Consistent with his socialist rhetoric, Chávez progressively took various enterprises into state ownership and required that other enterprises be restructured as "workers' cooperatives" in return for government loans. In addition, the government has taken over large rural farms and ranches that Chávez claimed were not sufficiently productive and turned them into state-owned cooperatives.

In mid-2000, the world oil market bailed Chávez out of mounting economic difficulties. Oil prices started to surge from the low $20s in 2003, reaching $150 a barrel by mid-2008. Venezuela, the world's fifth-largest producer, reaped a bonanza. Riding a wave of popularity at home, in December 2006 Chávez won reelection as president. He celebrated his victory by stepping on the revolutionary accelerator.

Notwithstanding his ability to consolidate political power, on the economic front Venezuela's performance under Chávez was decidedly mixed. His main achievements were to reduce poverty, which fell from 50 percent to 28 percent by 2012, and to bring down unemployment from 14.5 percent at the start of his rule to 7.6 percent in February 2013. State-owned enterprises helped Chávez achieve both these goals. However, despite strong global demand and massive reserves, oil production in Venezuela fell by a third between 2000 and 2012 as foreign oil companies exited the country. (Most recently, Venezuela's GDP has been shrinking every quarter since the beginning of 2014).

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Questions

1. High oil prices, both in Venezuela's past as well as in the Opening Case of Putin's Russia, have helped to give the existing government legitimacy and stability.

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

Management Focus: Did Wal-Mart Violate the Foreign Corrupt Practices Act?

Summary

In the early 2000s, Wal-Mart wanted to build a new store in San Juan Teotihuacan, Mexico. The owner of the land was happy to sell to Walmart, but one thing stood in the way of a deal—the city's new zoning laws. These prohibited commercial development in the historic area. Not to be denied, executives at the headquarters of Wal-Mart de Mexico found a way around the problem: They paid a $52,000 bribe to a local official to redraw the zoning area so that the property Wal-Mart wanted to purchase was placed outside the commercial-free zone.

A former lawyer for Wal-Mart de Mexico subsequently contacted Walmart executives at the company's corporate headquarters in Bentonville, Arkansas. He told them that Wal-Mart de Mexico routinely resorted to bribery, citing the altered zoning map as just one example. Alarmed, executives at Wal-Mart started their own investigation.

For several years, nothing happened; then, in April 2012, *The New York Times* published an article detailing bribery by Wal-Mart. The *Times* cited the changed zoning map and several other examples of bribery by Wal-Mart—for example, eight bribes totalling $341,000 enabled Wal-Mart to build a Sam's Club in one of Mexico City's most densely populated neighbourhoods without a construction license, or an environmental permit, or an urban impact assessment, or even a traffic permit. Wal-Mart responded to *The New York Times* article by ramping up a second internal investigation into bribery that it had initiated in 2011. By mid-2013 there were reportedly more than 300 outside lawyers working on the investigation, and it had cost more than $300 million in fees. In addition, the U.S. Department of Justice and the Securities and Exchange Commission both announced that they had started investigations into Walmart's practices. In November 2012, Wal-Mart reported that its own investigation into violations had extended beyond Mexico to include China and India. Among other things, they were looking into the allegations by the *Times*

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that top executives at Wal-Mart, including former CEO Lee Scott Jr., had deliberately squashed earlier investigations.

Questions

1. While students will likely answer that they would immediately do the right thing, and not pay bribes, push them to explain why bribery is so bad. And while paying money is clearly bribery, is donating to a certain politician or political party also a bribe?

2. Again, students may quickly state that no bribe is just a part of doing business, but push them to explain why this is so. In countries where bribery has been accepted for decades if not longer, isn't this imposing Western ideas of business on a host country? Are bribes ever acceptable?

Additional Readings and Sources of Information

Fairtrade Canada:

http://fairtrade.ca/

Index of Economic Freedom

http://www.heritage.org/index/

World News Report (a useful source for global news)

http://world.einnews.com/all_countries

World Economic Forum:

http://www.weforum.org/

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