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Chapter 2 Understanding Formal Institutions Politics Laws and Economics

TRUEFALSE

1. Institutional framework pertains only to a firm's behavior.

(A) True

(B) False

Answer : (B)

2. An institutional framework is made up of formal and informal institutions governing individual and firm behavior.

(A) True

(B) False

Answer : (A)

3. The laws of a country are part of the formal institution.

(A) True

(B) False

Answer : (A)

4. The regulatory pillar supports both informal and formal institutions.

(A) True

(B) False

Answer : (B)

5. The normative pillar supports informal institutions.

(A) True

(B) False

Answer : (A)

6. The values and beliefs of a culture are examples of a formal institution.

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(A) True

(B) False

Answer : (B)

7. Cognitive pillar is the coercive power of governments.

(A) True

(B) False

Answer : (B)

8. *Force majeure* is a method of interpreting a statute by understanding the legislative history leading up to the adoption of that statute.

(A) True

(B) False

Answer : (B)

9. Disabling formal institutes does not affect transaction costs.

(A) True

(B) False

Answer : (B)

10. Opportunism is a source of transaction costs.

(A) True

(B) False

Answer : (A)

11. Transition economies have static institutions.

(A) True

(B) False

Answer : (B)

12. According to the institution-based view, managers and firms make choices outside institutional

constraints.

(A) True

(B) False

Answer : (B)

13. Proposition 1 of the institution-based view specifically concerns bounded rationality.

(A) True

(B) False

Answer : (A)

14. Economic systems are examples of formal institutions.

(A) True

(B) False

Answer : (A)

15. Right-wing totalitarianism refers to the monopolization of power in the hands of a communist party.

(A) True

(B) False

Answer : (B)

16. Theocratic totalitarianism refers to the monopolization of political power in the hands of one religious party.

(A) True

(B) False

Answer : (A)

17. Totalitarian countries have less political risk than democratic ones.

(A) True

(B) False

Answer : (B)

18. Firms operating in democracies never confront political risk.

(A) True

(B) False

Answer : (B)

19. Civil law uses comprehensive statutes and codes as a primary means to form legal judgments.

(A) True

(B) False

Answer : (A)

20. The common law tradition is mostly spread in non-English speaking countries.

(A) True

(B) False

Answer : (B)

21. Contracts in civil law countries tend to be long and detailed compared to contracts in common law countries.

(A) True

(B) False

Answer : (B)

22. Islamic law is the only surviving example of a theocratic legal system that is formally practiced by some existing governments.

(A) True

(B) False

Answer : (A)

23. In the United States, only 1% of the land is formally registered.

(A) True

(B) False

Answer : (B)

24. Patents are exclusive rights of firms to use specific names and brands.

(A) True

(B) False

Answer : (B)

25. Trademarks are legal rights awarded by government authorities to inventors of new products or processes.

(A) True

(B) False

Answer : (B)

26. Adopting the Paris Convention is required in order to become a signatory country to the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights.

(A) True

(B) False

Answer : (A)

27. Intellectual property rights are enforced though the informal institution system.

(A) True

(B) False

Answer : (B)

28. A copyright is an example of an intellectual property.

(A) True

(B) False

Answer : (A)

29. In a pure market economy, the government only performs functions that the private sector cannot do.

(A) True

(B) False

Answer : (A)

30. In a command economy, all factors of production should be government-owned or state-owned.

(A) True

(B) False

Answer : (A)

31. A mixed economy has elements of both a market economy and a command economy.

(A) True

(B) False

Answer : (A)

32. All Western countries practice the absolute *laissez-faire* philosophy in trade.

(A) True

(B) False

Answer : (B)

33. In private ownership, liquidation of a firm is forced by competition.

(A) True

(B) False

Answer : (A)

34. The cultural school of thought in economic development suggests that rich countries tend to be endowed with natural resources.

(A) True

(B) False

Answer : (B)

35. The Washington Consensus emphasizes using government intervention over state ownership in business.

(A) True

(B) False

Answer : (B)

MULTICHOICE

36. The main supportive pillars of the informal institutions are _____.

(A) normative and cognitive

(B) regulatory and normative

(C) regulatory, normative, and cognitive

(D) cognitive and regulatory

Answer : (A)

37. In which of the following ways do formal institutions regulate trade?

(A) By inducing uncodified ethical beliefs into society

(B) By putting faith in individuals to expose perceived wrong doings

(C) By allowing the cultural beliefs of a society to dictate the terms of trade

(D) By imposing laws that make certain trades unacceptable

Answer : (D)

38. _____ are represented by laws, regulations, and rules.

(A) Normative institutions

(B) Sociocultural institutions

(C) Cognitive institutions

(D) Formal institutions

Answer : (D)

39. The _____ refers to the coercive power of governments.

(A) normative pillar

(B) regulatory pillar

(C) cognitive pillar

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(D) informal pillar

Answer : (B)

40. Which of the following would be considered an example of informal institutions?

(A) Laws

(B) Regulations

(C) Ethics

(D) Rules

Answer : (C)

41. Which of the following would be considered an example of formal institutions?

(A) Laws

(B) Norms

(C) Cultures

(D) Ethics

Answer : (A)

42. The _____ refers to the internalized, taken for granted values and beliefs that guide individual and firm behavior.

(A) normative pillar

(B) regulatory pillar

(C) cognitive pillar

(D) formal pillar

Answer : (C)

43. In which of the following examples can the role of the cognitive pillar be identified?

(A) A firm being exposed after one of its employees turned whistleblower

(B) A firm being punished for corporate espionage by the courts

(C) A firm not being able to sell a certain product in a country due to the prevalent cultural beliefs

(D) A firm outsourcing its jobs

Answer : (A)

44. The key role of institutions is to _____ in business transactions.

(A) reduce uncertainty

(B) increase normative limits

(C) increase opportunism

(D) reduce resource costs

Answer : (A)

45. _____ is a long-standing legal doctrine that excuses firms from living up to the terms of a deal in the event of natural disasters or other calamities.

(A) *De minimis*

(B) *Nolo contendere*

(C) *Force majeure*

(D) *Travaux préparatoires*

Answer : (C)

46. Which of the following would be an example of a *force majeure* defense for a seller?

(A) If the seller decides to stop delivery out of fear of nonpayment

(B) If the customer has already accepted nonconforming goods

(C) If the goods to be delivered are destroyed in an earthquake

(D) If the seller places warranties on the goods

Answer : (C)

47. The _____ view focuses on the dynamic interactions between the laws, cultures and ethics of a country and a firm, and considers firm behaviors as the outcome of such an interaction.

(A) internal strength-based

(B) competency-based

(C) institution-based

(D) resource-based

Answer : (C)

48. Which of the following is a proposition of the institution-based view?

(A) Decisions based on bounded rationality should be avoided.

(B) Dependency on informal constraints will always increase the political risks associated with a firm.

(C) When formal constraints are unclear, informal constraints will play a larger role in reducing uncertainty and providing constancy to managers and firms.

(D) Informal constraints always increases transaction costs for the firm.

Answer : (C)

49. A fundamental aspect of _____ is that it effectively conducts global business by providing an individual the right to freedom of expression and organization.

(A) communist totalitarianism

(B) right-wing totalitarianism

(C) democracy

(D) theocracy

Answer : (C)

50. Which of the following is a feature of right-wing totalitarianism?

(A) It does not curtail an individual's right to freedom of expression and organization.

(B) It concentrates power in the hands of one or more religious groups.

(C) It bases its economic policies on communist ideologies.

(D) It does not allow room for political freedom.

Answer : (D)

51. Which of the following is true of the civil law system?

(A) It is the most widely distributed legal system around the world.

(B) It originated in England, and was then spread as the legal system for all its former colonies.

(C) It is shaped by precedents and traditions from previous judicial decisions.

(D) It allows judges to interpret the law before making judicial decisions.

Answer : (A)

52. Which of the following is true of the common law system?

(A) It is the oldest legal system in the world.

(B) It has spread to all English-speaking countries and their (former) colonies.

(C) It bases its legal judgment primarily on the dominant religion of the country.

(D) It does not allow interpretations of the law by judges.

Answer : (B)

53. _____ refers to a legal system based on religious teachings.

(A) Common law

(B) Theocratic law

(C) Civil law

(D) Right-wing totalitarian law

Answer : (B)

54. Intellectual property specifically refers to _____ property.

(A) tangible

(B) intangible

(C) real

(D) moveable

Answer : (B)

55. Which of the following is an example of an intellectual property?

(A) Home

(B) Scientist's laboratory

(C) Office

(D) Website

Answer : (D)

56. _____ are legal rights awarded by government authorities to inventors of new products.

(A) Copyrights

(B) Patents

(C) Trade secrets

(D) Trade marks

Answer : (B)

57. _____ are exclusive legal rights of authors and publishers to publish and disseminate their work.

(A) Patents

(B) Trademarks

(C) Copyrights

(D) Trade secrets

Answer : (C)

58. _____ are exclusive legal rights of firms to use specific names, brands, and designs to differentiate their products from others.

(A) Patents

(B) Trademarks

(C) Copyrights

(D) Trade secrets

Answer : (B)

59. Which of the following would be considered an example of intellectual property rights?

(A) Rights associated with ownership of vehicles

(B) Rights associated with ownership of trademarks

(C) Rights associated with ownership of buildings

(D) Rights associated with ownership of business contracts

Answer : (B)

60. The TRIPS system was designed to _____.

(A) create IP rights that adhered to the norms of individual countries

(B) force firms to enforce IP rights through an informal system

(C) make sure that firms follow theocratic laws

(D) force firms to innovate while strictly adhering to IPR guidelines

Answer : (D)

61. Which of the following economies would be characterized as having a *laissez faire* policy?

(A) Pure market economy

(B) Mixed economy

(C) Command economy

(D) Socialist economy

Answer : (A)

62. Which of the following is true of a pure market economy?

(A) All factors of production are owned by the government.

(B) All factors of production are privately owned.

(C) It has elements of both a market economy and a command economy.

(D) Its policies are based on religious decree.

Answer : (B)

63. Which of the following is true of a command economy?

(A) All factors of production are privately owned.

(B) The government only performs those functions that the private sector cannot perform.

(C) It does not allow private entrepreneurship.

(D) It strictly follows the doctrine of *laissez faire*.

Answer : (C)

64. For which of the following types of economies would the factors of production depend on the relative distribution of market forces versus command forces?

(A) Mixed economy

(B) Pure market economy

(C) Strict *laissez faire* economy

(D) Command economy

Answer : (A)

65. Which of the following is the argument used by proponents of the "cultural" explanation for the difference in economic development across the globe?

(A) That rich countries have a smarter and harder-working population

(B) That rich countries tend to be endowed with natural resources

(C) That rich countries tend to have better market-supporting institutions

(D) That rich countries generally tend to have a democratic style of government

Answer : (A)

66. Which of the following is true of private ownership?

(A) It tends to force firms into liquidation due to high competition.

(B) It empowers the government to determine firm entry.

(C) It allows financing only through nationalized banks.

(D) Its primary objective is protecting jobs and minimizing social unrest.

Answer : (A)

67. State ownership differs from private ownership in that in state ownership _____.

(A) maximizing profits is the sole objective of a firm

(B) management appointments are made by owners and investors based on merit

(C) protecting jobs and minimizing social unrest is the objective of a firm

(D) managers' compensation is determined by competitive market forces

Answer : (C)

68. Private ownership differs from state ownership in that in private ownership _____.

(A) maximizing profits is the primary objective of a firm

(B) protecting jobs and minimizing social unrest is the primary objective of a firm

(C) establishing a firm is determined by government officials and bureaucrats

(D) failing firms deemed too big to fail may be supported by taxpayer money indefinitely

Answer : (A)

69. Which of the following is true of private ownership?

(A) Firms are established by entrepreneurs, owners, and investors.

(B) Management appointments are made by government officials and bureaucrats who may also use non-economic criteria.

(C) Firm's objective would be to find a "fair" deal for all stakeholders.

(D) Firms deemed "too big to fail" may be supported by taxpayer dollars indefinitely.

Answer : (A)

70. Which of the following is true of the Washington Consensus?

(A) It provided measures that governments can take in order to move toward a command economy.

(B) It listed the bail out procedures that governments could follow in case of a firm's bankruptcy.

(C) It advocated more governmental control in trade.

(D) It advocated the superiority of private ownership over state ownership.

Answer : (D)

ESSAY

71. Identify the basic characteristics of formal and informal institutions.

Graders Info :

An institutional framework is made up of formal and informal institutions governing individual and firm behavior. Formal institutions include laws, regulations, and rules. Their primary supportive pillar, the regulatory pillar, is the coercive power of governments. Informal institutions include norms, cultures, and ethics. The two main supportive pillars are normative and cognitive. Normative pillar refers to how the values, beliefs, and actions of other relevant players-collectively known as norms-influence the behavior of focal individuals and firms.

72. What are the two core propositions of the institution-based view?

Graders Info :

The first core proposition of the institution-based view is that managers and firms rationally pursue

their interests and make choices within the formal and informal constraints in a given institutional framework. The second proposition is that formal and informal institutions combine to govern firm behavior, in situations where formal constraints are unclear or fail, informal constraints will play a larger role in reducing uncertainty and providing constancy to managers and firms.

73. Outline the differences between democracy and totalitarianism.

Graders Info :

Democracy is a political system in which citizens elect representatives to govern the country on their behalf. A fundamental aspect of democracy that is relevant to the effective conduct of global business is an individual's right to freedom of expression and organization. Totalitarianism is a political system in which one person or party exercises absolute political control over the population. A totalitarian regime can also be known as a dictatorship.

74. What is totalitarianism? Outline the four major types of totalitarian systems.

Graders Info :

The opposite end of democracy is totalitarianism (also known as dictatorship), which is defined as a political system in which one person or party exercises absolute political control over the population. Communist totalitarianism centers on a communist party. This system had been embraced throughout Central and Eastern Europe and the former Soviet Union until the late 1980s. It is still practiced in China, Cuba, North Korea, and Vietnam.
Right-wing totalitarianism is characterized by its intense hatred of communism. One party, typically backed by the military, restricts political freedom, arguing that such freedom would lead to communism. In the postwar decades, Argentina, Brazil, Chile, the Philippines, South Africa, South Korea, and Taiwan practiced right-wing totalitarianism. Most of these countries have recently become democratic.
Theocratic totalitarianism refers to the monopolization of political power in the hands of one religious party or group. Iran and Saudi Arabia are leading examples.
Tribal totalitarianism refers to one tribe or ethnic group monopolizing political power and oppressing other tribes or ethnic groups.

75. Define political risk. How is it related to nationalization?

Graders Info :

Political risk is risk associated with political changes that may negatively influence domestic and foreign firms. The most extreme political risk may lead to nationalization (expropriation) of foreign assets. This happened in many totalitarian countries from the 1950s through the 1970s. It has not become a thing of the past. Recently, Argentina expropriated the assets of YPF-the subsidiary of Spanish oil firm Repsol. Zimbabwe demanded that foreign mining companies cede 51% of their equity without compensation. It is hardly surprising that foreign firms are sick and tired of such

expropriation and would rather go to "greener pastures" elsewhere.

76. Compare and contrast civil law, common law, and theocratic law.

Graders Info :

Civil law was derived from Roman law and strengthened by Napoleon's France. It is "the oldest, the most influential, and the most widely distributed around the world."28 It uses comprehensive statutes and codes as a primary means to form legal judgments. More than 80 countries practice civil law. Common law, which is English in origin, is shaped by precedents and traditions from previous judicial decisions. Common law has spread to all English-speaking countries and their (former) colonies. Relative to civil law, common law has more flexibility, because judges have to resolve specific disputes based on their *interpretation* of the law, and such interpretation may give new meaning to the law, which will shape future cases. Civil law has less flexibility, because judges only have the power to *apply* the law. On the other hand, civil law is less confrontational, because comprehensive statutes and codes serve to guide judges. Common law is more confrontational, because plaintiffs and defendants, through their lawyers, must argue and help judges to favorably interpret the law, largely based on precedents. Contracts in common law countries tend to be long and detailed to cover all possible contingencies, because common law tends to be relatively underdefined. In contrast, contracts in civil law countries are usually shorter and less specific, because many issues typically articulated in common law contracts are already covered in comprehensive civil law codes.
The third legal family is theocratic law, a legal system based on religious teachings. Examples include Jewish law and Islamic law. Although Jewish law is followed by some elements of the Israeli population, it is *not* formally embraced by the Israeli government. Islamic law is the only surviving example of a theocratic legal system that is formally practiced by some governments, such as those in Iran and Saudi Arabia. Despite the widespread characterization that Islam is anti-business, it is important to note that Mohammed was a merchant trader and that the tenants of Islam are pro-business in general.

77. How can a firm protect intellectual property rights (IP rights) when countries have different levels of IP rights' enforcement?

Graders Info :

The Paris Convention for the Protection of Industrial Property is the "gold standard" for a higher level of IPR protection. Adopting the Paris Convention is required in order to become a signatory country to the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Given the global differences in the formal rules, much stricter IPR protection is provided by TRIPS. Once countries join TRIPS, firms are often forced to pay more attention to innovation. IPR need to be asserted and enforced through a formal system, which is designed to provide an incentive for people and firms to innovate and to punish violators. However, the intangible nature of IPR makes their protection difficult. Around the world, piracy-unauthorized use of intellectual property-is widespread.

78. Describe the differences among the three economic systems.

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Graders Info :

A pure market economy is characterized by the "invisible hand" of market forces noted by Adam Smith in *The Wealth of Nations* in 1776. The government takes a hands-off approach known as *laissez faire*. The government should only perform functions the private sector cannot perform. A pure command economy is defined by a government taking, in the words of Lenin, the "commanding height" in the economy. All factors of production should be government-owned or state-owned, and all supply, demand, and pricing are planned by the government.
A mixed economy has elements of both a market economy and a command economy. It boils down to the relative distribution of market forces versus command forces.