National Differences in Political, Economic, and Legal Systems

Chapter Outline

Learning Objectives

1. Understand how the political systems of countries differ.

2. Understand how the economic systems of countries differ.

3. Understand how the legal systems of countries differ.

4. Explain the implications for management practice of national difference in political economy.

Chapter Summary

This 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. Finally, the chapter ends with a discussion of the managerial implications of differing political, economic, and legal systems of a country.

Opening Case: Putin's Russia

Summary

The opening case explores the state of the Russian economy since the collapse of the USSR, and in particular under the leadership of Vladimir Putin. While Russia's economy has grown rapidly in the so-called pseudo-democracy that now exists, the country is heavily dependent on oil and gas exports – both industries that are still largely state controlled. Indeed, the presence of the government remains an issue for the economy as a whole. Currently, roughly half of the total economy is still controlled by the state, a situation that could hamper future growth. Even private enterprises are dealing with considerable red tape and corrupt government officials. Both the World Bank and Transparency International have highlighted these problems as factors preventing commerce from flourishing in Russia. Discussion of the case can revolve around the following questions:

Suggestion Discussion Questions

QUESTION 1: Discuss the implications of corruption on the development and growth of a country. How can Russia's current political system best be described? What conclusions can you draw regarding Russia's economic prospects?

ANSWER 1: Since the collapse of the USSR, Russia has struggled to get its economy on track. Today, under the leadership of Vladimir Putin, Russia's economy is growing however there is considerable concern that the government's involvement in the business sector combined with high level of corruption could hamper future economic growth. Both the World Bank and Transparency International have raised the issue of corruption, giving the country poor rankings for ease of starting a business and outright corruption levels. Most students will probably recognize that corrupt behavior by government officials makes it very difficult for a country to gain traction. Some students may also wonder whether Putin's recent invasion of the Ukraine could signal an end to the country's pseudo-democracy.

QUESTION 2: Discuss the pros and cons of investing in Russia. As a CEO of a company in the oil industry would you invest in Russia? How does a stable government affect a country's ability to attract investment?

ANSWER: In general, companies exploring the opportunity to expand into foreign markets will be more attracted to countries where it is easy to conduct business as compared to locations where it is not. That being said, many students will probably suggest that the situation in Russia today is a tricky one. Corruption in the country is high, and the World Bank ranks Russia poorly on ease of doing business. Moreover, many students will probably advise caution given that the oil industry is still largely under the control of the government. Some students may also wonder whether sanctions by the United States and/or the European Union could further complicate matters if Putin's aggressive stance towards the Ukraine continues to persist.

Lecture Note: To extend this discussion, consider {http://www.businessweek.com/ap/2014-10-02/putin-state-will-support-sanctions-hit-sectors}.

Teaching Tip: Information on doing business in Russia is available at {http://www.doingbusiness.org/data/exploreeconomies/russia} and {http://moscow.usembassy.gov/business-russia.html}.

Video Note: McDonald's Russian stores have been the subject of scrutiny by Vladimir Putin. To learn more, go to (http://www.pinterest.com/mheibvideos/) and see *McDonald's: Russia Watchdog Widens Probe into Food Chain*.

Chapter Outline with Lecture Notes, Video 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 the changing political system in Russia illustrates how economic growth in a country can be affected by its politics. A series of reforms introduced after the collapse of the Soviet Union in 1991 were directed at creating a sustainable democracy and free market economy.

However, more recently, under the leadership of Vladimir Putin, some of these democratic freedoms have been curtailed. Today, the state accounts for about 50 percent of all economic activity and the government has both direct and indirect control over strategically important sectors including oil and gas.

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 system that stresses the primacy of collective goals over individual goals. When collectivism is emphasized, the needs of the society as whole are generally viewed as being more important than individual freedoms. Advocacy of collectivism can be traced to Plato, in modern times the collectivist mantle has been picked up by **socialists**, and their champion, Karl Marx.

Socialism

C) **Communists** generally believed that this could only be achieved through violent revolution and totalitarian dictatorship, while s**ocial 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 is not 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 became increasingly inefficient. Consequently, a number of Western democracies voted social democratic parties out of office and moved toward free market economies by selling state-owned enterprises to private investors, a process known as **privatization**.

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, Friedrich von Hayek, James Buchanan, and Milton Friedman. Individualism focuses on i) guaranteeing individual freedom and self-expression, and ii) letting people pursue their own self-interest in order to achieve the best overall good for society. The U.S. 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. Individualism is usually associated with democratic political systems and free markets.

Country Focus: Venezuela under Hugo Chavez, 1999-2013

Summary

This feature explores the political and economic situation in Venezuela under Hugo Chavez. When Chavez, who was elected president in 1998, ran on a platform against corruption and economic mismanagement, Venezuela's economy was in a deep recession. Once in office, Chavez consolidated his hold over the government by drafting a new constitution that put him in power until 2012. Chavez died in 2013, but during his presidency Venezuela was considered to be only "partly free." Economically, things were also difficult for Venezuela. Chavez did achieve some gains. Unemployment, though still high, fell to 7.6 percent in 2013 from its high of 14.5 percent in 1998. Similarly, poverty remained a problem despite falling from 50 percent to 28 percent in 2012. Yet, corruption was rampant, and there was a move to take certain industries into state ownership, with the oil industry being a particular target.

Suggested Discussion Questions

Please see Critical Thinking Question 5 for discussion of this feature.

Lecture Note: Since Chavez's death in 2013, the situation in Venezuela has become extremely uncertain. To learn more, consider {http://www.businessweek.com/news/2014-08-12/venezuela-sees-chavez-friends-rich-after-his-death-amid-poverty} and {http://www.businessweek.com/news/2014-05-03/chavez-food-utopia-withers-as-development-plans-left-unfulfilled}.

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.

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.

Video Note: A central theme in President George Bush's administration is a focus on spreading democracy around the globe. To learn more about this, consider the video in the International

Business Library on Pinterest (http://www.pinterest.com/mheibvideos/) *Experts Discuss Global Democracy.*

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**, (a form of totalitarianism that advocates achieving socialism through totalitarian dictatorship), **theocratic totalitarianism**, (a form of totalitarianism in which political power is monopolized by a party, group, or individual that governs according to religious principles), **tribal totalitarianism** (a form of totalitarianism found mainly in Africa in which a political party that represents the interests of a particular tribe monopolizes power), **right wing totalitarianism** (a 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.

Video Note: Yum! is opening locations in Myanmar. To learn more about how the company is approaching the market, consider the video in the International Business Library on Pinterest (http://www.pinterest.com/mheibvideos/) *Yum! To Bring First KFC to Myanmar in 2015.*

Pseudo-Democracies

K) The political system in many nations of the world can best be described as imperfect or pseudo-democracies – lying somewhere between a pure democracy and complete totalitarianism.

ECONOMIC SYSTEMS

A) There is a connection between political ideology and economic systems. In countries where individual goals are given primacy over collective goals, a free market system is more likely to exist. In contrast, in countries where collective goals are dominant, enterprises may be state-owned, and markets may be restricted. Three broad types of economic systems can be identified-a market economy, a command economy, and a mixed economy.

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 function there must be no restrictions on either supply - no monopolistic sellers. In a market economy, government encourages free and fair competition between private producers.

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. Until recently, Great Britain, France, and Sweden were all considered mixed economies. Today, however, as a result of extensive privatization, these countries function as market economies. In contrast, in recent years Russia and Venezuela have seen an increase in state-owned business.

LEGAL SYSTEMS

A) The **legal system** of a country refers to the rules, or laws, that regulate behavior, 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: To learn more about international law and the legal systems of the countries of the world consider {http://www.doingbusiness.org/law-library}.

Different Legal Systems

C) There are three main types of legal systems in use around the world: common law, civil law, and theocratic law.

Common Law

D) 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 the United States.

Civil Law

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

Theocratic Law

F) Islamic law is the most widely practiced **theocratic law** system (based on religious teachings) in the modern world.

Differences in Contract Law

G) **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 (CIGS)** 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 CIGS, a nation signals to other nations that it will treat the Convention's rules as part of its law.

Property Rights and Corruption

H) 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 source) are very important for the functioning of business. Property rights can be violated by either **private action** (theft, piracy, blackmail, Russian Mafia) or **public action** (governmental bribery and corruption, nationalization).

Private Action

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

Public Action and Corruption

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

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

Country Focus: Corruption in Nigeria

Summary

This feature describes the corruption that has characterized Nigeria's economy over the last 50 years. When the country initially gained its independence from Britain in 1960, expectations were high that Nigeria would become an economic heavyweight in Africa. With abundant natural resources and a large population, it seemed the stage was set for success. However, the 2012 United Nations Human Development Index ranked the country 153 out of 187 nations, noting that Nigeria suffers from extreme poverty, illiteracy, and high debt. Several factors have been blamed for Nigeria's troubles including political instability and corruption. Furthermore, in 2013 Transparency International still ranked Nigeria one of the most corrupt countries in the world.

Suggested Discussion Questions

1. What is meant by corruption? Explain how a corrupt political system affects the well being of a country. What are the implications of corruption for Nigeria?

Discussion Points: Corruption in Nigeria involves open and systematic plundering of the nation's state treasury. Bribery is also a regular part of business. In fact, the situation in Nigeria is so dismal that Transparency International ranked Nigeria one of the most corrupt countries in the world in 2013. When a country experiences this sort of activity, returns on business investments are lower, and there is less incentive for inward foreign direct investment. Most students will recognize that this then negatively affects economic growth.

2. With its huge oil reserves and large population, Nigeria was expected to emerge as a major player in Africa. Yet today the country is extremely poor with little expectation for an economic turnaround any time in the near future. Explain how Nigeria came to be in such a sad state.

Discussion Points: Studies show that countries with high levels of corruption have lower inward foreign direct investment, lower levels of international trade, and poor levels of economic growth. Nigeria is a perfect example of this type of country. Political strife resulting from in-fighting between the various tribes and ethnic groups within the nation has led to instability and questionable legitimacy in the government. Military dictatorships were inept and corrupt. Because the country is viewed so poorly thanks to its level of corruption and political instability, investors are reluctant to bring in the kinds of funds that could help the economy grow.

3. Clearly, Nigeria's corrupt government has been a major factor in the country's demise. In contrast, other countries including Finland and Canada expressly prohibit corruption. In your opinion, would Nigeria be better off following the example of countries like Finland and Canada? Why or why not?

Discussion Points: Many students will probably suggest that even if Nigeria explicitly prohibits corrupt behavior, it is unlikely to have little effect on the real way of doing business in the country. Other students however, may note that Nigeria's newly elected president, Goodluck Jonathon, has promised to put an end to corruption in the country, and is being seen by voters as a force for the future.

Teaching Tip: The CIA's World Factbook on Nigeria {https://www.cia.gov/library/publications/the-world-factbook/geos/ni.html} provides a wealth of information on the country.

Teaching Tip: To learn more about Transparency International's corruption ranking of Nigeria and general perspective of the country go to {http://www.transparency.org/country}.

Foreign Corrupt Practices Act

L) The **Foreign Corrupt Practices Act** makes it a violation of the 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.

Management Focus: Did Walmart Violate the Foreign Corrupt Practices Act?

Summary

This feature explores corruption at Walmart's Mexico division where managers allegedly bribed Mexican government officials to obtain permission to build the San Juan Teotihuacan store in the early 2000s. After leaders at Walmart's headquarters were alerted of the situation, Walmart launched an internal investigation. However, the investigation was turned over to Walmart Mexico to complete and only after a 2012 *New York Times* article again raised questions about the situation did Walmart reopen the investigation. Today, the company has spent more than $300 million on lawyers looking into the issue and Walmart is also facing scrutiny by the SEC and the U.S. Department of Justice.

Suggested Discussion Questions

Please see Critical Thinking Question 6 for discussion of this feature.

The Protection of Intellectual Property

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

Teaching Tip: For information on intellectual property rights and policies go to the World Trade Organization's web page at {http://www.wto.org/english/tratop_e/trips_e/trips_e.htm} and the United States Patent and Trade Office's web page {http://www.uspto.gov/ip/}.

N) 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.

Lecture Note: The U.S. Department of Commerce has made intellectual property protection a priority. To learn more about what the Department is doing go to {http://www.stopfakes.gov/about}.

Teaching Tip: Protecting intellectual property abroad is a key concern for many companies. The U.S. government maintains a web site devoted to helping companies understand their rights on intellectual property. To learn more, go to {http://www.export.gov/regulation/eg_main_018818.asp}.

Teaching Tip: For more information on U.S. Trademark law go to {http://www.law.cornell.edu/topics/trademark.html}.

O) Over 185 nations are part of the **World Intellectual Property Organization.** These countries have all signed an international agreement to protect intellectual property rights known as the **Paris Convention for the Protection of Industrial Property.** In addition, an 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 provides extensive information on various treaties and agreements between countries regarding the protection of intellectual property. Go to {http://www.wipo.int/portal/index.html.en} and click on About WIPO, and then on How WIPO Works, and on Treaties.

Management Focus: Starbucks Wins Key Trademark Case in China

Summary

This feature focuses on intellectual property laws in China. When Starbucks entered China in 1999, the company was quickly challenged by a look-alike competitor, Shanghai Xing Ba Ke Coffee Shop. Not only did the name Xing Ba Ke mimic the Starbucks name, but Xing Ba Ke's stores were virtual replicas of those operated by Starbucks. In 2003, Starbucks sued Xing Ba Ke for trademark violations. In 2006, Starbucks won its case, and Xing Ba Ke was fined $62,000 and ordered to stop using its name. The case was seen as a break through of sorts, a signal that China was finally caving to pressure from other nations and the World Trade Organization to respect intellectual property rights. Today, Starbucks operates over 400 stores in China and expects the market to become second only to the U.S.

Suggested Discussion Questions

1. Discuss the concept of property rights protection and why it is so important to companies. What does the court ruling against Xing Ba Ke mean for other companies that are already doing business in China, or are considering entering the market?

Discussion Points: Most students will recognize that firms that depend on proprietary property such a brand name or technology for their competitive advantage probably also rely on property rights protection to ensure that competitors cannot benefit from their efforts. The finding against Xing Ba Ke is a symbol that property rights protection should be taken seriously, and that blatant violations of property rights will not be tolerated.

2. How important is the Chinese market to Starbucks? Does the presence of look-alike companies like Xing Ba Ke deter firms from entering the market?

Discussion Points: With its growing middle class, the potential in the Chinese market is vast. Some students might argue that the presence of Xing Ba Ke is actually a positive force for Starbucks in that the coffee shop helps to promote the idea of coffee consumption in the Starbucks' way. Most students however, will probably suggest that companies like Xing Ba Ke are a nuisance because they could potentially damage the reputation of Starbucks if customers have a negative experience at the stores, and because they require constant monitoring, are a drain on profits.

Lecture Note: To extend this discussion, consider {http://www.businessweek.com/articles/2014-04-03/starbuckss-howard-schultz-on-mobile-payments-china-and-oprah} and {http://www.businessweek.com/news/2014-09-24/starbucks-expanding-into-russia-s-urals-even-as-sanctions-mount}.

Teaching Tip: To explore Starbucks in more depth, go to the company's web site at {http://www.starbucks.com/}. Click on "International" to explore individual country sites.

Product Safety and Product Liability

P) Different countries have different **product safety 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. **Product liability** involves holding a firm and its officers responsible when a product causes death, injury, or damage. Some executives believe that the high cost of liability insurance in U.S. hampers the competitiveness of U.S. companies in the global marketplace.

Q) 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 to 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?

FOCUS ON MANAGERIAL IMPLICATIONS

A) The material discussed in this chapter has two broad implications for international business. First, political, economic, and legal systems of a country raise important ethical issues that have implications for the practice of international business. Second, the political, economic, and legal environment of a country clearly influences the attractiveness of that country as a market and/or investment site.

B) 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.

C) In general, a country with democratic political institutions, a market-based economic system, and strong legal system that protects property rights and limits corruption will be more attractive to companies than a country that lacks democratic institutions, where there is strong government regulation of economic activity, and where the level of corruption is high and the rule of law is not respected.

Critical Thinking and Discussion Questions

1. Free market economies stimulate greater economic growth, whereas state-directed economies stifle growth. Discuss.

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 corporations 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. Discuss.

Answer: This question has no clear-cut answer. In the West, 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 35 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 (i.e., bribe taking by government officials) in a country 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 United States, despite its Foreign Corrupt Practices Act, does allow "grease payments" to expedite or secure the performance of a routine governmental action. According to Congress, "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. You are the CEO of a company that has to choose between making a $100 million investment in either Russia or Poland. 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 favor 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 Poland. Today, the risk in Russia would probably be considered higher than the risk in Poland. Poland has recently been accepted as a member of the EU, and as such gains the benefits and stability offered by the EU. Russia, by contrast, is still many years away from even being in a position to be considered by the EU for membership, and the recent actions of President Vladimir Putin, particularly in the Ukraine, have been alarming to many.

Lecture Note: Vladimir Putin may not be popular in the United States or Europe, but many Russians support him. Even so, Russian consumers have cut spending threatening continued economic growth. To extend the discussion, consider exploring this interesting phenomenon with {http://www.businessweek.com/articles/2014-08-28/putins-popularity-up-russian-economic-prospects-down}.

5. Read the Country Focus on Chavez's Venezuela, then answer the following questions:
a. Under Chavez's leadership, what kind of economic system was put in place in Venezuela? How would you characterize the political system?
b. How do you think that Chavez's unilateral changes to contracts with foreign oil companies will affect future investment by foreigners in Venezuela?
c) How will the high level of public corruption in Venezuela impact future growth rates?
d) Currently, Venezuela is benefiting from a boom in oil prices. What do you think might happen if oil prices retreat from their current high level?
e) In your estimation, what is the long run prognosis for the Venezuelan economy? Is this a country that is attractive to international businesses?
Answer:
a) Most students will probably agree that under Chavez, Venezuela moved toward a socialist regime. Numerous enterprises were taken over by the state, and other companies were forced into reorganizing as "workers cooperatives". The government also extended its reach into rural areas, where it seized farms and turned them into state-owned cooperatives. Chavez has also used some of the profits from the country's soaring oil revenues to increase government spending on various social programs, some of which were modeled after programs in Cuba.

b) In the oil industry, which the country depends on for some 70 percent of its exports, Chavez pushed out foreign companies, and expanded the hold of the state run company. Chavez announced in 2005 that the state would increase its royalties on oil sales from 1 percent to 30 percent, and that in 2006, the tax rate of oil sales would also increase from 34 percent to 50 percent. Most students will recognize that by making it more difficult for foreign investors to do business in the country, in the oil industry or otherwise, Chavez threatened future economic growth. Indeed, oil production in the country has fallen by one third since 2000.
c) Corruption in Venezuela is rampant. In 2012, Transparency International lowered its ranking of the country to 165 out of 174, making it one of the most corrupt countries in the world. Government officials are permitted to demand bribes in return for permission to expand operations or enter new lines of business. Many students will recognize the challenges of operating in an environment like the current situation in Venezuela. Some students will probably suggest that firms may reassess their investments given the new political and economic risks present in the country. Many students will probably conclude that a market that is considered to be only partly free, with rampant corruption and nationalization taking place, is no longer a worthwhile destination.
d) Oil prices are currently high making Venezuela, one of the world's largest producers of oil, very rich. So far, Venezuela has been using the oil profits for various social programs. Most students will probably recognize that if oil prices begin to retreat, these programs will probably suffer. Some students may wonder whether falling oil prices could spell disaster for Venezuela's oil industry. Venezuela has been maximizing the state's share of oil revenues by pushing out foreign companies and increasing the hold of state-run Petroleos de Venezuela SA. Consequently, if prices do fall, this organization will be more significantly affected.
e) A recent World Bank study puts Venezuela as being one of the most regulated economies in the world. The move to take various enterprises under state control is also impeding economic growth. In the oil industry, for example, Chavez reduced the stakes owned by foreign companies to give the state run company a bigger position. Most students will probably conclude that given the levels of corruption and regulation, the country is just too risky to consider as a destination for international companies.

Lecture Note: Victor Chavez died in 2013. To explore Venezuela since his passing, consider {http://www.businessweek.com/ap/2014-03-05/on-death-anniversary-chavez-revolution-challenged}.

6. Reread the Management Focus feature: Did Walmart Violate the Foreign Corrupt Practices Act? What is your opinion? If you think it did, what do you think the consequences will be for Walmart?

Answer: The Foreign Corrupt Practices Act prohibits companies from bribing foreign government officials to obtain or maintain business over which that foreign official has authority. Most students will probably agree that Walmart clearly violated the Act when it bribed Mexican officials to redraw the zoning area so that Walmart's San Juan Teotihuacan store could be built outside the commercial-free zone rather than inside it. Students will probably suggest that Walmart is likely to face significant fines if it is indeed found guilty of violating the Foreign Corrupt Practices Act.

Closing Case: Ghana: An African Dynamo

Summary

The closing case explores the changes in Ghana's political system that have helped the country achieve one of the fastest growth rates in sub-Saharan Africa and indeed the entire world. After Ghana gained its independence from Great Britain in 1957, the country suffered from high levels of corruption and a series of military coups that limited the development of a stable political system. In 1981, a coup put Jeremy Rawlings in power. Over the next 20 years, Rawlings worked to eliminate corruption and eventually to implement democratic policies. Under Rawlings' watch, some 300 state-owned enterprises were privatized. The recent discovery of oil has further benefited Ghana. Today, there is an effort underway to upgrade the country's infrastructure. Discussion of the case can revolve around the following 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: For more than 20 years after its independence from Great Britain, Ghana struggled to establish any sort of economic growth. In fact, at the time Ghana was one of the poorest countries in the world. A major factor contributing to this state was the country's high level of corruption. Most students will probably recognize that corrupt behavior by government officials makes it very difficult for a country to gain traction. Indeed, Ghana was able to turn the corner only after Jerry Rawlings claimed power and began to put an end to government corruption.

QUESTION 2: What were the main changes that Gerry Rawlings made in the Ghanian political and economic systems? What were the consequences of these changes? What are the lessons here?

ANSWER 2: When Jerry Rawlings initially took power in Ghana he pursued socialist policies and banned political parties. However, he later changed his view and embraced democratic reforms and economic liberalization policies. He was elected president in 1992 in a "free and fair" election and implemented liberalization policies to privatize state-owned businesses and opened the country to foreign investment. These changes were successful. Ghana's economy took off and has since maintained its democratic system. Many students will suggest that Ghana's success story is a testament to the benefits of democracy and open markets.

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: Jerry Rawlings led a military coup to take control of Ghana in 1981. At the time, Rawlings implemented socialist policies, but later he moved toward a democratic system and held "free and fair" elections. Many students will probably speculate that Rawlings was indeed inspired by the changes that were going on in Eastern Europe and the former USSR, and was prompted to make changes in Ghana as well. Other students may suggest that Rawlings may have already been considering a more democratic approach – one of the first things he did after taking control was to stop the corruption that had plagued the country – and the breakup of the former USSR had nothing to do with the timing of his shift in perspective.

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

ANSWER 4: When Ghana discovered its oil reserves in 2007, leaders took time to explore how other countries handled their oil reserves and then established policies designed to maximize the benefits of oil revenues. Many students will probably suggest that had Ghana's oil reserves been discovered in the 1980s things would probably have been very different for the country. Some students will probably agree that an earlier discovery would have probably led to corruption and misuse of oil revenues. Other students may wonder whether an earlier discovery could have led to another military coup as greedy individuals fought for control. Most students will probably conclude that for the country, the later discovery was well-timed. Ghana had already established and maintained its democratic system and economic liberalization policies were well underway.

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 in this chapter)? Which approach is in the best long-run interests of the country?

ANSWER 5: Ghana and Nigeria are at opposite ends of the spectrum when it comes to oil revenues. Ghana has established policies designed to limit any corruption that might occur with oil revenues and directed the money into its national budget. Ghana has even established a safety fund to stabilize any shifts in revenue streams. In contrast, 70 percent of Nigeria's oil revenue has been stolen or misused. Most students will recognize that when it comes to the long-run interests of the country, Ghana's approach is far superior to the approach used in Nigeria.

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

ANSWER 6: Just a few decades ago, Ghana was one of the poorest countries in the world. Today, thanks to the discovery of oil, as well as increased demand for gold and cocoa, Ghana's economy is booming. Now, government officials are scrambling to bring the country's infrastructure up to date. Already, the country has upgraded its electrical grid, built new roads, and expanded the main airport. Students should recognize that these efforts to modernize the infrastructure should help Ghana attract new investment. Companies exploring the opportunity to expand into foreign markets will be more attracted to countries where it is easy to conduct business as compared to locations where it is not.

Teaching Tip: Information on doing business in Ghana is available at {http://www.doingbusiness.org/data/exploreeconomies/ghana/}, {http://www.bbc.com/news/world-africa-13433790}, and {http://www.ghanaembassy.org/index.php?page=advantages-for-doing-business-in-ghana}.

Continuous Case Concept

Recent sanctions by the United States and Europe against Russia are posing problems for global automakers. The sanctions, imposed in response to Vladimir Putin's policy decisions are creating challenges not only for Russian citizens, but also for U.S. and European companies. France's Renault is likely to be hit hardest. It is the most dependent on the Russian market followed by South Korea's Kia and Hyundai, and Japan's Nissan, and German automakers VW and Mercedes. If these sanctions persist, the companies could experience considerable production issues. Already, General Motors is offering buyouts to its workers in Russia as sales slump in the country.

- Ask students to consider the impact of the sanctions relative to the overall attractiveness of the Russian market. What are the political and economic costs of doing business in countries like Russia where political problems threaten economic growth?

- Then, ask students to consider what strategic alternatives are open to companies like Renault that depend on the Russian market.

- Finally, ask students to consider the tradeoffs of operating in an emerging market like Russia where political uncertainty is high as compared to a more established market.

This exercise could be used at the beginning of the discussion of this chapter's material, and/or again at the end. It is especially relevant to the Opening Case: Putin's Russia. To take the discussion into greater depth, ask students read the pertinent selections in the *additional readings* section below. The exercise also works well at the beginning of the *implications for managers* section.

globalEDGE Exercises

The resources for each exercise can be easily located by using the search box at the top of the globalEDGE website at http://globalEDGE.msu.edu

Exercise 1

Search phrase: *Freedom in the World* or *Freedom House*
Resource Name: Freedom House Surveys
Website: http://www.freedomhouse.org/reports
globalEDGE Category: Publications

Additional Info:

Published annually since 1972, the survey ratings and narrative reports on 195 countries provide insight into an assessment of global political rights and civil liberties in each country. Political rights ratings are based on an evaluation of three subcategories: electoral process, political pluralism and participation, and functioning of government. Civil liberties ratings are based on an evaluation of four subcategories: freedom of expression and belief, associational and organizational rights, rule of law, and personal autonomy and individual rights.

Exercise 2

Search phrase: *World Bank Doing Business Indicators*
Resource Name: World Bank: Doing Business Indicators
Website: http://www.doingbusiness.org/
globalEDGE Category: Statistical Data Sources

Additional Info:
The World Bank's Doing Business Project provides objective measures of business regulations and their enforcement across 189 economies and selected cities at the subnational and regional level. To construct the indicators, two types of data are utilized: First, the relevant laws and regulations in each country are reviewed in detail. Second, official fee schedules and expert respondents' estimated of time each procedure takes is taken into account.

Additional Readings and Sources of Information

IMF Says Ghana, Zambia Most at Risk as Deficits in Africa Widen
http://www.businessweek.com/news/2014-04-24/imf-says-ghana-zambia-most-at-risk-as-deficits-in-africa-widen

Ghana Cocoa Board Says 2013-2014 Output to Beat Target on Weather
http://www.businessweek.com/news/2014-01-20/ghana-cocoa-board-says-2013-14-output-to-beat-target-on-weather

U.S. Ambassador to Ghana on Business Opportunities
http://www.businessweek.com/videos/2014-03-12/u-dot-s-dot-ambassador-to-ghana-on-business-opportunities

Profile: Valdimir Putin
http://www.bbc.com/news/world-europe-15047823

Vladimir Putin: The Rebuilding of "Soviet" Russia
http://www.bbc.com/news/magazine-26769481

Why U.S.-Russia Trade Is Stuck in the Cold War
http://www.businessweek.com/articles/2012-07-12/why-u-dot-s-dot-russia-trade-is-stuck-in-the-cold-war

Grounds Zero: A Starbucks-Free Italy
http://www.businessweek.com/magazine/grounds-zero-a-starbucksfree-italy-02092012.html

Columbians Keep Sipping Juan Valdez as Starbucks Arrives
http://www.businessweek.com/news/2014-10-03/colombians-keep-sipping-juan-valdez-as-starbucks-arrives

Chavez: Rival trying to destabilize Venezuela
http://www.businessweek.com/ap/2012-07-09/chavez-rival-trying-to-destabilize-venezuela

Oil Slump Rings Alarm Bell for Nigeria as Elections Loom
http://www.businessweek.com/news/2014-10-21/oil-slump-rings-alarm-bells-for-nigeria-as-elections-loom

Why Wal-Mart Hasn't Conquered Brazil
http://www.businessweek.com/articles/2014-05-08/why-wal-mart-hasnt-conquered-brazil#p1

To Stop the Coffee Apocalypse, Starbucks Buys a Farm
http://www.businessweek.com/articles/2014-02-13/to-stop-the-coffee-apocalypse-starbucks-buys-a-farm