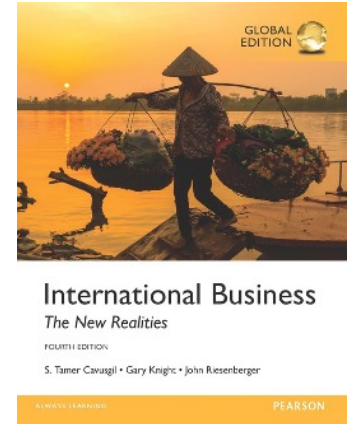


Chapter

6



Political and Legal Systems in National Environments

Presented by
Prof. Dr. Zafar U. Ahmed

Case Study:

Realities of Doing Business in Russia

- High rate of piracy in software, music, DVDs, other goods.
- Anti-piracy laws and law enforcement are weak
Obtaining business licenses requires bribing officials.
- SMEs may spend 1/5 of their net income on bribes.
- There is substantial organized crime, and killings.
- Criminal raiders may seize independent businesses.
- Conditions in Russia are typical of many emerging markets and developing economies.

Political Systems: Totalitarianism

- Government controls all economic and political matters.
 - Either *theocratic* (religion-based) or *secular*
 - A state party is led by a dictator. Membership is mandatory for those wanting to advance.
 - Power is sustained via secret police, propaganda, regulation of free discussion and criticism.
 - Today: Some countries in the Middle East and Africa; Cuba, North Korea.
 - Ex-totalitarian states tend to have much government intervention and bureaucracy.
- China (1949–1980s)
 - Germany (1933–1945)
 - Soviet Union (1918–1991)
 - Spain (1939–1965)

Political Systems: Socialism

- Capital is vested in the state and used primarily as a means of production for use rather than for profit.
- Group welfare outweighs individual welfare.
- Government's role is to control the basic means of production, distribution, and commercial activity.
- Socialism occurs in much of the world as social democracy (e.g., Western Europe, Brazil, India).
- Government intervention in the private sector.
- Corporate income tax rates are higher.

Political Systems: Democracy

- Economic activity occurs freely, as per market forces.
- **Limited government:** The government performs only essential functions that serve all citizens, such as national defense, maintaining law & order, foreign relations, and providing basic infrastructure.
- **Private property rights:** The ability to own property and assets and to increase one's asset base by accumulating private wealth. Property includes land, buildings, stocks, contracts, patents. Encourages initiative, ambition, innovation.

Democracy and Openness

- Democracy is associated with “openness”, the lack of regulation and barriers to the entry of firms in foreign markets.
- Openness is associated with:
 - Successful market entry.
 - Increased market demand.
 - Competition on quality, which improves overall product quality.
 - Increased competition, leading to efficiencies and lower prices.

Example

Since the 1980s, India steadily lowered entry barriers to its car market. Foreign carmakers entered the market, greatly increasing the number of models for sale. Greater competition increased the quality of available cars, and car prices fell.

Legal Systems: Common Law

- A legal system that originated in England and spread to Australia, Canada, USA, and other former members of the British Commonwealth (also known as *case law*).
- The basis of law is tradition, past practices, and legal precedents set by courts via interpretation of statutes, legislation, and past rulings.
- Judges have much power to interpret laws based on the circumstances of individual cases. Thus, common law is relatively flexible.

Legal Systems: Civil Law

- Found in France, Germany, Italy, Japan, Turkey, and much of Latin America.
- Based on an all-inclusive system of laws that have been “codified” – clearly written by legislative bodies.
- Laws are more “cast in stone” and not strongly subject to interpretation by courts.
- A key difference is that common law is mainly *judicial* in origin and based on court decisions, whereas civil law is mainly *legislative* and based on laws passed by national and state legislatures.

Legal Systems: Religious Law

- Strongly influenced by religious beliefs, ethical codes, and moral values, viewed as mandated by a supreme being.
- Most important religious legal systems are based on Hindu, Jewish, and Islamic law.
- Islamic law spells out norms of behavior regarding politics, economics, banking, contracts, marriage, and many other social and business issues.



Legal Systems: Mixed Systems

- Two or more legal systems operating together.
- The contrast between civil and common law has become blurred as countries combine both systems.
- Totalitarianism is most associated with religious law and socialist law.
- Democracy is associated with common law, civil law, and mixed systems.

Example

Legal systems in Lebanon, Morocco, and Tunisia share elements of civil law and Islamic law.

Dominant Legal Systems in Selected Countries

Primarily Common Law

Australia
Canada
Ireland
New Zealand
United Kingdom
United States

Primarily Civil Law

Much of western
Europe and Latin
America
Japan
Russia
South Korea

Primarily Religious Law

Much of the
Middle East and
North Africa
Afghanistan
Mauritania
Pakistan
Sudan

Mixed Systems

Bangladesh
India
Indonesia
Israel
Kenya
Malaysia
Philippines



Source: Based on World Legal Systems at www.juriglobe.ca.

Country Risk Produced by Political Systems:

Government Takeover of Corporate Assets

- ***Confiscation***: Seizure of corporate assets *without* compensation.
- ***Expropriation***: Asset seizure *with* compensation.
- ***Nationalization***: Takeover of an entire industry, with or without compensation.

Examples

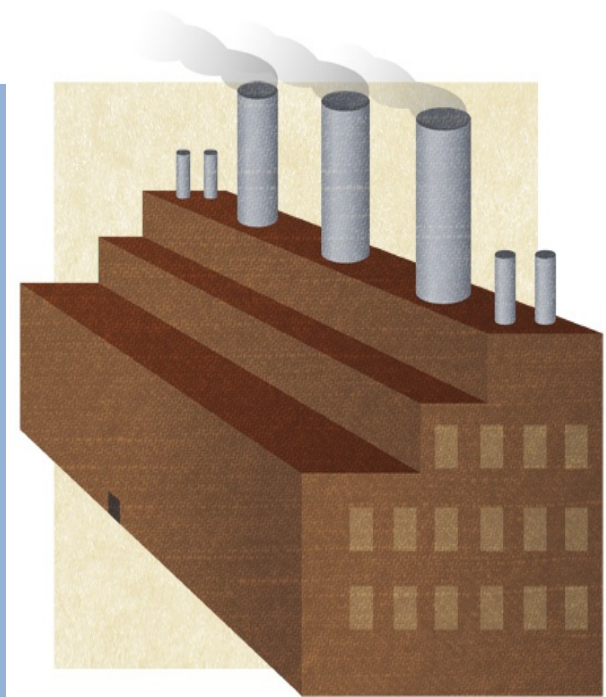
- In Venezuela, President Hugo Chavez confiscated an oil field owned by the French petroleum firm Total.
- In Bolivia in 2006, the Bolivian government nationalized the oil and gas industry.

Creeping Expropriation

- The most common expropriation today.
- The government gradually modifies regulations and laws after foreign MNEs have made big local investments in property and plants.

Examples

- Abrupt termination of contracts.
- Creation of laws that favor local firms.
- The governments in Bolivia, Russia, and Venezuela have modified tax regimes to extract revenues from coal, oil, and gas companies.



Embargoes and Sanctions

- Governments may respond to offensive activities of foreign countries by imposing embargoes and sanctions.
- **Sanctions** are bans on international trade, usually undertaken by a country, or a group of countries, against another judged to have jeopardized peace and security.
- **Embargoes** are bans on exports or imports that forbid trade in specific goods with specific countries. Example: The U.S. has enforced embargoes against Cuba, Iran, and North Korea, labeled as state sponsors of terrorism.

Country Risk Produced by Political Systems: **Wars, Insurrection, and Violence**

- ***War and insurrection*** – Indirect effects can be disastrous for company activities.
- ***Terrorism***: The threat or actual use of force or violence to attain a political goal through fear and intimidation.
- Some terrorism is sponsored by national governments.
- Terrorism particularly affects certain industries – tourism, hospitality, aviation, finance, retailing.

Country Risk Arising from the Host Country (cont'd)

- **Controls on operating forms and practices** are laws and regulations on how firms can conduct production, marketing, and distribution activities.

Example:

In the telecommunications sector in China, the Chinese government requires foreign investors to seek joint ventures with local firms. This ensures local control of the telecom industry; and China gains access to foreign capital and technology.

Country Risk Arising from the Host Country (cont'd)

- ***Marketing and distribution laws*** regulate practices in advertising, promotion, and distribution.

Examples:

- Finland, France, Norway, and New Zealand prohibit cigarette advertising on television.
- Canada and other countries cap prices in the pharmaceutical and other industries.

Country Risk Arising from the *Host Country* (cont'd)

- ***Laws on income repatriation*** limit the amount of net income or dividends that firms can bring back to the home country.
- ***Environmental laws*** aim to preserve natural resources, combat pollution, and ensure safety.
- ***Contract laws*** affect the sale of goods and services; intermediary agreements; licensing and franchising; foreign direct investment; and joint ventures.

Example:

In Germany, firms are responsible for recycling product packaging.

Country Risk Arising from the *Home Country*

- ***Extraterritoriality***: The application of home-country laws to other countries. For example, the European Union pursued Microsoft for monopolistic practices.
- The ***Foreign Corrupt Practices Act*** (1966; U.S.) made it illegal to offer bribes to foreign parties. But the act may harm U.S. firms because foreign competitors are usually not so constrained.



Managing Country Risk (cont'd)

- ***Protection through legal contracts***: Contract law varies widely. The firm must follow the law in each country. Three approaches for resolving contract disputes:
 - *Conciliation* is a formal process of negotiation whose objective is to resolve differences in a friendly manner. It is the least adversarial method. Common in China.
 - In *arbitration*, a neutral third party hears both sides of a case and decides in favor of one party or the other, based on an objective assessment of the facts.
 - *Litigation* occurs when one party files a lawsuit against another. The most adversarial approach, it is common in the United States.