Chapter 6

Political and Legal Systems in National Environments

Learning Objectives *After studying this chapter, you should be able to:*

6.1 Describe political and legal environments in international business.

6.2 Understand political systems.

6.3 Understand legal systems.

6.4 Describe the participants in political and legal systems.

6.5 Identify the types of country risk produced by political systems.

6.6 Identify the types of country risk produced by legal systems.

6.7 Know about managing country risk.

Galileo: Regional Disintegration and Its Consequences

A lot has been written about Brexit since the referendum in June 2016 in terms of both the threats and the opportunities it may entail, but there are a few points that are inarguable. The challenges it poses to transnational businesses and initiatives is one major point, and in no other case this is more evident than in the case of Galileo.

Galileo is the all-European satellite navigation system that, once fully operational in mid 2020s, will surpass any existing geo-localization in terms of accuracy and precision, GPS included. But it is Galileo's sophistication that creates issues in light of Brexit. Galileo's Public Regulated Service (PRS), a feature designed to serve as a secure, encrypted navigation system, is considered by the European Union as a back-up system vital for both civil and military purposes—and due to EU laws, it is available only to EU member states.

The United Kingdom has been involved since day one in the design and the construction of Galileo through the UK-based Surrey Satellite Technology Ltd., a subsidiary of both Germany's OHB and France's Airbus. This company manufactures a critical piece for Galileo's satellites: its "brain," or payload.

However, once the United Kingdom leaves the European Union, it may also find itself outside the Galileo project due to the restrictions mentioned above. Endless disputes around Galileo's membership and manufacturing contracts have been raging since January 2018, when the supplier contracts for Galileo had to be renewed and the renewal bidding procedure started.

Threatened with exclusion, the United Kingdom might decide to withdraw from the project and build a system on its own for which it has the technical capabilities. It could even go to the extent of stopping British companies from manufacturing components for Galileo's systems. Moreover, the

Source: dpa picture alliance archive/Alamy Stock Photo

country could also seek to reclaim the £1.2 billion spent so far on developing the new navigation system.

It is still unclear how this issue will be handled, and Galileo is one of many troubling areas of the Brexit divorce settlement, but there are precedents for non-EU participation in the navigation system. It is certain, however, that the project itself is very likely to be delayed in any circumstance other than full cooperation, proving yet again that the political landscape can have a massive effect on businesses.

Questions

6-1. Galileo is one of many ongoing EU initiatives in aerospace that the United Kingdom, as a member state, takes part. Why has Galileo attracted all this attention and controversy compared to others, such as Copernicus, which receives even more funding from the European Union? Illustrate the major difference and explain what specific issues affect Galileo.

6-2. The United Kingdom's reactions to the EU stance have been varied, but all of them amount to strong disagreement. What claim can the United Kingdom put forward in opposition to this position? Is anybody else supporting it?

6-3. What are the possible ways forward in the Galileo dilemma if the United Kingdom leaves the European Union as planned? Discuss the available options and their likelihood.

SOURCES: ESA, "Norway Signs Galileo Agreement with Commission," September 22, 2010, https://www.esa.int/Our_Activities/Navigation/Norway_signs_Galileo_agreement_with_Commission, accessed May 24, 2018; Stefania Paladini, "Brexit and the EU Space Industry," Centre for Brexit Studies Blog, May 29, 2018, https://centreforbrexitstudiesblog.wordpress.com/2018/05/29/brexit-and-the-eu-space-industry-the-galileo-conundrum/; "UK Makes Galileo Satellite a Condition for EU Defence Collaboration," *Financial Times*, 2018, https://www.ft.com/content/e8d45d26-5f34-11e8-9334-2218e7146b04, accessed May 24, 2018; M. Busby, "UK Plans Own Space Programme After Dispute with EU over Galileo Project, Defence Secretary Announces," *The Independent*, May 21, 2018, https://www.independent.co.uk/news/uk/home-news/brexit-galileo-satellite-programme-space-dispute-williamson-barnier-clarke-a8360276.html, accessed September 14, 2018; J. Amos, "UK Ups the Ante on Galileo Sat-nav Project," *BBC News*, http://www.bbc.com/news/science-environment-44116085, accessed May 24, 2018; Space Growth Partnership, "Prosperity from Space: A Partnership Strategy for UK," UK Space Agency, http://www.ukspace.org/wp-content/uploads/2018/05/Prosperity-from-Space-strategy_2May2018.pdf, accessed May 24, 2018.

This case was written by Stefania Paladini, Birmingham City University.

Most of us expect a familiar business landscape when we conduct business at home. Yet foreign markets differ in terms of political and legal systems as well as business norms. As illustrated by the opening case, foreign markets often pose major challenges and create vulnerabilities for the firm. Managers must be able to navigate difficult regulations and practices and avoid unethical or questionable conduct.

At the same time, the political and legal context may also present opportunities for companies. Preferential subsidies, government incentives, and protection from competition reduce business costs and influence strategic decision making. Many governments encourage domestic investment from foreign MNEs by offering tax holidays and cash incentives to employ local workers.

Country risk
Exposure to potential loss or adverse effects on company operations and profitability caused by developments in a country's political and/or legal environments.

Country risk is defined as exposure to potential loss or adverse effects on company operations and profitability caused by developments in a country's political and/or legal environments. Sometimes termed *political risk,* it is one of four major types of international business risks introduced in Chapter 1. Although the immediate cause of country risk is a political or legal factor, underlying such factors may be economic, social, or technological developments. Exhibit 6.1 identifies dimensions of country risk prevalent in international business. We address them in this chapter. Government intervention, protectionism, and barriers to trade and investment are particularly notable in international business. Mismanagement or failure of the national economy can lead to financial crises, recessions, market downturns, currency crises, and inflation. Such events usually arise from business cycles, poor monetary or fiscal policies, a defective regulatory environment, or imbalances in the underlying economic fundamentals of the host country.

Political or legislative actions can harm business interests, such as laws that are unexpectedly strict or result in unintended consequences. Many laws favor host-country interests—that is, interests in foreign countries where the firm has direct operations. For example, Coca-Cola's business suffered in Germany after the German government enacted a recycling plan that required consumers to return non-reusable soda containers to stores for a refund of 0.25 euros. Rather than coping with unwanted returns, big supermarket chains responded by yanking Coke

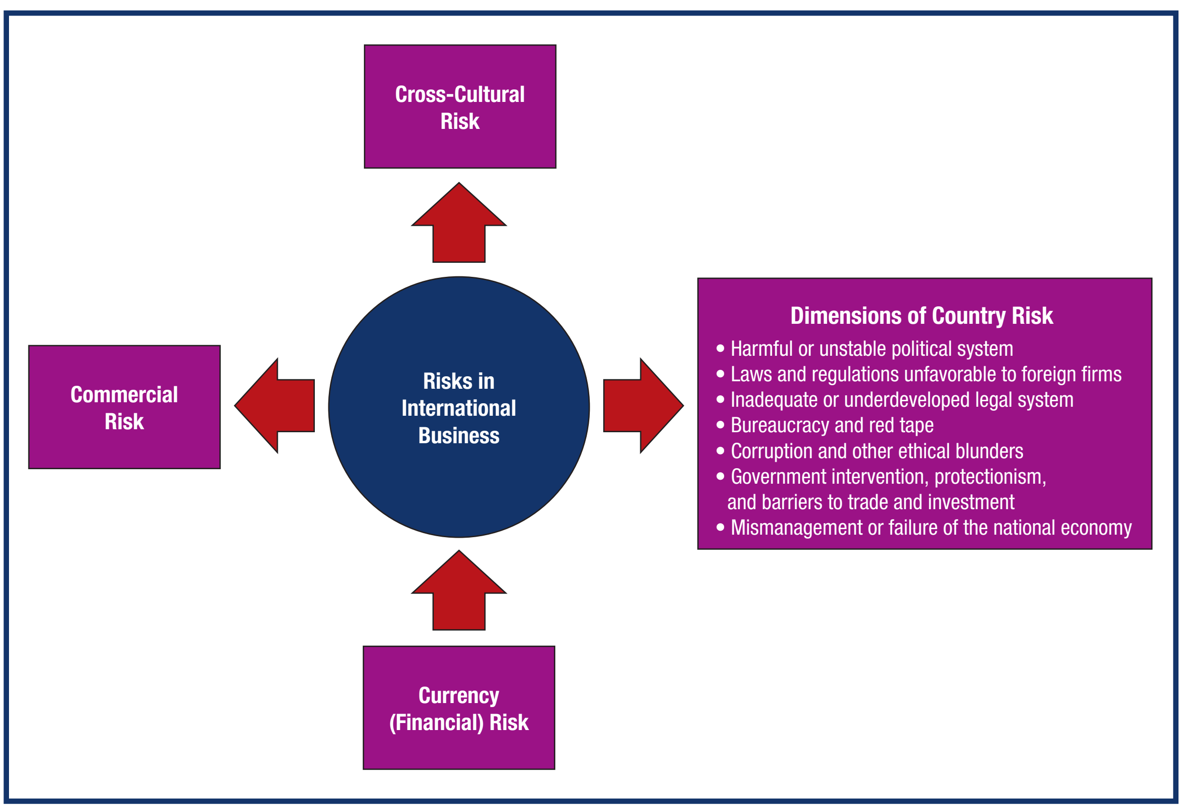


EXHIBIT 6.1

Country Risk as One of Four Major Risks in International Business

from their shelves and pushing their own store brands instead. The Hilton Hotel chain was fined $700,000 in 2017 for data breaches that compromised more than 350,000 credit card numbers. The European Union enacted a new law, the General Data Protection Rule (GDPR). Under the GDPR, if the breaches had occurred in 2018, Hilton would have had to pay about $420 million—or $1,200 for every compromised record. In China, the government has censored TV programs such as *Downton Abbey, House of Cards*, and *The Walking Dead*, whose content is considered inappropriate for Chinese citizens. Chinese authorities forbid the broadcast of Western shows that feature sex, violence, extramarital affairs, and content critical of the Chinese government.[1]

How Prevalent Is Country Risk?

Exhibit 6.2 presents the level of country risk in selected countries, measured as political stability, legal environment, economic indicators, and tax policy. Venezuela is dominated by an unpredictable, dictatorial government. Zimbabwe remains under authoritarian rule. Libya is risky in the wake of civil war and political instability. Such countries suffer from unstable governments, underdeveloped legal systems, or biased law enforcement. Conversely, countries such as Canada, Japan, and Singapore are characterized by stable, transparent, and well-founded political and legal systems. Exhibit 6.2 indicates that risk tends to be lower in countries with a favorable legal climate and political stability. In contrast, risks are higher in countries with political instability and substantial government intervention. Many of the riskiest states are poor countries that would benefit enormously from direct investment and integration into the world economy.[2] For the complete list of countries ranked by risk, visit the Risk Briefing site at the Economist Intelligence Unit (www.viewswire.eiu.com).

Country risk may affect all firms in a country equally or only a subset. For example, unrest in Zimbabwe has tended to affect all firms in that country. By contrast, in 2017 the Venezuelan government seized a factory owned by General Motors despite the presence of several competitors in Venezuela, such as Toyota and Fiat Chrysler.[3]

The government of India imposes many restrictions on imports and inward foreign investment. Strict regulations limit imports of agricultural products, chemicals, motor vehicles, and many other products. For example, high tariffs on crude edible oils affect imports of processed

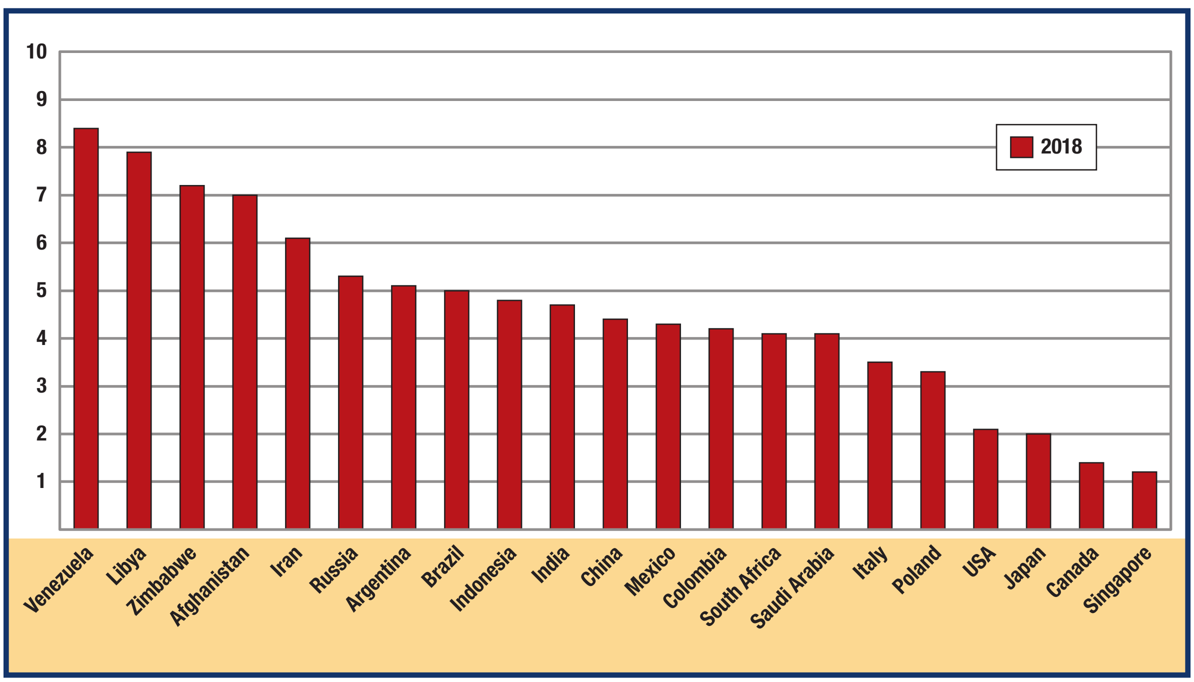


EXHIBIT 6.2

Country Risk in Selected Countries, 2018 (ranked 0 to 10; a high number indicates greater risk)

Sources: Based on *Economist Intelligence Unit*, "Risk Briefing," 2018, http://viewswire.eiu.com/index.asp?layout=homePubTypeRK; *Euler Hermes Country Risk Ratings*, 2017, www.eulerhermes.com/economic-research/country-risks/Pages/country-reports-risk-map.aspx; *Euromoney*, "Euromoney Country Risk," 2018, www.euromoneycountryrisk.com/.

foods and ingredients used in quick-service restaurants. Product sales are subject to substantial value-added and sales taxes, as well as various fees, at both the federal and state levels. India's system of tariffs and fees is complex and lacks transparency. Barriers to inward FDI limit the investment activities of foreign firms, particularly in the services sector. ArcelorMittal, Nissan, Walmart, and numerous other firms have faced delays in establishing operations in India due to government bureaucracy and Indian activist groups, which often oppose industrial development.[4]

6.1 Describe political and legal environments in international business

Political and Legal Environments in International Business

Political system
A set of formal institutions that constitute a government that include legislative bodies, political parties, lobbying groups, and trade unions.

A **political system** is a set of formal institutions that constitute a government. It includes legislative bodies, political parties, lobbying groups, and trade unions. The principal functions of a political system are to:

- Provide protection from external threats.
- Ensure stability based on laws.
- Govern the allocation of valued resources among the members of a society.
- Define how a society's members interact with each other.

Each country's political system is unique, having evolved within a particular historical, economic, and cultural context. Political systems are also constantly evolving in response to constituent demands and the evolution of the national and international environments. *Constituents* are the people and organizations that support the political system and receive government resources.

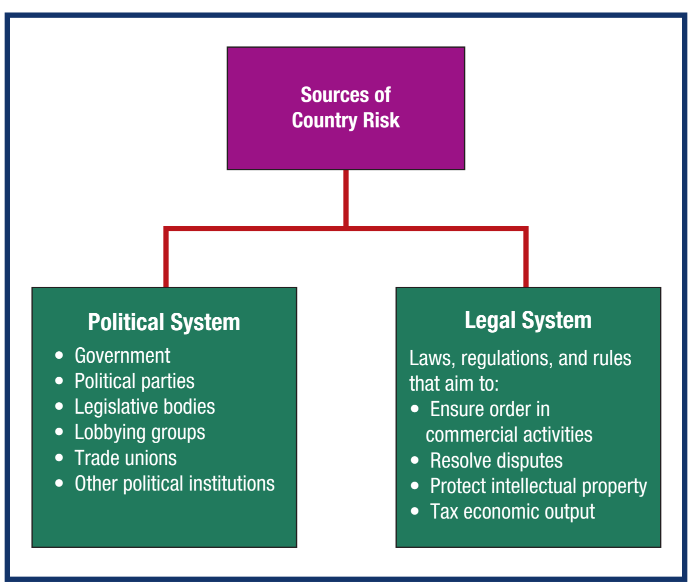
Legal system
A system for interpreting and enforcing laws.

A **legal system** is a system for interpreting and enforcing laws. Laws, regulations, and rules establish norms for conduct. A legal system includes institutions and procedures that:

- Ensure order.
- Resolve disputes in civil and commercial activities.
- Tax economic output.
- Provide protections for private property, including intellectual property and other company assets.

Exhibit 6.3 identifies the aspects of political and legal systems that contribute to country risk. Political and legal systems are dynamic and constantly changing. The two systems are interdependent—changes in one affect the other. Adverse developments in political and legal systems give rise to country risk. They can result from installation of a new government, shifting values or priorities in political parties, initiatives special interest groups develop, and the creation

EXHIBIT 6.3
Sources of Country Risk



of new laws or regulations. Gradual change is easier for the firm to accommodate; sudden change is harder to deal with and poses greater risk to the firm.

Unfavorable developments give rise to new conditions that may threaten the firm's products, services, or business activities. For example, a new import tariff may increase the cost of a key component used to manufacture a product. A change in labor law may alter the hours the firm's employees are allowed to work. Installing a new political leader may lead to government takeover of corporate assets.

Country risk is *always* present, but its nature and intensity vary over time and from country to country. In China, for example, the government is currently overhauling the national legal system, making it more harmonious with Western systems. Some new regulations have been poorly formulated or are confusing or contradictory. Foreign high-tech firms like Google, eBay, Amazon, and Facebook are all confronted with laws and regulations that restrict their entry and activities in the Chinese market. In disputes between local and foreign firms, governments are often inclined to protect local interests. Even where Western firms obtain favorable judgments in the courts, they may not be enforced.[5] Let's delve into political and legal systems in more detail.

Political Systems

6.2 Understand political systems.

The world is characterized by three major types of political systems: authoritarianism, socialism, and democracy. Exhibit 6.4 highlights countries that exemplify these systems. These categories are not mutually exclusive. Many democracies also include some elements of socialism. Many former authoritarian regimes now embrace a mix of socialism and democracy. To address sluggish economic conditions, governments in Europe have implemented relatively socialistic policies such as nationalizing firms in the banking industry. China has applied some democratic approaches, such as land reforms and open markets, to stimulate commercial activity.

Authoritarianism

Under authoritarianism, the state attempts to regulate most aspects of public and private behavior. Well-known authoritarian states from the past include China (1949–1980s) and the Soviet Union (1918–1991). Authoritarianism centralizes power in the government. The state may seek to control not only all economic and political matters but also the attitudes, values, and beliefs of the citizenry. Often, the entire population is mobilized in support of the state and a political or religious ideology. Authoritarian states are generally either theocratic (religion-based) or secular (non–religion-based). Usually there is a state party led by a dictator, such as Kim Jong-un in North Korea. Party membership is mandatory for those seeking to advance within the social and economic hierarchy. Power typically is maintained by means of secret police, propaganda disseminated through state-controlled mass media, regulation of free discussion and criticism, and/or the use of terror tactics. Authoritarian states usually do not tolerate activities by individuals or groups such as churches, labor unions, or political parties that are not directed toward the state's goals.[6]

Many authoritarian states have either disappeared or evolved toward democracy and capitalism. China initiated major reforms in the 1980s, and the Soviet Union collapsed in 1991. Agricultural land and state enterprises were sold to private interests, and entrepreneurs gained the right to establish their own businesses. The transition has not been easy, and former authoritarian

EXHIBIT 6.4

Examples of Countries Under Various Political Systems

Elements of Authoritarianism Found in	Elements of Socialism Found in	Largely Democratic
Afghanistan	Bolivia	Australia
Iran	China	Canada
North Korea	Egypt	Japan
Venezuela	India	New Zealand
Several Countries in Africa (such as Equatorial Guinea, Eritrea, Sudan, Zimbabwe)	Romania	United States
	Russia	Most European countries
	Tanzania	Most Latin American countries

Source: Leonid Andronov/123RF

By protecting private property rights, democracies promote entrepreneurship. The proprietors of the stores on this street in Madrid, Spain enjoy the benefits of their ownership.

states continue to maintain political control, including government intervention in business. Former Soviet Union states and China are still characterized by substantial red tape and bureaucracy that hinder economic activity (for examples, see the World Bank's www.doingbusiness.org). Today, numerous states exhibit elements of authoritarianism, particularly in Africa, Asia, and the Middle East. Several countries are controlled by heads of state with substantial dictatorial powers, such as Omar al-Bashir in Sudan, Emomali Rahmon in Tajikistan, and Nicolas Maduro in Venezuela.

Socialism

Socialism's fundamental principle is that capital and wealth should be vested in the state and used primarily as a means of production rather than for profit. Socialism is based on a collectivist ideology. Collective welfare of people is seen to outweigh the welfare of the individual. Socialists argue that capitalists receive a disproportionate amount of society's wealth relative to workers. They believe that in a capitalist society, the pay of workers does not represent the full value of their labor. They argue government should control the basic means of production, distribution, and commercial activity.

Socialism takes the form of *social democracy* in much of the world. Social democracy is an ideology that supports economic and social interventions to promote social justice through democratic means. Social democracies incorporate both capitalist and socialist practices and often feature highly developed welfare systems, distributing aid to those in need. Social democracy has been most successful in Western Europe and also plays a major role in the political systems of several large countries such as Brazil and India. Social democratic governments frequently intervene in the private sector and in business activities, as in Italy and Norway. Corporate income tax rates are often relatively high, as in France and Sweden. A few countries, such as Germany, have experienced net outflows of FDI as businesses seek to escape extensive regulation.

Democracy

Democracy is characterized by two major features:

- *Private property rights.* Individuals can own property and assets and increase one's asset base by accumulating private wealth. Property includes tangibles, such as land and buildings, as well as intangibles, such as stocks, contracts, patent rights, and intellectual assets. Democratic governments devise laws that protect property rights. People and firms can acquire property, use it, buy or sell it, and bequeath it to whomever they want. These rights are important because they encourage individual initiative, ambition, and innovation as well as thrift and the desire to accumulate wealth. People are less likely to have these qualities if there is uncertainty about whether they can control their property or profit from it.
- *Limited government.* The government performs essential functions that serve all citizens. These include national defense; maintenance of law and order and diplomatic relations; and constructing and maintaining infrastructure such as roads, schools, and public works. State control and intervention in the economic activities of private individuals or firms is minimal. By allowing market forces to determine economic activity, the government ensures that resources are allocated with maximal efficiency.[7]

Democracy is closely associated with *openness*, or lack of excessive regulation or barriers to the entry of firms in foreign markets. The greater the openness, the fewer the constraints placed on foreign firms. Absence of excessive regulations also benefits buyers because openness increases the quantity and variety of products available. Competition pressures firms to improve product quality continually. Increased efficiency and lower prices may follow. After India's government lowered entry barriers in the Indian automobile market, foreign automakers steadily entered the market. Their presence increased the number of models available for sale, raised the quality of available cars, and lowered prices. A similar response occurred in the mobile telephone market in China.[8]

Under democracy, the individual pursuits of people and firms are sometimes at odds with equality and justice. Because people have differing levels of personal and financial resources, each performs with varying degrees of success, leading to inequalities. Critics of pure democracy argue that when these inequalities become excessive, government should step in to correct them. Each society balances individual freedom with broader social goals. In democracies such as Japan and Sweden, the democracy's rights and freedoms are construed in larger societal terms rather than on behalf of individuals.

Virtually all democracies include elements of socialism, such as government intervention in the affairs of individuals and firms. Socialism emerges because of abuses or negative externalities that occur in purely democratic or capitalistic systems. For the past two decades, Japan has been striving to achieve the right balance between democracy and socialism. Poor management practices and an economic recession led to the bankruptcy of thousands of Japanese firms. To maintain jobs and economic stability, the Japanese government intervened to support numerous large firms and banks that, under pure capitalism, would have failed. However, such policies led to inflexibility in the Japanese economy and a delay of needed structural improvements.

Many countries, including Australia, Canada, the United States, and those in Europe, are best described as having a mixed political system—characterized by a strong private sector and a strong public sector, with considerable government regulation and control.

National Governance and Economic Prosperity

National governance refers to the system of policies and processes by which nations are governed. It reflects the manner in which public institutions develop laws and regulations, conduct public affairs, and manage public resources.[9] Exhibit 6.5 reveals that national governance is closely related to economic prosperity, measured as per-capita GDP. In the exhibit, national governance is assessed using six variables: public accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption.[10] As the quality of national governance rises, so does economic prosperity, leading to higher living standards for citizens. Nations with the highest living standards—for example, Canada, Ireland, and Singapore—also tend to have higher quality national governance. By contrast, countries with the lowest living standards—for example, North Korea, Pakistan, Venezuela—tend to score lowest on national governance.

National governance
The system of policies and processes by which nations are governed and the manner in which they develop laws and regulations, conduct public affairs, and manage public resources.

National governance is related to *political freedom* and *economic freedom*.[11] Political freedom is characterized by:

- Free and fair elections.
- The right to form political parties.
- Fair electoral laws.
- Existence of a parliament or other legislative body.
- Freedom from domination by the military, foreign powers, or religious hierarchies.
- Self-determination for cultural, ethnic, and religious minorities.

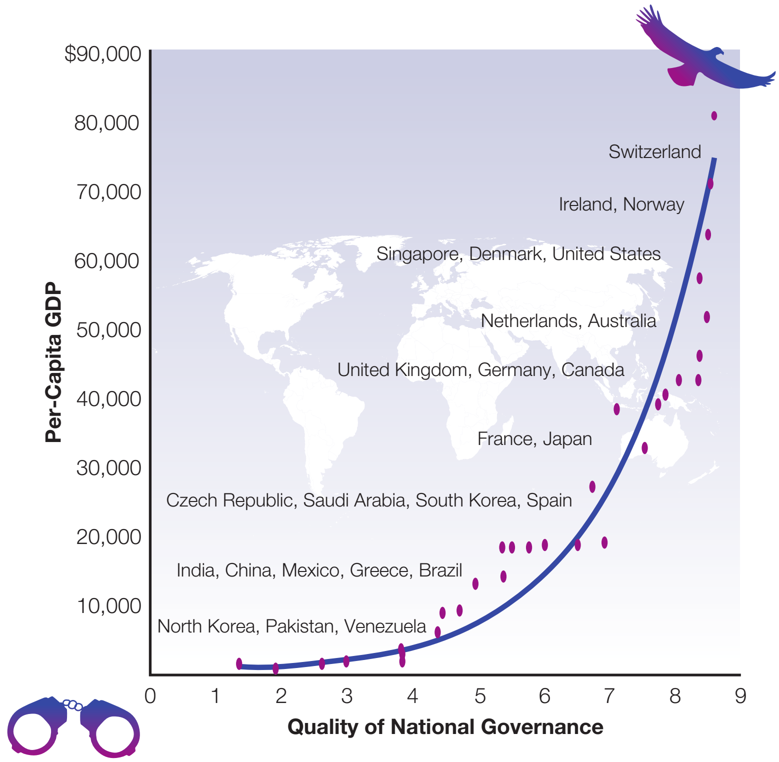
Economic freedom is related to:

- The extent of government interference in business.
- The strictness of the regulatory environment.
- The ease with which commercial activity is carried out according to market forces.

Economic freedom flourishes when governments support the institutions necessary for that freedom, such as freely operating markets and the rule of law.

EXHIBIT 6.5

Relationship Between Quality of National Governance and Per-Capita GDP (in US$)



Sources: International Monetary Fund, *World Economic Outlook Databases*, 2017, www.imf.org; Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi, "The Worldwide Governance Indicators: A Summary of Methodology, Data and Analytical Issues," World Bank Policy Research, Working Paper No. 5430, 2010, www.worldbank.org; World Bank, *Worldwide Governance Indicators*, 2018, www.info.worldbank.org.

Note: On the horizontal access, a high score indicates better quality national governance.

The Relationship Between Political Systems and Economic Systems

Each political system tends to be associated with a particular type of economic system. Generally speaking, authoritarianism is associated with command economies, democracy with market economies, and socialism with mixed economies. Let's review these economic systems.

COMMAND ECONOMY Also known as a centrally planned economy, a command economy makes the state a dominant force in the production and distribution of goods and services. Central planners make resource allocation decisions, and the state owns major sectors of the economy. In command economies, sizable bureaucracy thrives, and central planning tends to be less efficient than market forces in synchronizing supply and demand. For example, goods shortages have been so common in Venezuela that people often wait in lines for hours to buy basic necessities such as sugar and bread. China and Russia continue to exhibit some characteristics of command economies. However, the system is gradually dying out and being replaced by market economies and mixed economies.

MARKET ECONOMY Market forces—the interaction of supply and demand—determine prices in a market economy. Government intervention in the marketplace is limited, and economic decisions are left to individuals and firms. Market economies are closely associated with capitalism, in which the means of production are privately owned and operated. Participants typically exhibit a market-oriented mentality and entrepreneurial spirit. The task of the state is to establish a legal system that protects private property and contractual agreements. However, the government may also intervene to address the inequalities that market economies sometimes produce.

MIXED ECONOMY A mixed economy exhibits the features of both a market economy and a command economy. It combines state intervention and market mechanisms for organizing production and distribution. Most industries are under private ownership, and entrepreneurs freely establish, own, and operate corporations. But the government also controls certain functions, such as pension programs, labor regulation, minimum wage levels, and environmental regulation. State-owned enterprises operate in key sectors such as transportation, telecommunications, and energy. In France, for example, the government partly owns dozens of companies, mainly in the transportation, communication, and energy industries. Peugeot and Renault are partially state owned. In Germany, Japan, Norway, Singapore, and Sweden, the government often works closely with business and labor groups to determine industrial policy, regulate wage rates, and/or provide subsidies to support specific industries.[12]

The past century saw a large increase in the number of mixed economies and a concurrent rise in government involvement in economic matters. For example, in the United States, combined government spending increased from about 27 percent of GDP in 1960 to roughly 40 percent today and is expected to attain 50 percent by 2038. In Belgium, Denmark, France, Greece, and several other countries in Europe, annual government spending now exceeds 50 percent of GDP. In recent years, governments in Europe, Japan, and North America have imposed many new regulations on private firms.[13] Regulations were adopted that covered workplace safety, minimum wages, pension benefits, and environmental protection.

Legal Systems

6.3 Understand legal systems.

Legal systems provide a framework of rules and norms of conduct that mandate, limit, or permit specified relationships among people and organizations and provide punishments for those who violate these rules and norms. Laws require or limit specific actions while empowering citizens to engage in others, such as entering into contracts and seeking remedies for contract violations. Legal systems are dynamic—they evolve over time to represent each nation's changing social values and the evolution of their social, political, economic, and technological environments.

Political systems—authoritarianism, socialism, and democracy—tend to influence their respective legal systems. Democracies tend to encourage market forces and free trade. In countries with well-developed legal systems, such as Australia, Canada, Japan, the United States, and most European countries, laws are widely known and understood. In such countries, laws are effective and legitimate because they are:

- Applied to all citizens equally.
- Issued through formal procedures by recognized government authorities.
- Enforced systematically and fairly by police forces and formally organized judicial bodies.

In these countries, a tradition of law exists in which citizens consistently respect and follow the rule of law. **Rule of law** refers to a legal system in which rules are clear, publicly disclosed, fairly enforced, and widely respected by individuals, organizations, and the government. International business flourishes in societies where the rule of law prevails. In the United States, for example, the Securities and Exchange Act encourages confidence in business transactions by requiring public companies to disclose their financial indicators to investors frequently. Legal systems can be eroded by declining respect for the law, weak government authority, or burdensome restrictions that attempt to forbid behavior prevalent in the society. In the absence of the rule of law, firms must contend with great uncertainty, and economic activity can be impeded.

Rule of law
A legal system in which rules are clear, publicly disclosed, fairly enforced, and widely respected by individuals, organizations, and the government.

Nations are primarily governed by one of four basic legal systems: common law, civil law, religious law, or mixed. These legal systems are the foundation for laws and regulations. Exhibit 6.6 provides examples of countries where these legal systems are dominant.

Common Law

Also known as case law, common law is a legal system that originated in England and spread to Australia, Canada, the United States, and former members of the British Commonwealth. The basis of common law is tradition, previous cases, and legal precedents set by the nation's courts through interpretation of statutes, legislation, and past rulings. The national legislature in common-law countries (such as Parliament in Britain and Congress in the United States) holds ultimate power to pass or amend laws. In the United States, because the constitution is difficult to amend, the Supreme Court and even lower courts have much flexibility to interpret the law. Common law is more flexible than other legal systems because it is more open to interpretation by courts. Judges in a common-law system have substantial power to interpret laws based on the unique circumstances of individual cases.

Primarily Common Law	*Primarily Civil Law*	*Primarily Religious Law*	*Mixed Systems*
Australia Canada Ireland New Zealand United Kingdom United States	Much of western Europe and Latin America Japan Russia South Korea	Much of the Middle East and North Africa Afghanistan Mauritania Pakistan Sudan	Bangladesh India Indonesia Israel Kenya Malaysia Philippines

EXHIBIT 6.6

Dominant Legal Systems in Selected Countries

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

Civil Law

Also known as code law, civil law is found in France, Germany, Italy, Japan, Turkey, and Latin America. Its origins go back to Roman law and the Napoleonic Code. Civil law is based on an all-inclusive system of laws that have been codified; the laws are clearly written and accessible. It is divided into three codes: commercial, civil, and criminal. Civil law is considered complete as a result of catchall provisions found within the law. Rules and principles form the starting point for legal reasoning and administering justice. The codified rules emerge as specific laws and codes of conduct produced by a legislative body or some other supreme authority.

Both common law and civil law systems originated in Western Europe and represent the common values of Western Europeans. A key difference between the two systems is that common law is primarily judicial in origin and based on court decisions, whereas civil law is primarily legislative in origin and based on laws passed by national and local legislatures. Differences in common and civil law give rise to differing business approaches in different countries. These are highlighted in Exhibit 6.7. In reality, common-law systems generally contain elements of civil law and vice versa. The two systems complement each other, and countries that employ one also tend to employ some elements of the other.

Religious Law

This legal system is strongly influenced by religious beliefs, ethical codes, and moral values viewed as mandated by a supreme being. The most important religious legal systems are based on Hindu, Jewish, and Islamic law. Among these, the most widespread is Islamic law, found mainly in the Middle East and North Africa. In addition to these areas, other countries with substantial populations of Muslims (followers of Islam) include Indonesia (about 205 million Muslims), Pakistan (180 million), India (175 million), and Nigeria (75 million).

Legal Issues	*Civil Law*	*Common Law*
Ownership of intellectual property	Determined by registration.	Determined by prior use.
Enforcing agreements	Commercial agreements become enforceable only if properly notarized or registered.	Proof of agreement is sufficient for enforcing contracts.
Specificity of contracts	Contracts tend to be brief because many potential problems are already covered in the civil code.	Contracts tend to be very detailed, with all possible contingencies spelled out. Usually more costly to draft a contract.
Compliance with contracts	Noncompliance is extended to include unforeseeable human acts such as labor strikes and riots.	Acts of God (floods, lightning, hurricanes, etc.) are the only justifiable excuses for noncompliance with the provisions of contracts.

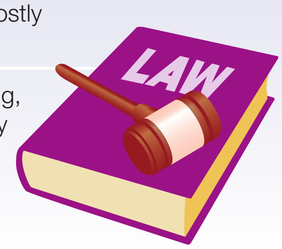


EXHIBIT 6.7

Examples of Differences Between Common Law and Civil Law

Islamic law, also known as the *shariah*, is based on the Qur'an, the holy book of Muslims, and the teachings of the Prophet Mohammed. Adherents generally do not differentiate between religious and secular life. Islamic law governs relationships among people, between people and the state, and between people and a supreme being. It spells out norms of behavior regarding politics, economics, banking, contracts, marriage, and many other social issues. Thus, Islamic law might be said to encompass all possible human relationships. Because it is seen as divinely ordained, it is relatively static and absolute. Unlike other legal systems, it evolves very little over time.[14]

Source: Zurijeta/Shutterstock

Islamic law specifies norms of behavior regarding commercial relations, contracts, banking, and other areas. This mosque is in Mecca, Saudi Arabia.

Most Muslim countries currently maintain a dual system, in which both religious and secular courts coexist. Other countries with large Muslim populations, such as Indonesia, Bangladesh, and Pakistan, have secular constitutions and laws. Turkey, another country with a majority Muslim population, has a strongly secular constitution. Saudi Arabia and Iran are unusual in that religious courts have authority over all aspects of jurisprudence.

Contemporary liberal movements within Islam oppose traditional views of religious law. For example, strict interpretation of Islamic law prohibits the giving and receiving of interest on loans or investments. To comply with Islamic law, financial institutions employ a variant of international banking known as Islamic finance, based on the principles of shariah law. Many Western banks—for example, JP Morgan and Deutsche Bank—have subsidiaries in Islamic countries that comply with shariah laws. Instead of requiring interest payments, they charge administrative fees or take equity positions in the projects they finance. Many issue *sukuks*, Islamic-compliant bonds that offer revenue from an asset, such as a rental property, rather than interest. The global market for shariah-compliant financial instruments now exceeds two trillion U.S. dollars.[15]

Mixed Systems

Mixed systems consist of two or more legal systems operating together. In most countries, legal systems evolve over time, adopting elements of one system or another that reflect their unique needs. The contrast between civil law and common law has become blurred as many countries combine them. For example, legal systems in South Africa and the Philippines mix elements of civil law and common law. Legal systems in Indonesia and most Middle Eastern countries share elements of civil law and Islamic law.

Historically, socialist law was a legal system found in the former Soviet Union, China, and a few states in Africa. It was based on civil law, with elements of socialist principles that emphasized state ownership of property. The rights of the state dominated those of the individual. When the Soviet Union collapsed and China began transitioning to capitalism, socialist law gave way to other legal systems, especially civil law.

MyLab Management Watch It!

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete the video exercise titled Anthony Shadid Unrest in the Middle East and North Africa.

Participants in Political and Legal Systems

6.4 Describe the participants in political and legal systems.

Political and legal systems evolve from the interplay among various societal institutions at both the national and international levels. Five types of participants are active in transforming political and legal systems.

Government

The government, or the public sector, is the most important participant, operating at national, state, and local levels. Governments have the power to enact and enforce laws. They strongly influence how firms enter host countries and how they conduct business there. Governments regulate international business activity through a complex system of institutions, agencies, and public officials. Agencies that possess such powers in the United States include the U.S. Trade Representative and the International Trade Administration (www.ita.doc.gov). In Canada, such functions are handled by the Ministry of Foreign Affairs (www.international.gc.ca), the Ministry of Finance, and the Export and Import Controls Bureau. Similar agencies operate in Australia, Britain, and virtually all other countries.

International Organizations

Supranational agencies such as the World Trade Organization (www.wto.org), the United Nations (www.un.org), and the World Bank (www.worldbank.org) strongly influence international business. For example, the United Nations Conference on Trade and Development (UNCTAD, www.unctad.org) helps oversee international trade and development in the areas of investment, finance, technology, and enterprise development. Such organizations facilitate free and fair trade by providing administrative guidance, governing frameworks, and, occasionally, giving financial support.

Regional Trade Organizations

Regional economic integration refers to the growing economic interdependence that results when two or more countries within a geographic region form an alliance whose goal is to reduce barriers to trade and investment. Regional trade organizations, such as the European Union (EU), the North American Free Trade Agreement (NAFTA), and the Association of Southeast Asian Nations (ASEAN), aim to advance the economic and political interests of their members. The EU is especially well developed, with its own executive, legislative, and bureaucratic bodies. It enacts and enforces laws and regulations that directly affect business. For example, in 2018 the EU implemented the Markets in Financial Instruments Directive, to better regulate financial markets and improve investor protections. The Directive restricts banks' ability to charge fees and increases reporting requirements for brokers and other financial institutions. Preparations associated with the new regulations were expected to cost banks, brokers, and other firms billions of dollars.[16]

Special Interest Groups

Special interest groups operate to advance the goals of a particular community. Numerous special interest groups serve the interests of specific countries, industries, or causes. For example, the Organisation for Economic Co-operation and Development (OECD, www.oecd.org) supports the economic developmental and business goals of advanced economies. The Organization of Petroleum Exporting Countries (OPEC, www.opec.org) is a powerful cartel that controls global oil prices, which, in turn, affect consumer prices and the cost of doing business. OPEC emerged as a powerful voice for oil-producing countries, including Saudi Arabia, Iran, Venezuela, Nigeria, and Indonesia. Other groups exercise similar control over the production and allocation of commodities such as sugar, coffee, and iron ore.

Special interest groups engage in political activity to advance specific causes, ranging from labor rights to environmental protection. They often influence national political processes and produce outcomes with far-reaching consequences for business. Many target industries and affect individual firms. In China, activists are pressuring the government to reduce pollution. Industrialization and a sharp rise in the use of fossil fuels are contaminating China's air, water, and soil.[17] In the United States, Greenpeace and other environmentalist groups opposed construction of the Keystone pipeline, fearing it would produce oil spills, polluting ground water and killing wildlife. Environmentalist groups were instrumental in halting construction of the pipeline.[18] Exhibit 6.8 provides a sample of interest groups and their likely stance toward various business issues.

Competing Firms

Rival domestic firms with a strong presence in the host country naturally have an interest in opposing the entry of foreign firms into the local market and may lobby their government for protection. For example, host-country competitors often complain when foreign firms

EXHIBIT 6.8

Issues of Concern to Special Interest Groups

Group	Typical Issue	Example
Labor unions	Oppose imported goods and global sourcing	U.S. United Steelworkers union opposed imports of steel from China
Competing businesses	Dislike competition from foreign firms	Japanese rice producers opposed imports of rice from the United States
Customers	May avoid foreign-made products. Dislike improper marketing practices.	Motorists in Australia accused BP of unfair pricing of petroleum products
Conservationists	Fight against wildlife loss and destruction of the natural environment	Environmentalists oppose lumber imports from countries with tropical rain forests

receive financial support from the parent or host-country governments. Asterix, a French theme park, opposed French government support for U.S.-based Disney when the latter established Disneyland Paris. Similarly, U.S. automakers in Detroit opposed BMW's construction of a factory in South Carolina. However, the state government of South Carolina supported the BMW facility on the grounds that it would generate jobs and increase tax revenues.

Types of Country Risk Produced by Political Systems

6.5 Identify the types of country risk produced by political systems.

How do political systems create challenges for firms engaged in international business? Let's examine the specific risks produced by political systems.

Government Takeover of Corporate Assets

Governments occasionally seize the assets of corporations. The industry sectors most often targeted by government seizure are natural resources (for example, mining and petroleum), utilities, and manufacturing. Fortunately, aggressive seizure is less common these days as governments in many developing countries have adopted institutional reforms that aim to attract FDI from abroad and foster economic growth.

Government seizure takes on various forms

- *Confiscation* is the seizure of corporate assets without compensation. Beginning in the 1980s, for example, the government of Zimbabwe systematically seized more than 5,000 farms mostly owned by farmers of European descent and redistributed the land to native Zimbabweans.
- *Expropriation* is seizure with compensation. In Venezuela, ExxonMobil and ConocoPhillips were forced to abandon multibillion-dollar investments in the local oil industry. The government of Bolivia seized Sabsa, a Spanish airline operating in the country. Gradual yet persistent pressure from the Russian government led TNK-BP, a Russian subsidiary of British energy giant BP, to sell a major stake in its oil business to the national gas monopoly Gazprom.
- *Nationalization* describes government seizure of an entire industry, with or without compensation. For example, the government of Bolivia nationalized much of the oil and gas industry in that country. President Hugo Chavez nationalized the cement industry in Venezuela. Nationalization occurs in advanced economies as well. Following the global financial crisis, the federal government of Iceland nationalized most of the country's banking industry.

Sources: Conor Gaffey, "In Zimbabwe, White Farmers Are Suing President Robert Mugabe over Land Seizures," *Newsweek,* August 22, 2017, www.newsweek.com; Carlos Quiroga, "Bolivia Nationalizes Spanish-Owned Airports Operator," *Reuters,* February 18, 2013, www.reuters.com; Robert Wade and Silla Sigurgeirsdottir, "Iceland's Rise, Fall, Stabilisation and Beyond," *Cambridge Journal of Economics* 36, No. 1 (2012), pp. 127–144.

"Creeping expropriation" is a subtle form of country risk in which governments modify laws and regulations after foreign MNEs have made substantial local investments in property and plants.[19] Examples include abrupt termination of contracts and the creation of new laws that favor local firms. Corporate raiders and government officials in Russia occasionally raid the offices of competitors and subject them to questionable criminal investigations. Such tactics can force foreign MNEs to cede control of their operations to local interests.[20] Governments in Bolivia, Kazakhstan, Russia, and Venezuela have modified tax regimes to extract revenues from foreign coal, oil, and gas companies. Troops stormed the Kazakhstan offices of U.S. mining company AES to enforce an alleged tax fine amounting to some $200 million. One of the country's largest providers of electricity, AES reduced its operations in Kazakhstan in the wake of persistent abuse by the Kazakh government.[21] Subtle or devious approaches to government takeover make country risk harder to predict.

Embargoes and Sanctions

Most countries are signatories to international treaties and agreements that specify rules, principles, and standards of behavior in international business. Nevertheless, governments may unilaterally resort to sanctions and embargoes to respond to offensive activities of foreign countries. A *sanction* is a type of trade penalty imposed on one or more countries by one or more other countries. Sanctions typically take the form of tariffs, trade barriers, import duties, and import or export quotas. They generally arise in the context of an unresolved trade or policy dispute, such as a disagreement about the fairness of some international trade practice. There is much evidence suggesting that sanctions often do not achieve desired outcomes. For example, the United States imposed trade sanctions on Iran and Syria. However, goods continue to flow in and out of both countries from China, Germany, Japan, and numerous other trading partners. The European Union and the United States imposed trade sanctions on Russia following the latter's military intervention in Ukraine. The sanctions contributed to collapse of the Russian ruble and to the Russian financial crisis and caused economic damage to many firms in the EU.[22]

An *embargo* is an official ban on exports to or imports from a particular country to isolate it and punish its government. It is generally more serious than a sanction and is used as a political punishment for some disapproved policies or acts. For example, the United States has enforced embargoes against Iran and North Korea, at times labeled as state sponsors of terrorism. The European Union has enacted embargoes against Belarus, Sudan, and China in certain areas, such as foreign travel, to protest human rights and weapon-trading violations.

Source: Igor Sobolev/123RF

Activists called for a boycott of Russian products and the Sochi Winter Olympics over charges that Russia's government discriminated against gays and lesbians. Pictured is the Kremlin in Moscow, site of the official residence of Russia's president.

Boycotts Against Firms or Nations

Consumers and special interest groups occasionally target particular firms perceived to have harmed local interests. Consumers may refuse to patronize firms that behave inappropriately. A *boycott* is a voluntary refusal to engage in commercial dealings with a nation or a company. Boycotts and public protests result in lost sales and increased costs (for public relations activities needed to restore the firm's image). Disneyland Paris and McDonald's have been the targets of boycotts by French farmers, who believe these firms represent U.S. agricultural policies and globalization, which many French citizens oppose. Activists in numerous countries organized a boycott of petroleum company BP following its oil spill in the Gulf of Mexico.[23] During the 2014 Winter Olympics in Sochi, Russia, activist groups advocated boycotting Russian products over concerns that Russia's government discriminates against gays and lesbians.[24]

Terrorism

Terrorism is the threat or actual use of force or violence to attain a political goal through fear, coercion, or intimidation.[25] It is sometimes sponsored by national governments. Terrorism has escalated in much of the world, as exemplified by attacks in France, India, the Philippines, Spain, the United Kingdom, and the United States as well as various countries in Africa and the Middle East. In India, more than 30,000 people have died in terrorist attacks in the past two decades.[26] Major terrorist attacks have occurred recently in Afghanistan, Iraq, Nigeria, Pakistan, and Syria. In addition to causing loss of life, terrorism can severely damage commercial infrastructure and disrupt business activities. It induces fear in consumers, who reduce their purchasing, potentially leading to economic recession. The transportation and retailing industries are particularly affected. Terrorism also affects financial markets. In the days following the September 11, 2001, attacks in New York, the value of the U.S. stock market dropped some 14 percent.[27]

War, Insurrection, and Violence

War, insurrection, and other forms of violence pose significant problems for business operations. Although such events usually do not affect companies directly, their indirect effects can be disastrous. Violent conflict among drug cartels and security services along the U.S.–Mexico border has led some firms and financiers to withdraw investments from Mexico because of perceived heightened risks and political instability. In India, Tata Motors (www.tatamotors.com) shifted the location of a major new factory due to violent protests by local farmers who feared the loss of their livelihood.[28] To minimize losses from violent acts, firms can purchase risk insurance.

Types of Country Risk Produced by Legal Systems

6.6 Identify the types of country risk produced by legal systems.

In addition to political concerns, country risk also arises due to peculiarities of national legal systems. Especially relevant to international business are *commercial law*, which specifically covers business transactions, and *private law*, which regulates relationships between persons and organizations, including contracts and liabilities that may arise due to negligent behavior. In many countries, the legal system favors home-country nationals. Laws are designed to promote the interests of local businesses and the local economy.

Legal systems in both the host country and the home country pose various challenges to firms, which we review next.

Country Risk Arising from the Host-Country Legal Environment

Governments in host countries impose various laws and regulations on foreign companies doing business there.

FOREIGN INVESTMENT LAWS These laws affect the type of entry strategy firms choose as well as their operations and performance. Many nations impose restrictions on inward FDI. For example, Indonesia restricts foreign investment in certain industries, such as tourism, alcoholic beverages, and some chemical manufactures, to protect the country's security or cultural assets. Investment in several other industries requires obtaining special permission from Indonesia's central government.[29] The United States restricts foreign investments that might affect national security. Proposed investments can be reviewed by the U.S. Committee on Investments. In 2017, following the committee's recommendation, the U.S. government blocked a Chinese company's attempt to acquire Lattice Semiconductor Corporation.[30]

CONTROLS ON OPERATING FORMS AND PRACTICES Governments impose laws and regulations on how firms can conduct production, marketing, and distribution activities within their borders. Such restrictions can hinder company performance abroad. For example, host countries may require companies to obtain permits to import or export. They may devise complex regulations that complicate transportation and logistical activities or limit the options for entry strategies. In China's huge telecommunications market, the government requires foreign investors to seek joint ventures with local firms; local operations cannot be wholly owned by foreigners. The government's goal is to ensure that China maintains control of its telecommunications industry but obtains inward transfer of technology, knowledge, and capital. In 2014, U.S. authorities banned Huawei, a giant Chinese telecommunications company, from bidding on U.S. government contracts for network equipment because of concerns over the possibility of espionage.[31]

Source: Wasin Pummarin/123RF

Shibuya is a popular shopping district in Tokyo. In Japan, foreign-owned large stores such as Carrefour and Walmart have faced restrictive laws designed to protect local retailers.

MARKETING AND DISTRIBUTION LAWS These laws determine which practices are allowed in advertising, promotion, and distribution. For example, Finland, France, and Norway prohibit cigarette advertising on television. Germany largely prohibits comparative advertising, in which a product is promoted as superior to a competing brand. Many countries cap the prices of critical goods and services, such as food and health care. Such constraints affect firms' marketing and profitability. Product safety and liability laws hold manufacturers and sellers responsible for damage, injury, or death defective products cause. In the case of violations, firms and company executives are subject to legal penalties, such as fines or imprisonment, as well as civil lawsuits. Product liability laws in developing countries are generally weak. Some firms take advantage of these weaknesses. For example, as litigants pursued tobacco companies in Europe and the United States, these companies shifted much of their marketing of cigarettes to developing countries.

LAWS ON INCOME REPATRIATION MNEs earn profits in various countries and typically seek ways to transfer these funds back to their home country. However, in some countries, governments devise laws that restrict such transfers. The action is often taken to preserve hard currencies, such as euros, U.S. dollars, or Japanese yen. Repatriation restrictions limit the amount of net income or dividends that firms can remit to their home-country headquarters. Although such constraints often discourage inward FDI, they are common in countries experiencing a shortage of hard currencies.

Source: Blend Images/123RF

Governments around the world are contemplating ways to tax and regulate e-commerce and the Internet.

ENVIRONMENTAL LAWS Governments enact laws to preserve natural resources; to combat pollution and the abuse of air, earth, and water resources; and to ensure health and safety. In Germany, for example, companies must follow strict recycling regulations. Manufacturers and distributors bear the burden of recycling product packaging. Governments usually try to balance environmental laws against the impact such regulations may have on employment, entrepreneurship, and economic development. For example, environmental standards in Mexico are looser or less well enforced than in some other countries, but the Mexican government is reluctant to strengthen them for fear that foreign MNEs may reduce their investments there.

CONTRACT LAWS International contracts attach rights, duties, and obligations to the contracting parties. Contracts are used in five main types of business transactions:

- Sale of goods or services, especially large sales.
- Distribution of the firm's products through foreign distributors.
- Licensing and franchising—that is, a contractual relationship that allows a firm to use another company's intellectual property, marketing tools, or other assets for a fee.
- FDI, especially in collaboration with a foreign entity, to create and operate a foreign subsidiary.
- Joint ventures and other types of cross-border collaborations.

Numerous countries are attempting to develop an international standard for international sales contracts. The United Nations Convention on Contracts for the International Sale of Goods (CISG) is a uniform text of law for international sales contracts. More than 75 countries are now party to the CISG, covering about three-quarters of all world trade. Unless excluded by the express terms of a contract, the CISG is deemed to supersede any otherwise applicable domestic law(s) regarding an international sales transaction.

INTERNET AND E-COMMERCE REGULATIONS Internet and e-commerce regulations are the new frontier in legal systems and continue to evolve.[32] Firms that undertake e-commerce in countries with weak laws face considerable risk. In China, for example, the government has developed legislation to ensure security and privacy due to the rapid spread of the Internet and e-commerce. Many consumer-privacy laws have yet to be enacted, and progress has been delayed on the development of methods to protect private data from criminal or competitive eyes. Protections for online contracting methods have been implemented with the recent adoption of e-signature laws. Emergent e-signature laws offer protections for online contracting.

INADEQUATE OR UNDERDEVELOPED LEGAL SYSTEMS Just as laws and regulations can lead to country risk, an underdeveloped regulatory environment or poor enforcement of existing laws can also pose challenges for the firm. Worldwide, safeguards for intellectual property are often inadequate. Regulations to protect intellectual property may exist on paper but not be adequately enforced. When an innovator invents a new product, develops new computer software, or produces some other type of intellectual property, another party may copy and sell the innovation without paying the inventor. Russia's legal framework is relatively weak and inconsistent. Russian courts lack substantial experience ruling on business matters. Due to the unpredictable and potentially harmful legal environment, Western firms frequently abandon joint ventures and other business initiatives in Russia.[33]

Inadequate legal protection is most common in developing economies but can be a factor in developed economies as well. The recent global financial crisis was precipitated, in part, by insufficient regulation in the financial and banking sectors of the United States, Europe, and other regions. Government authorities have been considering how regulatory structures can be revamped to provide a sounder footing for connecting global savers and investors as well as reliable methods for managing financial instability. Governments seek to expand regulation, provide new means to increase transparency and information flows, and find ways to harmonize regulatory policies and legal frameworks across national borders. Banks and other financial institutions are revising disclosure rules to make information more specific and consistent. Some experts believe the financial crisis does not imply that more regulation is needed. Rather, they argue for more intelligent regulation, better enforcement of existing regulation, and better supervision of financial institutions.[34]

Read the *You Can Do It: Recent Grad in IB*, which features Christopher Johnson. Chris enhanced his knowledge about the international regulatory and taxation environment through study abroad.

Country Risk Arising from the Home-Country Legal Environment

Does country risk arise only due to the host country's legal environment? No, home-country legal systems also play a role. **Extraterritoriality** refers to the application of home-country laws to persons or conduct outside national borders. In most cases, such laws are intended to prosecute individuals or firms located abroad for some type of wrongdoing.

Extraterritoriality
Application of home-country laws to persons or conduct outside national borders.

Examples of extraterritoriality in international business abound. A French court ordered Yahoo! to bar access to Nazi-related items on its website in France and to remove related messages and images from its sites accessible in the United States. In 2018, the European Union fined Qualcomm $1.2 billion for unfair and anti-competitive practices because, for several years, Qualcomm had paid billions of dollars to Apple to ensure Apple would use only Qualcomm's chipsets in the production of iPhones and iPads. In effect, the European Union fined Qualcomm for unfairly favoring Apple, at the expense of Intel, even though all three companies are based in the United States. Businesses generally oppose extraterritoriality because it tends to increase the costs and uncertainty of operating abroad.[35]

THE FOREIGN CORRUPT PRACTICES ACT (FCPA) The U.S. government passed the Foreign Corrupt Practices Act (FCPA), which bans firms from offering bribes to foreign parties to secure or retain business. The FCPA was enacted after more than 400 U.S. companies admitted paying bribes to foreign government officials and politicians. The Act also covers foreign firms and managers who act in furtherance of corrupt payments while in the United States. The FCPA requires

You Can Do It RECENT GRAD IN IB

CHRISTOPHER JOHNSON

- **Education:** Bachelor's and master's in accounting
- **Objectives:** Develop a career as a tax practitioner in the financial services industry
- **Internships during college:** State of Georgia, Georgia Lottery; Deloitte Tax LLP
- **Jobs held since graduating:** Deloitte Tax LLP in Chicago, IL, and Atlanta, GA; The Ayco Company: A Subsidiary of Goldman Sachs

Source: Christopher Johnson

During his junior year, Christopher participated in a two-week study abroad program in Istanbul, Turkey. The program gave Chris a global business perspective and inspired a passion to work for a multinational organization in the financial industry. Meetings with business executives and with students from a local university proved invaluable. The experience whetted Chris' desire to learn as much as possible about global business. Chris learned about various aspects of the political and legal environment in international business.

After graduation, Chris interned with Deloitte Tax. There he gained technical, analytical, and enhanced communication skills. Following his internship, Chris entered graduate school and earned a Master's in Accountancy. Upon graduation, he took a full-time position with Deloitte in their tax division. Initially he worked in domestic compliance and global jurisdictional exposure. After two years with the firm, Chris began consulting with multiple clients. Christopher consults on taxation with various multinational firms, including projecting tax implications of business combinations or acquisitions, managerial changes, proposed or enacted legislation, or other market factors.

Christopher's Advice for International Exposure

"Capitalizing on an opportunity to broaden your educational and professional horizon is not only enjoyable but essential in an ever-changing global society. Understanding the role that international business plays across cultural variations will allow for a well-developed global commerce perspective. Such exposure will also assist with determining your specific career path of choice."

Professional Success Factors

"The transition from college to corporate America has the potential to be extremely difficult. My advice to those that are approaching this milestone is to *have a strong sense of self*. Knowing your strengths and limitations will allow you to succeed anywhere your career takes you, domestically or abroad. Don't hesitate to step into unfamiliar situations, countries, or cultures. This experience will only give you more self-confidence. I believe exposing myself to a remarkably different country such as Turkey turned out to be more instructive than studying in London or Rome.

"The most important part of your career is the execution. Practical and skillful application of diverse knowledge is what employers seek worldwide. In many ways, the workplace is a classroom. I would advise new graduates that continuous learning will prove invaluable in professional roles and personal endeavors. Written and oral communication skills are important. Knowing my field is only half the battle; being an effective communicator is critical too. When communicating with foreign clients, it is important to develop interpersonal relations and teamwork, and seek to understand diverse and multicultural work environments."

Challenges

"The biggest challenge I faced in my early professional career was to learn how to take time for personal interests such as family, friends, and the study of cultures. Often, young professionals who are new to the corporate setting view themselves as working machines rather than actual human beings that require more than their employer's support. I have learned to enjoy the journey of success."

Source: Courtesy of Christopher Johnson.

companies with securities listed in the United States to meet U.S. accounting provisions. Such firms must devise and maintain accounting systems that control and record all company expenditures.[36] One problem with the FCPA is that "bribe" is not clearly defined. For example, the Act draws a distinction between bribery and facilitation payments; the latter may be permissible if making such payments does not violate local laws.[37]

Some U.S. managers argue the FCPA harms their interests because foreign competitors often are not constrained by such laws. FCPA criminal and civil penalties are increasingly harsh. Firms can be fined up to $2 million, and individuals can be fined up to $100,000 and face imprisonment. In 2017, the U.S. energy services company Halliburton agreed to pay a $29 million fine to settle charges related to payments made to a company in Angola. Halliburton had paid the Angolan firm in order to win lucrative oilfield services contracts.[38]

ACCOUNTING AND REPORTING LAWS Accounting practices and standards differ greatly around the world, posing difficulties for firms. For example, when assigning value to stocks and other securities, most countries use the lower of cost or market value. Brazil, however, encourages firms to adjust portfolio valuations because of historically high inflation. When valuing physical assets such as plant and equipment, Canada uses historical costs. Some Latin American countries use inflation-adjusted market value. Although firms can write off uncollectible accounts in the United States, the allowance is not permitted in France, Spain, and South Africa. Research and development costs are expensed as incurred in most of the world but capitalized in South Korea and Spain. Belgium, Malaysia, and Italy use both conventions.

TRANSPARENCY IN FINANCIAL REPORTING The timing and transparency of financial reporting vary widely around the world. **Transparency** is the degree to which firms regularly reveal substantial information about their financial condition and accounting practices. In the United States, public firms are required to report financial results to stockholders and to the Securities and Exchange Commission each quarter. In much of the world, however, financial statements are prepared annually or less often, and they often lack transparency. Transparency improves business decision making and the ability of citizens to hold companies accountable.

Transparency The degree to which companies regularly reveal substantial information about their financial condition and accounting practices.

Recently, the U.S. Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act, which aims to increase transparency in the United States financial sector. Passed in response to the late-2000s recession, the Act created an oversight board that monitors banking activities. It aims to reduce financial risk-taking by restricting certain banking activities and requiring bank executives to be responsible for compliance. Running to more than 2,000 pages of new regulations, banks have condemned the Act for imposing too many regulatory costs. U.S. affiliates of foreign multinational banks must comply with the Act's provisions. In an effort to avoid rigid financial requirements, some European banks are reducing their banking activities in the United States. Recently, the European Union introduced the Basel III global regulatory standard, which aims to increase the quality and transparency of the capital base of European banks. U.S. banks will be required to comply with the new Basel III rules.[39]

Ethical Connections

Many countries lack antibribery laws for international transactions. The Organisation for Economic Co-operation and Development recently called for a ban on grease payments, small-scale bribes intended to speed up telephone hookups, government paperwork, and other everyday matters in international commerce. A culture of grease payments and other corruption is corrosive, harming the rule of law and sustainable economic development.

Managing Country Risk

6.7 Know about managing country risk.

How should managers respond to country risk? In the discussion that follows, we highlight several specific strategies managers can employ to manage country risk.

Proactive Environmental Scanning

Anticipating country risk requires advance research. Initially, managers develop a comprehensive understanding of the political and legal environment in target countries. They then engage in *scanning* to assess potential risks and threats to the firm. Scanning allows the firm to improve practices in ways that conform to local laws and political realities and to create a positive environment for business success.

One of the best sources of intelligence in the scanning process is employees working in the host country. They are knowledgeable about evolving events and can evaluate them in the context of local history, culture, and politics. Embassy and trade association officials regularly develop and analyze intelligence on the local political scene. Some consulting firms, such as Verisk Maplecroft (www.maplecroft.com) and Business Entrepreneurial Risk Intelligence (www.beri.com), specialize in country-risk assessment and provide guidelines for appropriate strategic responses. Once the firm has researched the political climate and contingencies of the target environment, it develops and implements strategies to facilitate effective management of relations with policymakers and other helpful contacts in the host country. The firm then takes steps to minimize its exposure to country risks that threaten its performance.

Strict Adherence to Ethical Standards

Ethical behavior is important not only for its own sake but also because it helps insulate the firm from some country risks that less-conscientious firms encounter. Those companies that engage in questionable practices or operate outside the law naturally invite redress from the governments of the host countries where they do business.

Alliances with Qualified Local Partners

A practical approach to reducing country risk is to enter target markets in collaboration with a knowledgeable and reliable local partner. Qualified local partners are better informed about local conditions and better situated to establish stable relations with the local government. Western firms often enter China and Russia by partnering with local firms that assist in navigating complex legal and political landscapes.

Protection Through Legal Contracts

A legal contract spells out the rights and obligations of each party. Contract law varies widely from country to country, and firms must adhere to local standards. For example, a Canadian firm doing business in Belgium generally must comply with the laws of both Belgium and Canada as well as with the evolving laws of the European Union.

Firms generally employ any of three approaches for resolving international disputes.

- *Conciliation* is the least adversarial method. It is a formal process of negotiation with the objective to resolve differences in a friendly manner. The parties in a dispute employ a conciliator, who meets separately with each in an attempt to resolve their differences. Parties can also employ mediation committees—groups of informed citizens—to resolve civil disputes.
- *Arbitration* is a process in which 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. Compared to litigation, arbitration saves time and expense while maintaining the confidentiality of proceedings. Arbitration is often handled by supranational organizations such as the International Chamber of Commerce in Paris or the Stockholm Chamber of Commerce.
- *Litigation* is the most adversarial approach and occurs when one party files a lawsuit against another to achieve desired ends. Litigation is most common in the United States; most other countries favor arbitration or conciliation.

CLOSING CASE The Global Biopharmaceutical Industry: Political, Legal, and Ethical Dilemmas

The global biopharmaceutical industry develops, produces, and markets medications. The industry includes a dozen large firms, including Pfizer (based in the United States, www.pfizer.com), Roche (Switzerland, www.roche.com), Sanofi (France, www.sanofi.com), and AstraZeneca (United Kingdom, www.gsk.com). Europe and North America account for most of global pharmaceutical sales, but emerging market countries like Brazil and China are experiencing rapid sales growth and show much promise. The industry achieved worldwide sales of over $1.1 trillion in 2017. The industry is confronted with several challenges.

High Cost of Research and Development

Among all industries, the biopharmaceutical industry invests the most in R&D, creating and marketing medications meant to treat everything from cancer to hair loss. Thousands of biopharmaceutical medications allow people to live longer and healthier lives. Europe and the United States benefit from strong patent protection laws and abundant investment capital. According to industry statistics, it takes 10 to 15 years from initial discovery to approval of a new medicine. For every 5,000 to 10,000 compounds that enter the research pipeline, only one receives approval. The average R&D investment for each new approved medicine, including the cost of failures, exceeds $1.2 billion. Some estimates are much higher. Only three out of every 10 newly approved medicines are successful enough to recover their R&D costs. For their successful products, biopharmaceutical firms must charge prices high enough not only to recover the high costs of product development but also to recover the cost of products that never achieve profitability.

Limited Protection for Intellectual Property

Protecting property rights is a key objective of legal systems. Governments grant patents and provide other types of protections for intellectual property. In practice, such protection is often inadequate, especially in developing countries, where biopharmaceutical firms encounter substantial country risk. India has a history of weak intellectual property protection, which has discouraged R&D and innovation. Most people in India have low incomes, and few Indians can afford medications. India has a long history of producing counterfeit and pirated medications, often by violating the drug patents of foreign pharmaceutical firms. Illicit laboratories in India have freely infringed on drug patents and engaged in a selling free-for-all in the huge Indian biopharmaceutical market. They reverse-engineered patented compounds developed by European and U.S. companies and began selling the pirated generics at drastically lower prices. Foreign biopharmaceutical firms routinely pursue legal action against these violations, but given limited patent protection, India's generic drug manufacturers have flourished.

The Challenge from Generic Brands

Under World Trade Organization (WTO) rules, a patent protects a drug inventor from competition for up to 20 years. In reality, when the lengthy testing and approval phase is factored in, the effective life of a drug patent is often less than 12 years. The manufacturer typically has only five to eight years of patent protection in which to recover its investment before generic manufacturers can legally enter the market. Once a patent expires, generic manufacturers have the right to produce medications originally invented by major pharmaceuticals. Generic manufacturers typically sell the medications that they produce at very low prices. Patent protections are important because they encourage innovation by allowing inventors a limited opportunity to recover their R&D investments. However, patent protection laws governing biopharmaceuticals differ substantially around the world.

Each year biopharmaceutical firms invest some 20 percent of revenues in R&D to invent new compounds, used to develop new medications. The main reason that generic manufacturers can charge lower prices is that they do not incur the high costs of R&D to develop new medications. Because the medications are already established in the marketplace, generic manufacturers also incur substantially lower marketing and sales expenses.

In the world of generic drugs, Israel-based Teva (www.tevapharm.com) is the largest manufacturer with global sales of more than $22 billion. In the United States, generic medications account for more than half of all dispensed prescriptions. Once a branded compound's patent expires, generic manufacturers begin producing generic versions. Retail prices for the compound can fall by as much as 90 percent within 12 to 18 months.

Counterfeit Drugs

Worldwide, enforcement of intellectual property law varies. Many governments fail to ensure the quality of imported medicines. As a result, a growing industry of counterfeit and bio-inequivalent medications has emerged worldwide. A counterfeit ring from China supplied 1 million fake OneTouch Test Strips (used to treat diabetes) to hundreds of pharmacies in Canada, India, the United States, and numerous other countries. In Niger, some 2,500 people died after receiving fake vaccines for meningitis. European Union officials seized more than 35 million fake pills at ports around Europe, including drugs intended to treat malaria, cancer, cholesterol, and pain.

The World Health Organization estimates that up to 30 percent of medicines sold in developing economies may be counterfeit. In sub-Saharan Africa, counterfeits contribute to 115,000 deaths from malaria annually. Fake drugs are a factor in as many as 300,000 deaths each year in China. Up to 160,000 children die annually from pneumonia after receiving counterfeit medications. Sales of counterfeit biopharmaceuticals exceed $500 billion each year. Counterfeiting is greatest in countries where regulatory oversight is weakest.

Internet-based pharmacies are especially dubious. MarkMonitor, an industry watchdog, found that only a fraction of several thousand online pharmacies it examined were legitimate. Many of the pharmacies claiming to be based in Canada and the United States were in fact traced to China, Russia, and India. It is estimated that more than 50 percent of medicines sold through the Internet are fake—often containing no or too little of the active ingredient.

Because of the threats that counterfeit manufacturers pose, branded biopharmaceutical firms spend significant resources to protect their patents and intellectual property around the world. Branded manufacturers have pursued legal actions at the WTO and against individual nations. The WTO's agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) was approved by approximately 150 WTO member countries.

Neglected Therapeutic Areas

A large portion of biopharmaceutical research is focused on developing treatments for diseases that can return the cost of capital and generate profits. For these reasons, biopharmaceutical firms tend to target the most attractive markets. For example, these firms are more likely to develop a drug for cancer and cardiovascular diseases than for ailments common to poor countries such as tuberculosis. R&D to develop drugs common in poor countries is often perceived as too costly and risky.

At the same time, governmental and private initiatives have begun to address these market realities by providing incentive packages and public–private partnerships. For example, the Bill and Melinda Gates Foundation (www.gatesfoundation.org) is investing billions of dollars to fight AIDS, tuberculosis, and various infectious diseases that affect developing countries.

Public Scrutiny

The biopharmaceutical industry's actions are often subject to public scrutiny within national political and legal systems. For example, the government of South Africa got into a tussle with several manufacturers of branded AIDS drugs. Because of high prices, the government sanctioned the importation of nonapproved generics. The reaction from branded biopharmaceutical manufacturers was to sue South Africa, which created an international backlash against the firms. Not only did the episode generate much negative publicity for the branded pharmaceutical firms, it made people more aware of the generic drug industry and its potential for helping those the AIDS pandemic affects. In the wake of the South African debacle, Brazil and several other countries threatened to break patents if biopharmaceutical firms did not make their drugs more affordable. In the interest of good public relations, several branded biopharmaceutical firms began to offer their AIDS drugs at lower prices in Africa. The United States and various European governments have provided billions of dollars in subsidies to support AIDS treatment in Africa.

The Future

Without adequate intellectual property protection, the biopharmaceutical industry has fewer incentives to invent new drugs. At the same time, consumers in poor countries need access to drugs but can't afford them. Lax intellectual property laws facilitate the production of cheap generic drugs, but without these protections, major biopharmaceutical firms have fewer incentives to fund the R&D that results in new treatments for the diseases that plague the world. As selling prospects in Brazil, China, and other emerging markets develop over time, biopharmaceutical firms increasingly target those markets but face enormous challenges.

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Case Questions

6-4. Specify the types of country risks that biopharmaceutical firms face in international business. How do the political and legal systems of countries affect the global biopharmaceutical industry?

6-5. People need medications, but the poor often cannot afford them. Governments may not provide subsidies for health care and medications. Meanwhile, biopharmaceutical firms focus their R&D on compounds likely to provide the best returns. What is the proper role of the following groups in addressing these dilemmas: national governments, branded biopharmaceutical firms, and generic manufacturers?

6-6. Consult www.phrma.org, the Pharmaceutical Research and Manufacturers of America. What steps is the branded industry taking to address the various ethical issues it faces, such as providing affordable drugs to poor countries?

6-7. Consult the TRIPS agreement at the WTO portal (www.wto.org). What are the latest developments regarding this treaty? What types of protection does this treaty provide to pharmaceutical firms? What enforcement mechanisms does TRIPS provide for ensuring that these protections will be carried out?

6-8. Recommend a strategy that management at a large biopharmaceutical firm should employ to reduce the likelihood of political and legal risks that such firms face. What steps should management take to minimize its exposure to such risks?

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Note: Kevin McGarry assisted in the development of this case.

END-OF-CHAPTER REVIEW

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Key Terms

country risk 184	National governance 189	rule of law 191
extraterritoriality 199	political system 186	transparency 201
legal system 186		

Summary

In this chapter, you learned about:

- **Political and legal environments in international business**

  International business is influenced by political and legal systems. Country risk refers to exposure to potential loss or to adverse effects on company operations and profitability caused by developments in national political and legal environments. A political system is a set of formal institutions that constitute a government. A legal system is a system for interpreting and enforcing laws. Adverse developments in political and legal systems increase country risk. These can result from events such as a change in government or the creation of new laws or regulations.

- **Political systems**

  The three major political systems are authoritarianism, socialism, and democracy. They provide frameworks within which laws are established and nations are governed. Democracy is characterized by private property rights and limited government. Socialism occurs mainly as social democracy. Today, most governments combine elements of socialism and democracy. Authoritarianism is associated with command economies, socialism with mixed economies, and democracy with market economies.

- **Legal systems**

  There are four major legal systems: common law, civil law, religious law, and mixed systems. The rule of law implies a legal system in which laws are clear, understood, respected, and fairly enforced.

- **Participants in political and legal systems**

  Actors include government, which exists at the national, state, and municipal levels. The World Trade Organization and the United Nations are typical of international organizations that influence international business. Special interest groups serve specific industries or country groupings and include labor unions, environmental organizations, and consumers that promote particular viewpoints. Companies deal with competing firms in foreign markets, which may undertake political activities aimed at influencing market entry and firm performance.

- **Types of country risk produced by political systems**

  Governments impose constraints on corporate operating methods in areas such as production, marketing, and distribution. Governments may expropriate or confiscate the assets of foreign firms. Governments or groups of countries also impose embargoes and sanctions that restrict trade with certain countries. Boycotts are an attempt to halt trade or prevent business activities and are usually pursued for political reasons. War and revolution have serious consequences for international firms. Terrorism has become more salient recently.

- **Types of country risk produced by legal systems**

  Foreign investment laws restrict FDI in various ways. Such laws include controls on operating forms and practices, regulations affecting marketing and distribution, restrictions on income repatriation, environmental laws, and Internet and e-commerce regulations. Extraterritoriality is the application of home-country laws to conduct outside of national borders. Accounting and reporting laws vary around the world. Transparency is the degree to which firms reveal substantial and regular information about their financial condition and accounting practices.

- **Managing country risk**

  Successful management requires developing an understanding of the political and legal context abroad. The firm should scan the environment proactively and strictly adhere to ethical standards. Country risk is also managed by allying with qualified local partners abroad. The firm should seek protection through legal contracts.

Test Your Comprehension

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6-9. Adverse and sudden developments in political and legal systems can create country risk. Suggest three examples of such adverse developments.

6-10. Define the concept of national governance. What are the common characteristics and the associate economic freedoms of national governance?

6-11. What are the specific characteristics of market economies and mixed economies? Which is more common?

6-12. What are the pillars upon which effective and legitimate laws are based?

6-13. Special interest groups operate in most countries. They tend to have distinctive agendas. What is their role in the political and legal system?

6-14. Why should an organization strictly adhere to ethical standards wherever it operates?

Apply Your Understanding

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6-15. Country risk refers to the ways governments restrict or fail to restrict business activities. The nature of such restrictions varies around the world. In each country, national economic success substantially depends on the quality of laws and regulations. Government must strike the right balance—too little regulation promotes uncertainty; too much causes hardship. Country risk is revealed in various ways.

- Foreign investment laws
- Controls on operating forms and practices
- Environmental laws
- Contract laws
- E-commerce laws
- Underdeveloped legal systems
- Accounting and reporting laws

Conduct research online, and give specific examples of each type of country risk. Describe how each might help or hinder company activities.

6-16. Suppose you get a job at Aoki Corporation, a firm that manufactures glass for industrial and consumer markets. Aoki is a large firm but has little international experience. Senior managers are considering a plan to move Aoki's manufacturing to China, Mexico, or Eastern Europe and to begin selling its glass in Latin America and Europe. However, they know little about the country risks that Aoki may encounter. Describe how each of the following factors might contribute to country risk as Aoki ventures abroad: foreign investment laws, controls on operating forms and practices, and laws regarding repatriation of income, environment, and contracts.

6-17. *Ethical Dilemma*: The United States imposed a trade and investment embargo on Iran. U.S. citizens were barred from doing business with Iran. Proponents argued the embargo was justified because Iran has supported terrorism, is developing nuclear weapons, and is a disruptive force in the Middle East. However, critics condemned the trade sanctions for several reasons. First, they argued the sanctions represented a double standard because the United States supports other countries that have engaged in terrorism and other bad behaviors. Second, the best way to nurture healthy dissent and civil society in Iran may be to engage the country rather than restrict economic relationships. Third, the sanctions harmed the Iranian people, who were deprived of the benefits of trade with the United States. Fourth, the sanctions were largely ineffective because other countries supply Iran with products it needs. Finally, the sanctions harmed U.S. companies, especially oil and gas firms, which were prevented from doing business with Iran. What is your view? Using the ethical framework in Chapter 4, analyze the arguments for and against trade with Iran. Can the United States, acting alone, compel desired changes in Iran by imposing sanctions? Justify your answer.

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INTERNET EXERCISES

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6-18. Supranational organizations such as the World Bank (www.worldbank.org) and the World Trade Organization (www.wto.org) oversee much of the legal framework within which the world trading system operates. Political frameworks for industries or country groupings are influenced by organizations such as the Organization of Petroleum Exporting Countries (www.opec.org) and the Organisation for Economic Co-operation and Development (www.oecd.org). Using globalEDGE™ and the online portals cited here, address the following question: What is the goal of each organization, and how does it go about achieving its goal? By viewing the news and press releases at each website, summarize the latest initiatives of each organization.

6-19. When companies venture abroad, managers seek information on the legal and political environments in each country. This information is available from various web sources, as illustrated in the following exercises. (a) Suppose you want to sign up distributors in the European Union and want to learn about EU contract law. What should you do? Consult the globalEDGE™ portal to learn about EU trade and contract laws. Try the following: At globalEDGE™, click Reference Desk, Global Resource Directory, and then Trade Law. Describe the resources there for learning about contract law in Europe. (b) The Central Intelligence Agency's portal provides up-to-date information about national governments and political environments. Go to www.cia.gov, click World Factbook, and summarize the political environment in each of China, Colombia, France, and Russia.

6-20. Freedom House is a nonprofit organization that monitors the state of freedom worldwide. It conducts an annual Freedom in the World Survey, which you can view at www.freedomhouse.org. The survey compares the state of political rights and civil liberties in nearly 200 countries over time. Visit the site, and answer the following questions. (a) What is the role of political rights and civil liberties in the Freedom House rankings? (b) What can governments in these countries do to facilitate more rapid social and political development? (c) What are the implications of the rankings for companies doing international business?

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Chapter 7

Government Intervention and Regional Economic Integration

Learning Objectives *After studying this chapter, you should be able to:*

7.1 Understand the nature of government intervention.

7.2 Know the instruments of government intervention.

7.3 Explain the evolution and consequences of government trade intervention.

7.4 Describe how firms can respond to government trade intervention.

7.5 Understand regional integration and economic blocs.

7.6 Identify the leading economic blocs.

7.7 Understand and explain the advantages and implications of regional integration.

Tripartism: Singapore's Key Competitive Advantage

The Hollywood blockbuster *Crazy Rich Asians*, featuring the lives of ultra-rich Chinese Singaporeans, reflects the island nation's global reputation for its wealth. Yet Singapore is a country with a precarious beginning. When Singapore was expelled from Malaysia on August 9, 1965, Singapore's then prime minister Lee Kuan Yew gave an emotional speech that conveyed a sense of hopelessness. To deepen the gloom, Britain's plans to withdraw its military bases from Singapore by the early 1970s meant a loss of more than 20 percent of Singapore's GDP. How did a small island nation with no natural resources survive under such circumstances?

To facilitate export-oriented economic growth, the Singaporean government had to attract foreign direct investment (FDI) to bring in crucial capital and technology. A more conducive business environment was created through government-linked corporations such as PSA, a port operator founded in April 1964; SIA, which was founded in May 1947 as Malayan Airways and commenced operations in October 1972 as Singapore Airlines; NOL, a shipping line founded in December 1968; DBS Bank, founded in July 1968; and JTC Corporation, a real-estate company and statutory board founded in June 1968. Other statutory boards included the Economic Development Board, formed in August 1961 to coordinate industrialization; the National Productivity Board, established in 1972 to focus on productivity; and the Trade Development Board, established in 1983 to coordinate trade. The government's