GLOBAL EDITION

INTERNATIONAL BUSINESS

The Challenges of Globalization

TENTH EDITION

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response to allegations of abuse of the Uyghur minority there. The issue caused human rights groups worldwide to call for a boycott of the 2022 Winter Olympics in Beijing. Rights organizations will likely continue to criticize businesses that engage with countries accused of such actions.

4.1.2 Democracy

democracy
Political system in which government leaders are elected directly by the wide participation of the people or by their representatives.

A **democracy** is a political system in which government leaders are elected directly by the wide participation of the people or by their representatives. Democracy differs from totalitarianism in nearly every respect. The foundations of modern democracy go back at least as far as the ancient Greeks.

The Greeks tried to practice a *pure* democracy, one in which all citizens participate freely and actively in the political process (though participation was only open to adult males). But a pure democracy is more an ideal than a workable system for several reasons. Some people have neither the time nor the desire to get involved in the political process. Citizens can also be less able to participate completely and actively as a population grows and as the barriers of distance and time increase. Direct voting sometimes reflects a wide variety of conflicting opinions and little or no consensus among citizens. This can make it extremely difficult or impossible for leaders in a pure democracy to form cohesive policies.

representative democracy
Democracy in which citizens elect individuals from their groups to represent their political views.

REPRESENTATIVE DEMOCRACY For practical reasons, then, most nations resort to a **representative democracy**, in which citizens elect professional individuals from their groups to represent their political views. These representatives help govern the nation and pass laws. The citizens periodically vote and reelect representatives they approve of and replace those they no longer want to represent them.

Representative democracies strive to provide some or all of the following:

- ***Freedom of Expression*** A constitutional right in most democracies, freedom of expression ideally grants the right to voice opinions freely and without fear of punishment.
- ***Periodic Elections*** Each elected representative serves for a period of time, after which the citizens (or electorate) decide whether to retain that representative.
- ***Full Civil and Property Rights*** Civil rights include freedom of speech, freedom to organize political parties, and the right to a fair trial. Property rights are the privileges and responsibilities of owners of property, such as homes, businesses, and trademarks.
- ***Minority Rights*** Democracies try to preserve peaceful coexistence among groups of people with diverse cultural, ethnic, lifestyle, and racial identities. Ideally, the same rights and privileges extend legally to each group, no matter how few its members.
- ***Nonpolitical Bureaucracies*** The bureaucracy is the part of government consisting of appointed individuals that implements and enforces legislation. *Politicized bureaucracies* implement decisions according to the bureaucrats' political views rather than those of the people or their representatives. This clearly contradicts the purpose of the democratic process.

Despite such shared principles, countries vary in their practice of representative democracy. Britain practices *parliamentary democracy*. The nation divides itself into geographical districts and people in each district vote for competing *parties* rather than individual candidates. A party wins the right to govern the country if it gains an *absolute majority*—that is, the number of representatives that a party gets elected exceeds the number of representatives elected by all other parties.

If the party with the largest number of representatives lacks an absolute majority, it can join with one or more other parties to form a *coalition government*. This means the strongest political parties share power by dividing government responsibilities among themselves. Coalition governments are often formed in Italy, Israel, and the Netherlands where the large number of political parties makes it difficult for any single party to gain an absolute majority.

Nations also differ in the relative power that each political party commands. In some democracies a single political party has effectively controlled the system for decades. In Japan the Liberal Democratic Party (which is actually conservative) has enjoyed nearly continuous control of the government since 1955. In Mexico the Institutional Revolutionary Party (PRI) ran the country for 71 years until 2001 when the conservative National Action Party (PAN) won the presidency. The PRI returned to power for six years following the presidential election in 2012 but lost again in 2018.

DOING BUSINESS IN DEMOCRACIES Nations having democratically elected governments strive to maintain stable business environments primarily through a legal system that protects individual property rights. Democracies tend to encourage entrepreneurial activity and protect business with strong property-rights laws. In theory, commerce prospers when an economy predominantly consists of independently owned firms that seek to earn profits. Market-based economies are rooted in the belief that private ownership of the means of production leads to the greatest economic progress for everyone. The levers of capital left in the hands of private individuals and companies is the foundation of what is called the *free market*.

Although participative democracy, property rights, and free markets tend to encourage economic growth, they do not always do so. For instance, India is the world's largest democracy but it experienced slow economic growth for decades until recently. Meanwhile, some countries achieved rapid economic growth under political systems that were not truly democratic. The four tigers of Asia—Hong Kong, Singapore, South Korea, and Taiwan—built strong market economies in the absence of truly democratic practices.

Political economist Dani Rodrik explains that a country can pursue further growth through globalization, national sovereignty, and democracy but only two of these at a time. For example, if a nation wishes to pursue further growth through globalization it must sacrifice either some national sovereignty to global institutions or a degree of its democratic politics.[7] In fact, that was the approach many nations followed, including the United States. But in recent years some countries are sacrificing globalization and choosing to retain their sovereignty and democratic politics.

QUICK STUDY 4.1

1. How are anarchism, totalitarianism, and pluralism different?
2. What are the main characteristics of the political system known as communism?
3. What five things does a representative democracy strive to provide for its people?
4. How does doing business in a totalitarian country differ from doing business in a democracy?

4.2 Economic Systems

4.2 Explain how the three types of economic systems differ.

economic system
Structure and processes that a country uses to allocate its resources and conduct its commercial activities.

An **economic system** consists of the structure and processes that a country uses to allocate its resources and conduct its commercial activities. Every economy displays a *tendency* toward individualist or collectivist economic values that reflects the nation's culture. For example, one culture might prefer theories grounded in individual freedom and responsibility and create a market-based economic system. Meanwhile, another culture might value collectivist ideas and build a socialist or even centrally planned system.

We can arrange national economies on a horizontal scale that is anchored by two extremes. At one end of the scale is a theoretical pure *centrally planned economy*, at the other end is a theoretical pure *market economy*, and in between is a *mixed economy* (see Figure 4.1).

There is a fourth *traditional economy* from which all more-developed economies have grown. Traditional economies tend to not have complex divisions of labor and to engage in little or no trade. They are characterized by traditional yet highly sustainable activities such as farming, fishing, hunting, and gathering. We do not discuss traditional economies because of their low level of economic development. Still, as many as three to four billion people live in traditional economies and they are an important part of our world.[8]

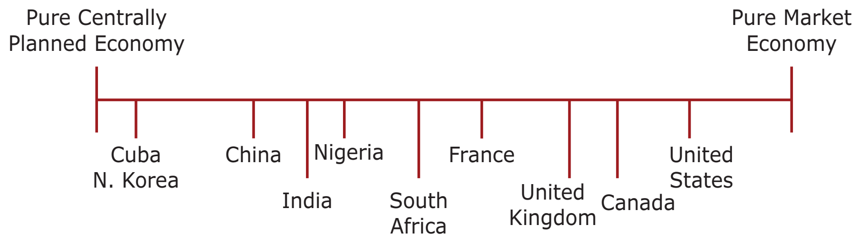

Figure 4.1
Range of Economic Systems

4.2.1 Centrally Planned Economy

centrally planned economy
Economic system in which the government owns a nation's land, factories, and other economic resources and plans nearly all economic activity.

A **centrally planned economy** is a system in which the government owns a nation's land, factories, and other economic resources. The government makes nearly all economic decisions including who produces what and the prices of products, labor, and capital. Central planning agencies specify production goals for factories and other production units, and they even decide prices. In the former Soviet Union, for example, central planners set prices for milk, bread, eggs, and other essential goods. The ultimate goal of central planning is to achieve a wide range of political, economic, and social objectives by taking complete control over the production and distribution of a nation's resources. This makes it a favorite choice among leaders of communist political systems.

ORIGINS OF THE CENTRALLY PLANNED ECONOMY Central planning is rooted in the ideology of collectivism. Just as collectivist cultures emphasize group goals over individual ones, a centrally planned economy strives to achieve economic and social equality for the sake of the collective, not the individual.

German philosopher Karl Marx popularized the idea of central economic planning in the nineteenth century. Marx formulated his ideas while witnessing the hardship endured by working-class people in Europe during and after the Industrial Revolution. Marxist ideology stresses the inequality of society between the owners of capital (bourgeoisie) and workers (proletariat). It argues that public ownership of productive resources can right this perceived ill. This ideology says an economy cannot be reformed but must be overthrown and replaced with a *communist* system.

Different versions of Marx's ideas were implemented in the twentieth century by means of violent upheaval. Revolutions installed totalitarian leaders and central planning in Russia in 1917, in China and North Korea in the late 1940s, and in Cuba in 1959. By the 1970s, central planning was the economic law in lands stretching across Central and Eastern Europe (Albania, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, and Yugoslavia), Asia (Cambodia, China, North Korea, and Vietnam), Africa (Angola and Mozambique), and Latin America (Cuba and Nicaragua).

DECLINE OF CENTRAL PLANNING Shortly after the former Soviet Union implemented its twin policies of *glasnost* (political openness) and *perestroika* (economic reform) in the late 1980s, its totalitarian government crumbled. Nation after nation in Central and Eastern Europe dismantled central planning in favor of market-based economies. Countries such as the Czech Republic, Hungary, Poland, Romania, and Ukraine created republican governments. But still today, Cuba and North Korea remain hardline communist nations.

North Koreans are shown working for a South Korean company at the Kaesong Industrial Zone inside North Korea. The special economic zone ran successfully for a dozen years. South Korean companies obtained lower-wage factory workers and North Korea received $90 million a year in hard currency it needed. Companies in the zone performed ginseng processing, textile and shoe production, and other light manufacturing. The venture symbolized cooperation between these two nations of one people. What benefits in addition to lower-cost labor and hard currency do you think the two Koreas gained from this economic cooperation?

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Centrally planned economies declined due to several factors:

- ***Failure to Create Economic Value*** Central planners failed to produce high-quality goods and services at low cost that created value for customers. Scarce resources were wasted in the pursuit of commercial activities that were not self-sustaining.
- ***Failure to Provide Incentives*** Government ownership of economic resources reduced incentives to maximize the output obtained from those resources. Except for the hard sciences (in which government scientists excelled), little commercial innovation occurred.
- ***Failure to Achieve Rapid Growth*** Some communist leaders noted the brisk economic growth of Hong Kong, Singapore, South Korea, and Taiwan. Rapidly rising standards of living in those nations awakened central planners to the promises of private ownership and innovation.
- ***Failure to Satisfy Consumer Needs*** Central planning was conceived to create a more equitable system of distributing wealth. But it failed to provide basic necessities such as adequate food, housing, and medical care. Underground (shadow) economies for goods and services flourished and sometimes outgrew official economies in which supplies were scarce.

China was experimenting with market economics even before the former Soviet Union began its reform programs. China's then-leader, Deng Xiaoping, encouraged dabbling in market economics and saw the incredible value the system created. Today China's economic system is characterized by what we call **state capitalism**—a system in which the state plays the role of the leading economic actor that exercises significant control and influence over industries and many firms.[9] China's experience with state capitalism has been highly successful in that the nation continues to register strong economic growth.

state capitalism
Economic system in which the state plays the role of the leading economic actor that exercises significant control and influence over industries and many firms.

4.2.2 Mixed Economy

A **mixed economy** is a system in which land, factories, and other economic resources are rather equally split between private and government ownership. The government controls economic sectors considered important to national security and stability. These sectors usually include iron and steel manufacturing (to build military equipment), oil and gas production (to guarantee availability), and heavy manufacturing (to guarantee employment). Mixed economies tend to assist key industries with special subsidies, maintain generous unemployment support, and provide subsidized or free health care. Mixed economies are found in Denmark, France, Norway, Spain, and Sweden in Western Europe; India, Indonesia, Malaysia, and South Korea in Asia; Argentina in South America; and South Africa.

mixed economy
Economic system in which land, factories, and other economic resources are rather equally split between private and government ownership.

ORIGINS OF THE MIXED ECONOMY Advocates of mixed economies contend that a successful economic system should be efficient and innovative yet protect society from the excesses of individualism and organizational greed. The goal is to achieve low unemployment, low poverty, steady economic growth, and an equitable distribution of wealth through government policies.

Citizens of many European nations prefer a combination of extensive benefits and higher unemployment to the low jobless rates and smaller social safety net of the United States. In France, for instance, the electorate holds fast to a deeply embedded tradition of social welfare and job security. It believes that the benefits of a more collectivist economy outweigh the efficiency advantages of an individualist one.

Yet when assets are owned by the government, there does not appear to be the tight budgetary focus on efficiency that one sees in a company's focus on the bottom line of profits.[10] Extensive government ownership tends to result in relatively higher costs and slower economic growth. And some government-owned businesses require infusions of taxpayer money to survive as world-class competitors. This can raise prices for the goods and services they create.

PROGRESS OF MIXED ECONOMIES Proponents of mixed economies point out that European and US rates of productivity and growth were almost identical for decades after the Second World War. They say that although the United States has created more jobs, it has done so at the cost of widening social inequality. Mixed economies believe they should not dismantle their social-welfare institutions but should modernize them so they contribute to national competitiveness.

Austria, the Netherlands, and Sweden modernized their economies to grow more competitive.[11] For example, labor unions and the government in the Netherlands agreed to an epic deal involving wage restraint, shorter working hours, budget discipline, new tolerance for part-time and temporary work, and the trimming of social benefits. As a result, unemployment in the Netherlands consistently hovers around 2.7 percent. By comparison, the average jobless rate for all nations in the Euro currency area is around 7.3 percent.[12]

Somewhat slow economic growth caused many mixed economies to want to increase economic efficiency, boost productivity, and raise living standards. These motives led them to pursue **privatization**—the selling of government-owned economic resources to private operators. Privatization helps eliminate subsidized materials, labor, and capital formerly provided to government-owned companies. Privatized companies confront the forces of the free market and must produce competitive products at fair prices to survive.

privatization
Policy of selling government-owned economic resources to private operators.

4.2.3 Market Economy

In a **market economy** (or **capitalism**), most of a nation's land, factories, and other economic resources are privately owned, by either individuals or businesses. Capitalism stands in stark opposition to socialism. In a market economy, the interplay of two forces determines who produces what as well as the prices of products, labor, and capital:

market economy (capitalism)
Economic system in which most of a nation's land, factories, and other economic resources are privately owned, by either individuals or businesses.

- **Supply:** the quantity of a good or service that producers are willing to provide at a specific selling price.
- **Demand:** the quantity of a good or service that buyers are willing to purchase at a specific selling price.

supply
Quantity of a good or service that producers are willing to provide at a specific selling price.

demand
Quantity of a good or service that buyers are willing to purchase at a specific selling price.

As supply and demand change for a good or service, so does its selling price. The lower a product's price, the greater buyer demand will be; and the higher its price, the lower demand will be. Likewise, the lower a product's price, the smaller the quantity that producers will supply; and the higher the price, the greater the quantity they will supply. In this respect, what is called the *price mechanism* (or market mechanism) dictates supply and demand.

Market forces and uncontrollable natural forces influence product prices. Chocolate lovers, for example, should consider how the interplay of several forces affects the price of cocoa, the principal ingredient in chocolate. Suppose cocoa consumption suddenly rises in large cocoa-consuming nations such as the United Kingdom, Japan, and the United States. Suppose further that disease and pests plague crops in cocoa-producing countries such as Brazil, Ghana, and the Ivory Coast. As worldwide consumption of cocoa begins to outstrip production, market pressure is felt on both the demand side (consumers) and the supply side (producers). Falling worldwide reserves of cocoa then force the price of cocoa higher.

ORIGINS OF THE MARKET ECONOMY Market economics is rooted in the belief that individual freedom and responsibilities should be placed above group concerns. According to this view, the entire group benefits when individuals receive incentives and rewards to act in specific ways.

For many centuries, the world's dominant economic philosophy supported government control of a significant portion of a society's assets. People generally expected and wanted their government to be involved in the nation's business activities. But in the mid-1700s a new approach to national economics called for less government interference in commerce and greater individual economic freedom. This approach became known as a *laissez-faire* system, loosely translated from French as "allow them to do [without interference]."

Canada and the United States are examples of contemporary market economies. It is no accident that both these countries have individualist cultures (although Canada to a somewhat lesser extent than the United States). Just as a cultural tendency toward individualism fosters a democratic form of government it also supports a market economy.

FEATURES OF A MARKET ECONOMY To function smoothly and properly, a market economy requires three things:

- ***Free choice*** gives individuals access to alternative purchase options and places few restrictions on consumers' ability to make selections. For example, a consumer shopping for a new smartphone has many options including the service provider; the number of lines; the type of wireless plan for data, talk, and text; the iPhone or Android operating system; and the phone's model, size, color, case, and so forth.

Unlike communist North Korea, South Korea's economy is grounded in free-market principles. The standard of living in South Korea is significantly higher versus that in North Korea. In fact, life expectancy is 86 for women and 80 for men in South Korea, and 76 years for women and 69 years for men in North Korea. Experts think that South Korea may even lead the world in life expectancy by 2030. Many South Korean firms dominate their industries and 15 South Korean firms appear in the Fortune Global 500 list of the world's largest companies. What do you think are the main reasons for the standard-of-living differences between North and South Korea?

Pat Behnke/Alamy Stock Photo

- ***Free enterprise*** gives companies the ability to decide which goods and services to produce and the markets in which to compete. Companies are free to enter new and different lines of business, enter geographic markets and customer segments, hire workers, and advertise their products. They are, therefore, guaranteed the right to pursue interests profitable to them.
- ***Price flexibility*** allows prices of most products to rise and fall to reflect the forces of supply and demand. Prices will rise and fall according to market forces, not government decree. By contrast, nonmarket economies often set and maintain prices at stipulated levels. Interfering with the price mechanism violates a fundamental principle of the market economy.

GOVERNMENT'S ROLE IN A MARKET ECONOMY In a market economy, the government has far less direct involvement in business than it does in centrally planned or mixed economies. Even so, government in a market economy plays four important roles.

- ***Enforce Antitrust Laws*** When one company controls a product's supply—and, therefore, its price—it is considered a monopoly. **Antitrust (antimonopoly) laws** prevent companies from fixing prices, sharing markets, and gaining unfair monopoly advantages. These laws are designed to encourage competition and innovation that lowers prices and increases product choice. Recent attempts at closer regulation of technology firms by governments worldwide represent efforts to constrain their potential monopoly power.
- ***Preserve Property Rights*** A smoothly functioning market economy rests on a legal system that safeguards individual **property rights**—the legal rights to resources and any income they generate. Protecting property rights encourages individuals and companies to take risks, including investing in technology, inventing new products, and starting new businesses. It ensures entrepreneurs that their claims to assets and future earnings are legally safeguarded.
- ***Provide a Stable Fiscal and Monetary Environment*** A stable economy helps companies to forecast costs and revenues, plan new product development, and promote future business expansion. Governments attempt to control inflation and unemployment through effective *fiscal policies* (policies regarding taxation and government spending) and *monetary policies* (policies controlling money supply and interest rates).
- ***Preserve Political Stability*** A market economy depends on a stable government for its smooth operation and its continued existence. This helps relieve businesses of worries about political violence, civil unrest, and so forth. But some economists argue that unless market economies do better at benefitting people of all socioeconomic groups, instability could rise and prompt calls for greater socialism.[13]

antitrust (antimonopoly) laws
Laws designed to prevent companies from fixing prices, sharing markets, and gaining unfair monopoly advantages.

property rights
Legal rights to resources and any income they generate.