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POLITICAL AND LEGAL ENVIRONMENT

CHAPTER OVERVIEW

1. POLITICAL ENVIRONMENT—INDIVIDUAL GOVERNMENTS
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Business has been considered an integral part of economic forces. Indeed, economics was once called *political economy*, and as such, business could not be conducted devoid of political and legal forces. Although we tend to take political and legal forces for granted most of the time in doing business domestically, they could become central issues in international business and cannot be ignored. It is human nature that we tend to look at other countries' political and legal systems as peculiar because they differ from ours. We might even make some value judgment that our own country's political and legal system is always superior to other countries' and that they should change their system to our way. This ethnocentrism, however, hinders our proper understanding of, and sensitivity to, differences in the system that might have major business implications. By the very nature of their jobs, international marketers cannot afford to be ethnocentric as they interact with a multitude of political and legal systems, including their own at home.

International marketers should be aware that the economic interests of their companies could differ widely from those of the countries in which they do business and sometimes even from those of their own home countries. There are various international agreements, treaties, and laws already in place for them to abide by. Furthermore, there is an increased level of visible distrust of multinational firms around the world, calling for creating codes of conduct for them.[1]

[1] S. Prakash Sethi, *Setting Global Standards: Guidelines for Creating Codes of Conduct in Multinational Corporations,* Hoboken, NJ: Wiley, 2003.

In this chapter, we will examine political and legal forces that affect the company's international marketing activities from the following three perspectives: the political and legal climates of the host country, those of the home country, and the international agreements, treaties, and laws affecting international marketing activities transcending national boundaries. Although political and legal climates are inherently related and inseparable because laws are generally a manifestation of a country's political processes, we will look at political climate first, followed by legal climate.

POLITICAL ENVIRONMENT—INDIVIDUAL GOVERNMENTS

Government affects almost every aspect of business life in a country. First, national politics affect business environments directly, through changes in policies, regulations, and laws. The government in each country determines which industries will receive protection in the country and which will face open competition. The government determines labor regulations and property laws. It determines fiscal and monetary policies, which then affect investment and returns. We will summarize those policies and regulations that directly influence the international business environment in a country.

Second, the political stability and mood in a country affect the actions a government will take—actions that may have an important impact on the viability of doing business in the country. A political movement may change prevailing attitudes toward foreign corporations and result in new regulations. An economic shift may influence the government's willingness to endure the hardships of an austerity program. We will discuss the strategic importance of understanding political risk in an international business context.

Home Country versus Host Country

Whenever marketing executives do business across national boundaries, they have to face the regulations and laws of both the home and host countries. A **home country** refers to a country in which the parent company is based and from which it operates. A **host country** is a country in which foreign companies are allowed to do business in accordance with its government policies and within its laws. Therefore, international marketing executives should be concerned about the host government's policies and their possible changes in the future, as well as their home government's political climate.

Because companies usually do not operate in countries that have been hostile to their home country, many executives tend to take for granted the political environment of the host country in which they currently do business. Sweeping political upheavals, such as the Cuban crisis in the 1960s, the Iranian Revolution in the 1980s, the breakup of the Soviet Union in the late 1980s, the Persian Gulf War in the 1990s, the Kosovo crisis in Yugoslavia[2] in 1999, the suicide bombings in Indonesia during the last few years, and more recently, the U.S.-led war against Iraq have already made many business executives fully aware of dire political problems in some regions, and many companies have since stayed away from those areas. Despite the fact that those major political upheavals provide the largest single setting for an economic crisis faced by foreign companies, what most foreign companies are concerned about on a daily basis should be a much larger universe of low-key events that may not involve violence or a change in government regime but that do involve a fairly significant change in policy toward foreign companies.[3] In recent years, the end of apartheid in South Africa also signals foreign companies' cautious yet optimistic attitude toward resuming business relations with this African country.[4] Similarly, Vietnam has begun to attract foreign direct

[2]As a series of ethnic tensions since 1980, the former Yugoslavia is now divided into seven independent states: Serbia, Croatia, Bosnia and Herzegovina, Kosovo, Macedonia, Slovenia, and Montenegro.

[3]Stephen J. Kobrin, "Selective Vulnerability and Corporate Management," in Theodore H. Moran, ed., *International Political Risk Assessment: The State of the Art, Landegger Papers in International Business and Public Policy*, Georgetown University, Washington, D.C. 1981, pp. 9–13.

[4]"South Africa: Investment Climate Statement," *Tradeport*, www.tradeport.org/ts/countries/safrica/climate.html, April 10, 1999, accessed on August 20, 1999.

investment to spur its domestic economic growth and shift toward a more market-based economy.[5]

The U.S.–China diplomatic relationship, which was re-established in the mid-1970s under the Nixon administration, illustrates the intertwined nature of home and host government policies. As a result, the Chinese government finally opened its economy to foreign direct investment—mostly through joint ventures—in the 1980s. The first pioneer foreign companies have stood to gain from the host government policies designed to protect the domestic producers they teamed up with in China. Thus, the United States' Chrysler, Germany's Volkswagen, and France's Peugeot, with their respective Chinese partner companies, were such beneficiaries. However, the U.S.–China relationship has since been anything but smooth. The United States, in particular, has been openly critical of China's human rights "violations" since the Tiananmen Square massacre of 1989 and has tried to make its trade policy with China contingent upon measurable improvements in China's human rights policy.

As China entered the World Trade Organization (WTO) in December 2001, the United States also offered extension of permanent Normal Trade Relations to China. The situation is very promising, but still challenges lie ahead. The U.S. government needs to do more to help China change its legal and political system to meet the challenges of its accession to the WTO. The wrenching social changes—including increased unemployment in large cities—caused by the opening of China's economy carry the risk of serious political instability. Besides, the current government and Communist Party leadership, which mixed with the politics of WTO implementation, could create systemic instability in China. If the United States the European Union, and Japan could provide assistance to China in restructuring its financial and legal systems, and in developing a public health infrastructure and systems for improved environmental protection, the possibility could be averted. Otherwise, foreign companies operating in, or contemplating entry into, China may experience undue uncertainties for the foreseeable future.[6]

The emergence of the Internet could also pose problems for Chinese trade relations. Though China seeks to free its markets in response to global pressure, particularly from the U.S., the Internet undermines China's general censorship policies. This dilemma was recently shown when China imprisoned a Chinese Internet entrepreneur for exchanging lists of e-mail addresses with a U.S. organization in the hope of growing his Web-based business.[7] Nonetheless, encouraged by reformist leaders, Internet use is growing explosively. In 1997, only 640,000 Chinese were connected. By April 2008, China's Internet users totaled 220 million individuals, surpassing the United States.[8] Today e-commerce has become a strong driver of China's market economy by expanding with annual sales rising at 40 percent. According to statistics from the Shanghai Modern Business Promoting Council, China's online transaction volume hit 1.7 trillion yuan ($243.55 billion) in 2007.[9] With the leading consumer marketplaces counting 50 million users, the value of daily online transactions for the first time surpassed the cash taken by major physical retailers in China, such as Wal-Mart.[10] Included in its plan for national economic and social development, China is vigorously promoting e-government, which includes a taxation management information system, a customs management information system, a financial management information system, an agricultural management information system, and a quality supervision management information system. E-commerce is on the development

[5]Sandie Robb, "Investors Eye Favorable Environment," *Foreign Affairs*, 84 (September/October 2005), p. 3.

[6]Andrew Batson, "China Needs Help Meeting Challenges of WTO-Academic," *Dow Jones Newswire*, June 28, 2002.

[7]Craig S. Smith, "China Imprisons Internet Entrepreneur," *Wall Street Journal* (January 21, 1999), p. A13.

[8]"China Vaults Past USA in Internet Users," *USA Today*, April 21, 2008.

[9]Hao Zhou, "First E-Business Specifications Go Public," *Chinadaily.com.cn*, May 14, 2008.

[10]Jack Ma, "E-commerce with Chinese Characteristics," *Economist.com*, http://www.economist.com/theworldin/displaystory.cfm?story_id=10125658, accessed August 30, 2008.

agenda and China is eager to expedite the application of information technology in such key areas as foreign trade, petrochemicals, metallurgy and machinery.[11]

International marketers must understand the fluid nature of the host country political climate in relation to the home country policies. Some countries are relatively stable over time; other countries experience different degrees of political volatility that make it difficult for international marketers to predict and plan ahead. Nonetheless, there are a few crucial political factors international executives should know that determine the nature of the host country's political climate.

Structure of Government

Ideology. One way to characterize the nature of government is by its political ideology, ranging from **communism** and socialism to capitalism. Under strict communism, the government owns and manages all businesses and no private ownership is allowed. As the recent breakup of the Soviet Union shows, the strict government control not only strip its people of private incentives to work but also is an inefficient mechanism to allocate scarce resources across the economy. On the other hand, **capitalism** refers to an economic system in which free enterprise is permitted and encouraged along with private ownership. In a capitalistic society, free-market transactions are considered to produce the most efficient allocation of scarce resources. However, capitalism is not without critics. Even the Wall Street financier, George Soros, has called attention to the threat that the values propagated by global laissez-faire capitalism poses to the very values on which open and democratic societies depend. Without social justice as the guiding principle of civilized life, life becomes a survival of the fittest.[12] For example, capitalism, if unfettered, may result in excessive production and excessive consumption, thereby causing severe air and water pollution in many parts of the world, as well as depleting the limited natural resources. Government roles would be limited to those functions that the private sector could not perform efficiently, such as defense, highway construction, pollution control, and other public services. An interesting example can be found in Japan. Although Japanese companies perfected an efficient just-in-time (JIT) delivery system, frequent shipments have caused increased traffic congestion and air pollution in Japan, and thus may not be as efficient in delivering social well-being.[13] Now the Japanese government is trying to regulate the use of JIT production and delivery systems. **Socialism** generally is considered a political system that falls in between pure communism and pure capitalism. A socialistic government advocates government ownership and control of some industries considered critical to the welfare of the nation.[14]

After the breakup of the Soviet Union, most Central and East European countries have converted to capitalistic ideology.[15] Similarly, China is in a transition stage, although some uncertainties still remain. There remain few countries that adhere to the extreme communist doctrine other than North Korea and Cuba. While many countries cherish capitalism and democracy, the extent of government intervention in the economy varies from country to country. (Both capitalistic and socialistic countries in which government planning and ownership play a major role are also referred to as **planned economies**).

Political Parties. The number of political parties also influences the level of political stability. A one-party regime does not exist outside the communist country. Most countries have a number of large and small political parties representing different views and value systems of their population. In a **single-party-dominant country**, government policies tend to be stable and predictable over time. Although such a government

[11] "Report on China's Economic and Social Development Plan," *Xinhua*, March 16, 2005.

[12] George Soros, *The Crisis of Global Capitalism*, New York: PublicAffairs, 1998.

[13] Kamran Moinzadeh, Ted Klastorin, and Emre Berk, "The Impact of Small Lot Ordering on Traffic Congestion in a Physical Distribution System," *IIE Transactions*, 29 (August 1997), pp. 671–79.

[14] Refer to an excellent classic treatise on capitalism, socialism, and communism by Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy*, New York: Harper & Brothoers, 1947.

[15] Tom Diana, "Steady Economic Progress in Central and Eastern Europe," *Business Credit*, 107 (June 2005), pp. 54–57.

provides consistent policies, they do not always guarantee a favorable political environment for foreign companies operating in the country. A dominant party regime may maintain policies such as high tariff and non-tariff barriers, foreign direct investment restrictions, and foreign exchange controls, which reduce the operational flexibility of foreign companies. For example, in Mexico a few political parties have always existed, but one party, called the Institutional Revolutionary Party, had been dominant in the past seventy years. However, since 1994, Mexico's ruling party has lost its firm grip on its politics. Although the opening of the Mexican political system may eventually lead to a stronger democracy over time, it is believed that its economy will experience an unknown degree of political instability for the foreseeable future.[16]

The trauma followed by the collapse of one-party-dominant systems can be relatively large, as experienced by the breakup of the Soviet Union. In the early 1970s, PepsiCo had cultivated ties with Soviet leaders that led to a deal providing the Soviet Union and its East European allies with Pepsi concentrate and state-of-the-art bottling technology in return for the inside track to the huge unexploited soft-drink market within the Soviet Empire. However, when the Soviet Union collapsed in 1991, PepsiCo was devastated. Almost overnight, all the hard earned skills and nepotism that PepsiCo had developed for operating in a centralized command economy counted for nothing. Making matters worse, customers associated PepsiCo with the discredited former regime. Archrival Coca-Cola almost immediately launched a drive for market share. The results were striking. In Hungary, for example, PepsiCo's market share tumbled from 70 percent to 30 percent almost overnight.[17]

In a **dual-party system**, such as the United States and Britain, the parties are usually not divided by ideology but rather have different constituencies. For example, in the United States, the Democrats tend to identify with working-class people and assume a greater role for the federal government while the Republicans tend to support business interests and prefer a limited role for the federal government. Yet both parties are strong proponents of democracy. In such a dual-party system, the two parties tend to alternate their majority position over a relatively long period. In 1995, the Democrats finally relinquished control of Congress to the Republican majority after many years. We have since seen some sweeping changes in government policy, ranging from environmental protection to affirmative action, usually in support of business interests.[18]

The other extreme situation is a **multiple-party system** without any clear majority, found in Italy and more recently in Japan and Taiwan. The consistency of government policies may be compromised as a result. Since there is no dominant party, different parties with differing policy goals form a coalition government. The major problem with a coalition government is a lack of political stability and continuity, and this portends a high level of uncertainty in the business climate. Since, in Japan, career bureaucrats, who are not political appointees, used to be in virtual control of government policy development and execution, the changes in government leadership did not seem to pose any measurable policy change until recently. However, in recent years owing to Japan's prolonged recession, those non-political elite bureaucrats had lost clout, and instead the current prime minister, leading the ruling party, has initiated many economic and financial reforms for Japan's resurgence.[19]

Besides the party system, foreign businesses also have to pay attention to the local government structure. Some governments are very weak and hardly have any control at the local level. For example, Indonesia, whose government used to be very centralized and straightforward, now has been steadily releasing power to local communities. This means that foreign businesses now have to deal with local government and political system in each of its 32 provinces.[20]

[16]"Mexico: Money, the Machine and the Man," *Economist,* July 7, 2005, p. 30.

[17]Hugh D. Menzies, "Pepsico's Soviet Travails," *International Business*, November 1995, p. 42.

[18]"Shades of '94—But Cloudier," *CQ Weekly*, August 15, 2005, pp. 2230–238.

[19]"The Push for Freer Markets in Japan," *Wall Street Journal*, December 14, 2007, p. C5.

[20]John McBeth, "Power to The People," *Far Eastern Economic Review*, August 14, 2003, pp. 48–50.

Government Policies and Regulations

It is the role of government to promote a country's interests in the international arena for various reasons and objectives. Some governments actively invest in certain industries that are considered important to national interests. Other governments protect fledgling industries in order to allow them to gain the experience and size necessary to compete internationally. In general, reasons for wanting to block or restrict trade are as follows:

1. National security
   - Ability to produce goods necessary to remain independent (e.g., self-sufficiency)
   - Not exporting goods that will help enemies or unfriendly nations
2. Developing new industries
   - Idea of nurturing nascent industries to strength in a protected market
3. Protecting declining industries
   - To maintain domestic employment for political stability

For example, Japan's active industrial policy by the Ministry of International Trade and Industry (MITI) in the 1960s and 1970s is well known for its past success and has also been adopted by newly industrialized countries (NICs), such as Singapore, South Korea, and Malaysia.[21] Governments use a variety of laws, policies, and programs to pursue their economic interests. More recently, the Baltic States of Estonia, Latvia, and Lithuania, controlled by the Soviet regime until the late 1980s, have liberalized their economies significantly by opening up their economies to international trade and foreign direct investment as well as treating foreign companies no differently than domestic companies. As a result of their rapid transition to open market economies, they were formally inducted into the European Union in 2004.[22]

This section focuses on describing those government programs, trade and investment laws, and macroeconomic policies that have an immediate and direct impact on the international business in a country. We will discuss laws regulating business behavior—such as antitrust laws and anti-bribery laws—in a subsequent section on international legal environments. Later sections of this chapter will discuss the legal systems that produce and enforce a country's laws.

Incentives and Government Programs. Most countries use government loans, subsidies, or training programs to support export activities and specific domestic industries. These programs are important for host-country firms, as well as for firms considering production in one country for export to others. In the United States, the International Trade Administration (ITA) has a national network of district offices in every state, offering export promotion assistance to local businesses. Furthermore, in light of federal budget cuts and as a supplement to the ITA's trade promotion efforts, state governments have significantly increased their staff and budgets, not only for export assistance, particularly in nurturing small local businesses,[23] but also for attracting foreign direct investment to increase employment in their respective states.[24] Thus, the major objectives of any state government support are (1) job creation and (2) improving the state balance of trade (as in any country).

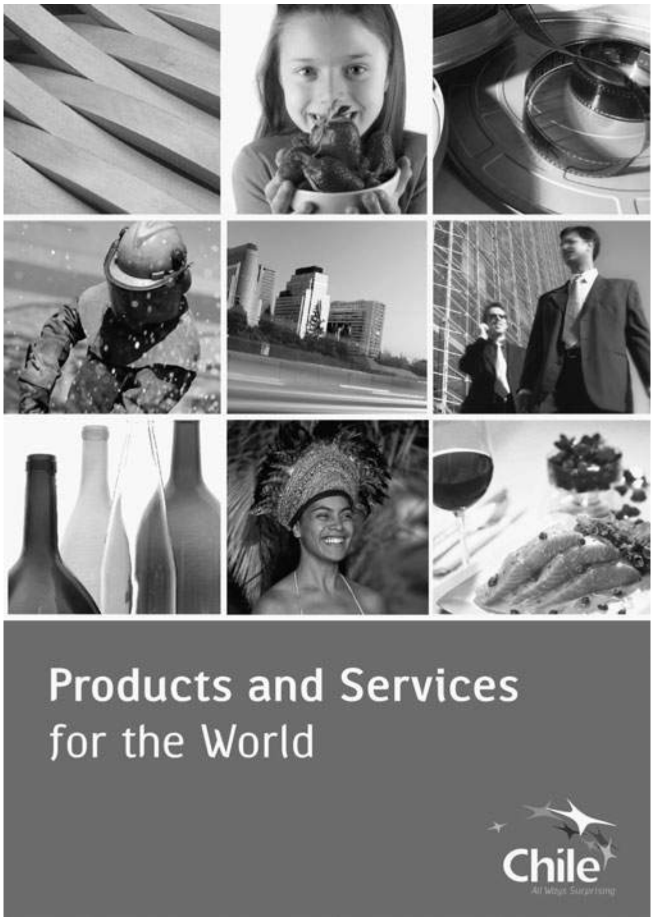
The state government's export promotion activities are more systematic, while its investment attraction activities are characterized by their case-by-case nature. Foreign

[21]Masaaki Kotabe, "The Roles of Japanese Industrial Policy for Export Success: A Theoretical Perspective," *Columbia Journal of World Business*, 20 (Fall 1985), pp. 59–64; Mark L. Clifford, "Can Malaysia Take That Next Big Step?" *Business Week* (February 26, 1996), pp. 96–106.

[22]"The External Sector: Capital Flows and Foreign Debt," *Country Profile. Estonia*, 2005, pp. 43–45.

[23]Masaaki Kotabe and Michael R. Czinkota, "State Government Promotion of Manufacturing Exports: A Gap Analysis," *Journal of International Business Studies*, 23 (Fourth Quarter 1992), pp. 637–58; and for the most recent comprehensive study, see Timothy J. Wilkinson, Bruce D. Keillor, and Michael d'Amico, "The Relationship between Export Promotion Spending and State Exports in the U.S.," *Journal of Global Marketing*, 18 (3/4), 2005, pp. 95–114.

[24]J. Myles Shaver, "Do Foreign-Owned and U.S.-Owned Establishments Exhibit the Same Location Pattern in U.S. Manufacturing Industries?" *Journal of International Business Studies*, 29, Third Quarter 1998, pp. 469–92.



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A government agency actively solicits foreign buyers by helping them find sales leads with local firms.

investment attraction activities generally consist of seminars, various audio-visual and printed promotional materials, and investment missions, among others. Of these, investment missions and various tax and other financial incentives appear to play the most important role in investment promotional efforts. Investment missions are generally made by government officials, particularly by the governor of the state, visiting with potential investors. One study has shown that whether or not they participate in foreign investment attraction activities, state governments that are active in export promotion tend to attract more foreign companies' direct investment in their states than those state governments that are not active.[25] For example, export-active states may be more politically favorable and receptive to foreign companies operating there. A well-known example is that to attract a Nissan plant, Tennessee spent $12 million for new roads to the facility, and provided a $7 million grant for training plant employees and a $10 million tax break to the Japanese company in 1985.[26] Similarly, Alabama provided a $253 million package of capital investments and tax breaks to lure Mercedes-Benz's sports utility vehicle production facility to the state in the early 1990s.[27] Similarly, to encourage Japanese automakers to produce in Thailand, the Thai government provides cheap labor, 8-year tax holiday, and virtually eliminated excise taxes on domestic pickup sales.[28] Since the mid 1980s, the Chinese government has offered preferential tax rates to attract foreign companies' investment in China. On average, the income tax rate for domestic companies is 33 per cent while foreign

[25]Masaaki Kotabe, "The Promotional Roles of the State Government and Japanese Manufacturing Direct Investment in the United States," *Journal of Business Research*, 27 (June 1993), pp. 131–46.
[26]"Tennessee's Pitch to Japan," *New York Times* (February 27, 1985), pp. D1, D6.
[27]"Tax Freedom Day Index Would Be Keen Indicator," *Orlando Sentinel* (May 8, 1994), p. D1.
[28]"In a World of Car Builders, Thailand Relies Heavily on a Pickup," *New York Times*, June 16, 2005.

companies pay half of that. Foreign manufacturers also often received "tax holidays," like two-year exemptions followed by three years in which their rates were cut in half. Statistics show that foreign companies used to get an annual tax break of approximately US$50 billion in China. But the tax honeymoon for foreign companies investing in China ended with the implementation of a new corporate income tax law from January 1 2008. In the new tax regime, the unified tax rate is set at 25 percent for both the Chinese and foreign firms, creating a competitive environment for both domestic and foreign investors. While putting an end to many preferential tax policies and incentives enjoyed by foreign firms, the new law retains some favorable terms for companies whose development is in line with the nation's strategic priorities, such as the 20 percent preferential rate for small enterprises with small profit margins and also a 15 percent rate for high-tech companies.[29]

Most governments subsidize certain industries directly. Direct government subsidies are an important international consideration. In Europe, Airbus Industries was established with joint government subsidies from the governments of Britain, France, Germany, and Spain in 1970 to build a European competitor in the jet aircraft industry once dominated by U.S. companies, including Boeing and McDonnell-Douglas-Lockheed. The United States is no exception. When threatened by Japanese competition in the semiconductor industry in the 1980s, the Reagan administration launched a Japanese-style government-industry joint industrial consortium known as SEMATECH (Semiconductor Manufacturing Technology) in 1987, with the federal government subsidizing half of its $200 million operating budget.[30] Thanks to SEMATECH, the U.S. semiconductor industry has finally recaptured the leading market share position by 1995, long lost to Japanese in the 1980s.

The point is to recognize how government support for particular industries or for exporting in general will affect which industries are competitive and which are not. International businesses can benefit by planning for and utilizing home-country and host-country government programs.

Government Procurement. The ultimate government involvement in trade is when the government itself is the customer. It engages in commercial operations through the departments and agencies under its control. The U.S. government accounts for a quarter of the total U.S. consumption, so the government has become the largest single consuming entity in the United States. Thus, the government procurement policy has an enormous impact on international trade. In the United States, the Buy American Act gives a bidding edge to domestic suppliers, although the U.S. Congress has recently begun to open certain government procurements to goods and services from countries that are parties to various international trade agreements that the United States also belongs to.[31] For foreign suppliers to win a contract from a U.S. government agency, their products must contain at least 50 percent of U.S.-made parts, or they must undercut the closest comparable U.S. product by at least 6 percent.[32] This "buy domestic" policy orientation is not limited to the United States, but applies to all other nations. In other words, when a U.S. company tries to sell to any foreign government agency, it should always expect some sort of bidding disadvantage relative to local competitors.

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[29] Jim Yardley, "China Moves to End Tax Breaks for Foreign Businesses," *International Herald Tribune*, March 8, 2007; "Tax Burdens Equalized for Chinese, Foreign Firms," *Beijing*, http://www.btmbeijing.com, April 15, 2007; and Bi Xiaoning, "Businesses Positive about Corporate Tax Law," *China Daily*, April 11, 2008.

[30] Due to the U.S. government's gradual budget cut, SEMATECH became a technology consortium funded solely by member companies in 1998.

[31] William T. Woods, "Federal Procurement: International Agreements Result in Waivers of Some U.S. Domestic Source Restrictions," GAO-05-188, *GAO Reports*, January 26, 2005, pp. 1–24.

[32] Robert Fryling, "Buy American Act: Help for United States Manufacturers," *Contract Management Magazine*, 42 (April 2002), pp. 42–43; and "Part 25.001: The Buy American Act," Federal Acquisitions Regulation, http://www.arnet.gov/far/current/html/Subpart%2025_1.html, accessed February 10, 2006.

Trade Laws. National trade laws directly influence the environment for international business. Trade controls can be broken into two categories—economic trade controls and political trade controls. Economic trade controls are those trade restraints that are instituted for primarily economic reasons, such as to protect local jobs. Both **tariff** and **non-tariff** barriers (NTBs) work to impede imports that might compete with locally produced goods (See **Exhibit 5.1**). Tariffs tax imports directly, and also function as a form of income for the country that levies them. In industrialized countries today, average tariff rates on manufactured and mining products are about 5-6 percent. Tariff protection for agricultural commodities is higher than for manufactured products, both in industrial and in developing countries. But in industrialized countries the average tariff rate on agriculture is almost double the tariff for manufactured products. Tariffs on labor-intensive products also largely surpass the average for industrial goods. Compared to industrial products as a whole, labor-intensive products are again more protected in industrialized countries than in developing countries, by an estimated one-third.[33]

Non-tariff barriers include a wide variety of quotas, procedural rules for imports, and standards set upon import quality that have the effect of limiting imports or making importing more difficult. For example, European carmakers are facing challenges from non-tariff barriers in South Korea. Rather than adopting internationally harmonized standards, South Korea sets a series of complicated domestic regulations on noise, emissions, safety belts and other issues that have prevented many European firms from entering the market. In 2007, European carmakers only managed to sell 15,000 vehicles in South Korea, generating revenue of $650 million. In contrast, Korean automakers exported slightly more than 74,000 cars to Europe with revenue of $3,900 million.[34-] **Embargoes** and **sanctions** are country-based political trade controls. Political trade restraints have become an accepted form of political influence in the international community. They are coercive or retaliatory trade measures often enacted unilaterally with the hopes of changing a foreign government or its policies without resorting to military force. Embargoes restrict all trade with a nation for political purposes. The United States maintains an economic embargo on Cuba today in an effort to change the country's political disposition. Sanctions are more narrowly defined trade restrictions, such as the U.S. government's threat in 1999 to impose retaliatory tariffs of 100 percent on hundreds of millions of dollars in European imports to compensate U.S. banana companies for their lost sales to Europe and the government's declaration in March 2008 about introduction of sanctions concerning of some foreign companies (such as Armenian Blue Airways and Iranian Mahan Airways) for illegal re-export of the American planes to Iran.[35]

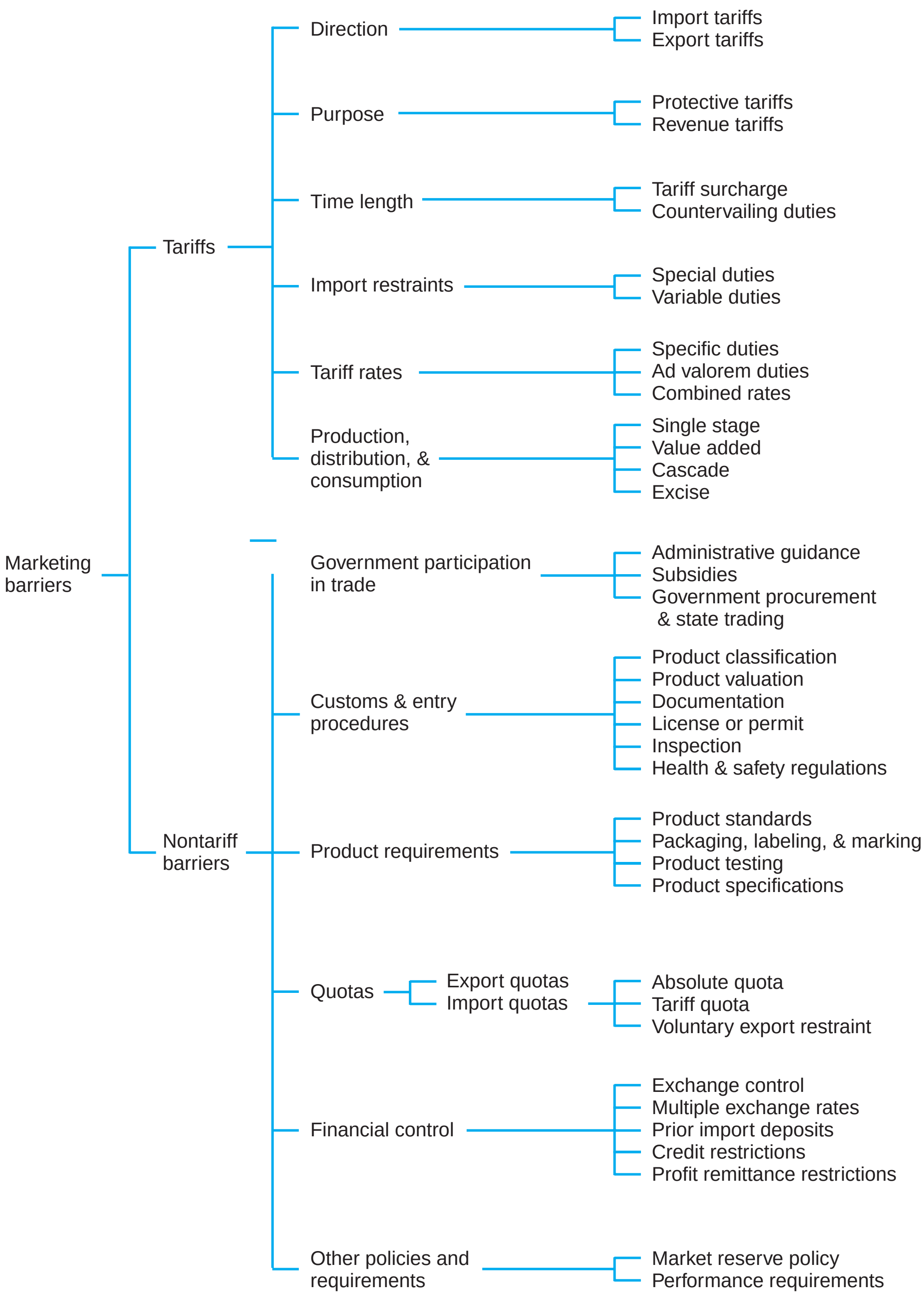
A trade war waged by the U.S. government could make such seemingly unrelated items as Scottish cashmere sweaters, Pecorino cheese (but only the soft kind), German coffee makers, and French handbags scarce on American store shelves.[36] **Global Perspective 5-1** describes the relationships between the United States and the European Union in terms of government regulations and trade war currently under way.

Export license requirements are product-based trade controls. All exports officially require a specific export license from the Export Administration of the Department of Commerce. However, most products that are not sensitive to national security or are in short supply in the country may be sent to another country using only a general license. The application process for more sensitive products, including much high-technology exports, is quite extensive and can include review by numerous government agencies (See Chapter 16 for export control).

International businesses have a number of reasons to be concerned with trade restrictions. First, trade restrictions may completely block a company's ability to export

[33]*Global Economic Prospects and the Developing Countries 2002,* Washington, D.C.: World Bank, 2002 (see Chapter 2).
[34]Lawrence J. Speer, "Talks Aim to Ease Access to Korean Market," *Automotive News Europe*, May 12, 2008.
[35]"USA Enter Sanctions against Some Companies for their Assistance to Iran," http://www.world-terrorism.org/. March 23, 2008.
[36]"Trade Fight Spills Over into Handbags, Coffee Makers," *CNN Interactive*, www.cnn.com, March 3, 1999.

EXHIBIT 5-1
TARIFF AND NON-TARIFF BARRIERS



Source: Adapted from Sak Onkvist and John J. Shaw, "Marketing Barriers in International Trade," Business Horizons, 31, May–June 1988, p. 66.

to a country. Even if the company can export its goods, restrictions such as quotas or local modification requirements may make the product so expensive that an otherwise lucrative market is eliminated. Some companies attempt to benefit from import restrictions by establishing production facilities inside the foreign market country. For example, Brazil suddenly raised a tariff on imported cars from 20 percent to 70

GLOBAL PERSPECTIVE 5-1

RELATIONSHIPS BETWEEN THE UNITED STATES AND THE EUROPEAN UNION: GOVERNMENT REGULATIONS AND TRADE WAR

American business has an enormous stake in the trading relationship with the EU. The EU is the United States' largest trading partner, and together they account for almost 40 percent of world trade and 60 percent of the world's gross national product. Importantly, this trade relationship directly supports a total of more than seven million jobs in the United States and the fifteen EU countries.

Over the last thirty years, as a result of a series of treaties agreed to by the member countries of the EU, the EU has won wide and growing powers to regulate business. In every area of economic activity, the EU has used these new powers to push through a determined harmonization program in an effort to unify marketplace standards throughout Europe. Harmonization has made selling to all 350 million western Europeans easier, as opposed to selling to each individual country within the EU.

Importantly for U.S. businesses, the EU is now in a much stronger position to punish American companies—and not with just trade sanctions, but also with domestic European legislation targeted at American companies.

For Americans, the EU is unlike any lawmaking body they are familiar with at home. A mixture of different political governance philosophies, and with a strong bureaucracy supporting the democratic voice of members of the European Parliament and national governments—but without the check upon centralization provided by the U.S. Supreme Court—the EU regulatory environment is unique, powerful and generally the first and last word on regulatory matters.

Trade wars between the United States and Europe are spreading. In 2004, the European Union EU imposed tariffs on $4 billion of U.S. the biggest authorized sanctions in the World Trade Organization's (WTO) history. These latest fines are over so-called Foreign Sales Corporation and Extraterritorial Income tax breaks for American exporters, which were ruled illegal by the WTO in two years earlier. Although the EU had notified the U.S. of its plans in 2003, the U.S. Congress has done next to nothing to stop the damage. As result, protectionist sentiment is running higher than ever in the United States. In another case, the WTO ruled that the EU could sue the United States for damages caused by its anti-dumping laws. In addition, there is yet a further dispute at the WTO over the United States' hormone-treated beef, which the EU wants labeled to protect its consumers.

Sources: John Grimley and Anthony Brown, "U.S.–EU Trading Relationships: The Stakes are Mounting," *Financial Executive*; 18, May 2002, pp. 21–22; and "Transatlantic Tiff," *Economist*, March 6, 2004, pp. 66–67.

percent in late 1994. As a result, foreign auto makers Fiat and Ford, with operating plants in Brazil, enjoyed a definite cost advantage over Chrysler, Toyota, Volvo, and others that exported cars to the country. Naturally, those latecomers decided to begin production in Brazil to avoid its hefty import tariffs. This is one illustration of strategic reasons why firms sometimes have plants in various countries rather than rely solely on exporting from home. In this manner those companies, domestic or foreign, already manufacturing in the market can access the desired market with little competition from external producers.

However, trade restrictions are not necessarily good, even for companies inside a protected country. Trade restrictions often block companies from purchasing needed inputs at competitive prices. For example, in 1992 the U.S. International Trade Commission levied an import tariff on the flat panel display screens used in laptop computers in response to a complaint that foreign companies were dumping the screens below cost on the U.S. market. Although local producers of computer screens benefited from the protection from competition, U.S. producers of laptop computers, which relied mostly on imported screens, could no longer compete. Many laptop producers were forced to ship their assembly plants overseas in order to stay in the market.

At a more macro level, if trade laws harm other countries, they are likely to invoke retaliation. For example, wrangling over the United States' inability to repeal the Byrd Amendment that the antidumping duties are channeled to U.S. steel companies that filed the antidumping charges against foreign steel producers, The Byrd Amendment literally encourages U.S. steel companies to file antidumping charges against foreign producers for their own interest, and The WTO ruled that the Byrd amendment violates international trade agreements. Canada is threatening to impose 100 percent duties on U.S.-made bicycles and a few hundred other American products, ranging from fish byproducts to plywood to skis to home exercise equipment. Brazil, Canada, Chile, the European Union, India, Japan, Mexico and South Korea apparently drew the same conclusion. They also promise to retaliate and target U.S. industries that assure that Congressmen feel their constituents' pain.[37] However, trade wars, if left unchecked, usually harm all countries by limiting the ability of competitive firms to export and generate the benefits created by specialization. One thing is clear—government trade laws have a complex and dynamic impact on the environment for international business (See **Global Perspective 5-2**).

GLOBAL PERSPECTIVE 5-2

WANT TO DO BUSINESS IN SOUTH ASIA?–ARE YOU READY FOR TRADE BARRIERS THERE?

In the era of globalization, many countries in South Asia have conducted a noticeable cut in tariff rates. However, this region is still highly protected as compared with other regional trade blocs. The non-tariff barriers, including anti-dumping and countervailing duties, quota, restrictions, packaging and labeling requirements, testing, quarantine and other certifications, are a common mode to restrict imports. This is especially true in India, which is known to have a larger number of such barriers compared to other South Asian countries.

There are 109 specific commodities, including food preservatives, additives, milk powder, infant milk foods, certain types of cement, household and similar electrical appliances, gas cylinders and multi-purpose dry cell batteries, that the Bureau of Indian Standards (BIS) must certify before goods are imported. In order to get this certificate, importers must pay a licensing fee of 0.2–1 percent of the value of certified goods.

For plant imports, such as almonds, pulses, fresh fruits and vegetables, India applied plant quarantine (regulation of import) order-2003 and its amendments without prior notification to the WTO SPS Committee. India has also implemented several sanitary restrictions that are not in consonance with the Office of International Epizootics (OIE) and CODEX (an international food standards organization) recommendations. India maintains a negative import list involving three categories: (1) prohibited items (i.e., tallow, fat, and roils of animal origin); (2) restricted items which require a non-automatic import license (e.g., livestock products, certain chemicals); and (3) "canalized" items (e.g., petroleum products, certain pharmaceuticals, and bulk grains) importable only by the government trading monopolies subject to cabinet approval on timing and quantity.

In addition to the applied customs rates, importers are required to pay another one percent customs handling fee and a two percent education assessment on all sales, a surcharge applied to almost all direct and indirect taxes. After these, the process does not end yet—during inter-state commerce, each state levies taxes adding further confusion to the tax system. What is worse, for the tariff, fees and additional tax rates applied to imports, there is no single official publication that includes all information. Importers have to consult separate tariff and excise schedules as well as any applicable additional public notifications and notices, to determine current tariff and tax rates, the system of which lacks transparency.

This situation is further complicated due to extensive documentation required by the customs that hinders the free flow of trade and leads to frequent processing delays. Delay is mainly caused by complex tariff structure and multiple exemptions. The number of signatures in South Asia is 12 for export and 24 for import. In India, the number is as high as 22 for export and 27 for import.

For other South Asia countries, they also impose non-tariff barriers, although not as high and complicated as India sets. For example, Pakistan's Import Policy Order bans imports of certain items on religious, environmental, security and health grounds. Sri Lanka requires import licenses for over 300 items at the 6-digit level of the harmonized system mostly for health, environment and national security reasons. Importers have to pay a fee equal to 0.1 percent of the import price to receive an import license. There are 85 items that come under die Sri Lanka standard institutions (SLSI) mandatory import inspection schemes. Importers are required to obtain a clearance certificate from die SLSI to sell their goods.

Despite the South Asian Preferential Trade Agreement, the customs procedures at borders make intra-regional trade difficult and costly. Export and import in China or performers in ASEAN (Association of Southeast Asian Nations) states takes about 20 days to export and import. Of the South Asian countries, only Pakistan scores similarly. In India and Bangladesh, export-import time averages 34 days and 46 days, respectively. Besides, it costs less than $400 in the PRC and less than $500 in Malaysia to bring a standard 20-foot container across the border. Prices in South Asia range from about $800 in Sri Lanka to $1100 in Bangladesh.

Doubtlessly, high non-tariff barriers in South Asia have the potential of frustrating efforts for regional economic integration. In order to prosper the economy in this region through international business, the high trade barriers should be further removed.

Source: Jamil Nasir, "Trade Barriers in South Asia," *Economic Review*, 38 (August), 2007, pp. 62–63.

[37] "U.S. Bike Makers Caught in Trade War with Canada," *Bicycle Retailer & Industry News*, February 1, 2005, p. 1 and p. 43.

Trade war can have positive consequences, however, if it leads to freer trade instead of more restricted trade. The Association of South East Asian Nations (ASEAN) nations are slashing tariffs among themselves to compete with China. A pact to drop tariffs on goods traded within the 10-nation group to 5 percent or less now makes it possible for P&G to export to most of Asia out of its single remaining shampoo factory in Bangkok. Before the pact, P&G had to buy new production gear for separate plants in Thailand, Indonesia, and the Philippines.[38]

Investment Regulations. International investments have been growing at a much faster pace than international trade. Many of these investments are being made by multinational corporations. Foreign direct investments are explained in terms of various market imperfections, including government imposed distortions, but governments also have a significant role in constructing barriers to foreign direct investment and portfolio flows. These barriers can broadly be characterized as ownership and financial controls.

Ownership Controls. Most countries feel that some assets belong to the public—there is a sense of "national ownership." In a highly nationalistic country, this sentiment could apply to the ownership of any company. In many countries, the natural resources (e.g., the land and mineral wealth) are viewed as part of the national wealth, not to be sold to foreigners. For example, Kuwait has a constitutional ban on foreign ownership of its oil reserves. Recently, there was a heated debate as to whether or not state-owned Kuwait Petroleum Corp. (KPC) had the right to sign agreements with foreign oil companies to produce local oil. The government argued that KPC was allowed under existing laws to forge foreign participation accords in return for cash incentives. But its efforts to advance the plan repeatedly came under attack by opposition members of parliament who argued that foreign companies' provision of cash incentives would amount to foreign direct investment, thus foreign control.[39] In a similar vein, Russia has decided to revive its ailing auto industry—which is rapidly losing market share to Western and Japanese imports and locally assembled foreign models—through direct state intervention. The Russian government seized control of General Motors' pioneering joint venture with Russia's largest automaker, OAO Avtovas in early 2006.[40]

The United States has very few restrictions on foreign ownership; however, for reasons of national security, limitations do exist. For example, the Federal Communications Commission limits the control of U.S. media companies to U.S. citizens only. This was one of the motivating factors for Rupert Murdoch to relinquish his Australian citizenship for U.S. citizenship in order to retain control of his media network, Fox Television. Similarly, the U.S. Shipping Act of 1916 limits noncitizen ownership of U.S. shipping lines. The Federal Aviation Act requires airlines to be U.S. citizens (defined as one where 75 percent of the voting rights of the firm are owned and controlled by U.S. citizens) in order to hold U.S. operating rights. The International Banking Act of 1978 limits interstate banking operations by foreign banks. Consequently, foreign banks cannot purchase or take over U.S. banks with interstate operations.

Financial Controls. Government-imposed restrictions can serve as strong barriers to foreign direct investments. Some common barriers include restrictions on profit remittances, and differential taxation and interest rates. Restrictions of profit remittances can serve as a disincentive to invest, since returns cannot be realized in the home currency of the parent company. Although government controls on profit remittance are drawbacks in attracting investment, some governments also use such restrictions as a way to encourage foreign companies to increase exports from the host country. For

[38]Michael Shar, "A New Front in the Free-Trade Wars," *Business Week*, June 3, 2002.

[39]Jeanne M. Perdue, "Kuwait Gets Green Light to Invite Majors," *Petroleum Engineer International*, 72 (September 1999), p. 7.

[40]"GM Venture in Russia Hits Snag Following Kremlin Involvement," *Wall Street Journal*, February 18, 2006, p. A7.

example, Zimbabwe permits higher profit remittance rates—up to 100 percent—to foreign companies operating in that country that export significantly.[41]

Various multinational companies have been able to exploit legal loopholes to circumvent this problem to some extent. Tactics include currency swaps, parallel loans, countertrade activities, and charging for management services, among others. Also, various countries treat operations of foreign companies differently from those of local companies. Two means through which local companies are supported are lower tax rates and lower interest rates for loans secured from local financial institutions. These differences can put foreign companies at a significant disadvantage relative to domestic companies in that particular market, and can also act as a deterrent to foreign direct investments.

Macroeconomic Policies. Companies search internationally for stable growing markets where their profits will not be deteriorated by exchange loss or inflation. Government policies drive many economic factors such as the cost of capital, levels of economic growth, rates of inflation, and international exchange rates. Governments may directly determine the prime lending rate, or they may print or borrow the funds necessary to increase money supply. Governments may fix their currencies' exchange rates, or they may decide to allow the international currency market to determine their exchange rates. The monetary and exchange policies a government pursues will affect the stability of its currency—which is of critical concern to any company doing business abroad. Mexico kept the peso's exchange rate artificially high despite its increasing trade deficit in the early 1990s. One primary objective for such an exchange rate policy was to make it relatively easy for Mexico to import capital goods, such as machinery, from the United States for economic development. When Mexico's trade deficit rose to well over 8 percent of the country's GNP by 1994, Mexico could no longer hold on to an artificially high value of the peso and let it loose in December 1994. How serious was Mexico's trade deficit? Think, for a moment, that the United States had registered the large trade deficit of $172 billion in 1987, which once ushered in a doomsday prophecy of the decline of U.S. competitiveness. Yet, the U.S. trade deficit was no more than 3 percent of the country's GNP then! Now, as shown in Chapter 2, the U.S. trade deficit had constantly increased to $813 billion, or about 6 percent of U.S. GDP by 2008. As we discussed in Chapter 3, the U.S. trade deficit could not keep growing without a possibility of more ominous consequences than the current unprecedented recession since late 2008. Today, the United States is the world's largest debtor, with Japan being the largest creditor and China an increasingly important creditor to the United States. A sharp reversal in Japan's and China's appetite for U.S. treasury bonds could send U.S. interest rates soaring.[42] The U.S. government, too, needs to develop policies by which to reduce the country's trade deficit.

Government fiscal policies also strongly influence macroeconomic conditions. The types of taxes a government employs will influence whether a particular type of business is competitive within a country. For example, if a government lowers long-term capital gains taxes or allows accelerated depreciation of corporate capital assets, it will encourage investment in manufacturing facilities. The Japanese government has been known for its pro-business tax abatement and depreciation policies that helped develop the world's leading manufacturing industries in Japan, ranging from steel and shipbuilding in the 1960s and 1970s, to machine tools, automobiles, and consumer electronics in the 1970s and 1980s, and to semiconductor and semiconductor manufacturing equipment in the 1980s and 1990s.

Although a government can play a role in a thriving economy and accessible capital, a number of other factors also determine a country's political environment. Historical considerations, social and political pressures, and the interests of particular constituencies will affect the political environment in important ways. For example, during the early 1990s China was enjoying an unprecedented economic boom.

[41] Cris Chinaka, "Zimbabwe Announces Measures to Boost Investment," *Reuter Library Report* (April 27, 1993).
[42] "World Bank Warns Global Recovery Has Peaked," *Wall Street Journal*, April 7, 2005, p. A2.

However, companies that tried to take advantage of China's open market policy have met with mixed results.[43] When China joined the WTO in December 2001, it agreed to open up its financial industry, but only gradually. Foreign companies are not yet permitted to become majority owners. In banking, foreigners' stakes are limited to 15 percent, and it is not until 2006 can foreigners conduct local-currency business with Chinese citizens in banking.[44]

India, on the other hand, still has some restrictions on foreign investment over the years. One example is Press Note 18 that requires any investor with previous or existing joint ventures or technology agreements to seek approval from the Foreign Investment Promotion Board (FIPB) for new direct investments in the same or related field. Applicants must prove that the new proposal will not jeopardize the interest of the existing joint venture or technology partner. The Press Note 18 is intended to protect the interests of shareholders, public financial institutions and workers. Although many foreign investors complain about the policy, influential government officials do not want to abandon the guidelines because they consider their domestic industry not strong enough to face direct competition from foreign firms in selected sectors. Under the guidelines, recently Suzuki, a small Japanese automaker, has to include Maruti Udvog, its existing joint venture, in its plans to make new investments for a car assembly plant and a diesel engine plant. According to Suzuki, the governmental regulations have become a tool of the Indian partners to demand unrealistic and opportunistic exit valuations or to create more barriers for foreign competitors.[45]

POLITICAL ENVIRONMENT—SOCIAL PRESSURES AND POLITICAL RISK

Foreign companies also have to consider social factors as part of the political environment of host countries. The political environment in every country is regularly changing. New social pressures can force governments to make new laws or to enforce old policies differently. Policies that supported international investment may change toward isolationism or nationalism. In order to adequately prepare for international business or investment, the environment in each target country should be analyzed to determine its level of economic and political risk and opportunity.

Social Pressures and Special Interests

Governments respond to pressures from various forces in a country, including the public at large, lobbyists for businesses, the church, non-governmental organizations (NGOs), and sometimes the personal interests of the members of the government. In order to assess the political stability of a country, it is critical to evaluate the importance of major forces on the government of the country. Many developing countries have undertaken significant liberalization programs during the 1980s and 1990s.[46] Although regularly promoted by the International Monetary Fund (IMF), the success of these programs during recent years must be attributed to a larger social acceptance of the potential benefits of necessary austerity measures. For example, one study has shown that the IMF's Structural Adjustment Program helped improve the economic efficiency of both domestic and foreign companies operating in Nigeria in the 1980s.[47] The benefits of liberalization extend beyond the borders of the countries involved. Consider the liberalization in Mexico, where the privatization of the state telephone company

[43]"To Enter or Not to Enter?" *Country Monitor*, January 28, 2002, p. 5.

[44]"Strings Attached," *Economist*, March 8, 2003, pp. 67–68.

[45]"Can They Let Go?" *Business India Intelligence*, October 16, 2004, pp. 1–2.

[46]Kate Gillespie and Hildy J. Teegen, "Market Liberalization and International Alliance Formation," *Columbia Journal of World Business*, 31 (Winter 1996), pp. 40–54.

[47]Sam C. Okoroafo and Masaaki Kotabe, "The IMF's Structural Adjustment Program and Its Impact on Firm Performance: A Case of Foreign and Domestic Firms in Nigeria," *Management International Review*, 33 (2) (1993), pp. 139–56.

(TelMex) led to large investments by Southwestern Bell. Similarly, private companies are moving rapidly to finance other large public projects. An international consortium composed of Mexico's Grupo Hermés, the United States' AES Corp., and the Japanese firm Nichimen constructed Mexico's first independent power-producing plant in Yucatán State.[48] While liberalization may provide unprecedented opportunities, the forces of special interests or the backlash of public sentiment may also cause governments to limit or curtail entirely certain international business operations.

Feelings of national interest can act as a deterrent to international business. For example, Carrefour, the world's No. 2 retailer from France, faced a boycott in China in April 2008 because of pro-Tibet protests in Paris and President Sarkozy's threat to shun Olympic ceremonies. Angry Chinese crowds gathered outside Chinese outlets of Carrefour to protest France's efforts to use the Beijing Olympics to pressure China on human rights and Tibet. Although Carrefour in reality did not have any involvement in politics regarding the related issues, it still suffered largely from it and faced the huge social pressures from Chinese people. Another striking example involves Dell Computer.[49] As a manifestation of nationalistic sentiment, there were regular complaints from Dell China customers over the display of the Taiwan flag on the Dell Taiwan website. Dell Computer tried to placate these customers in China via various visual interface designs back in 2002. During the last Taiwan presidential election in 2005, Chinese customers again lodged another massive complaint with Dell Computer over the flag issue. Executives at Dell Computer came to learn that political events often supersede meticulous business plans. As Dell Computer sees China as the main revenue growth in Asia, the company has finally decided to remove all flags from Dell Asia-Pacific websites immediately for fear of a potential boycott of Dell products in China. At the time of this writing, therefore, there are no flag displays for China, Taiwan, Korea, India, Singapore, Vietnam, and other Asian countries, except Dell Japan, which retained its own flag display since it is considered a separate business entity from the Asia-Pacific segment (due to maturity of its customer base and purchasing power). Of course, since Dell Computer is dealing with nationalistic sensitivities, it could be only a matter of time before Dell China customers will suddenly realize the Chinese flag not being displayed while Dell Japan still has its own flag display. Corporate diplomacy can indeed be very delicate. As one ex-Dell executive confides, "One can never foresee all possibilities, but as marketers, we always need to plan for such contingencies."[50]

Besides such outcries from local customers, large-scale strikes organized by labor union could equally harm businesses across national boundaries. In June 2002, thousands of passengers across Europe got left stranded as air traffic controllers went on strike. The strike was in protest at a plan for a continent-wide "single-sky" plan intended to reduce congestion and delays. Ninety percent of Air France's long-haul flights did not take off, Germany's Lufthansa airlines cancelled 130 of its 140 flights to and from France, and British Airways was operating only four of its usual 126 flights into France. Partial strikes in Greece, Hungary, Portugal, Spain, and Italy also halted some flights.[51]

Furthermore, in recent years, the emergence of nongovernmental organizations (NGOs) as organizational manifestations of broader social movements has dramatically altered the global political-economic landscape. NGOs are relatively informal organizations established by "concerned people" who participate in global value creation and governance. Sometimes, NGOs are anti-government or anti-MNCs, trying to address societal and environmental issues that they feel are unsatisfactorily addressed.[52] The

[48]"Mexico's Energy Infrastructure Expanding to Match Growth," *NAFTA Works* (February 1997), pp. 1–2.

[49]"France's Carrefour Feels China's Ire," *BusinessWeek.com*, April 22, 2008.

[50]This paragraph is based on the authors' personal discourse with Leon Z. Lee, an former executive at Dell Computer in charge of the company's global branding, Web globalization and intercultural relations, March 10, 2006.

[51]"Strike Cripples European Air Travel," *CNN News*, June 19, 2002.

[52]Hildy Teegen, Jonathan P. Doh, and Sushil Vachani, "The Importance of Nongovernmental Organizations (NGOs) in Global Governance and Value Creation: An International Business Research Agenda," *Journal of International Business Studies*, 35, November 2004, pp. 463–83.

GLOBAL PERSPECTIVE 5-3

SOCIAL PRESSURES AFFECTING GOVERNMENT AND CORPORATE POLICIES: A ROLE OF NGOS

The emergence of nongovernmental organizations (NGOs) as organizational manifestations of broader social movements has dramatically altered the global political-economic landscape. NGOs are relatively informal organizations established by "concerned people" who participate in global value creation and governance. Sometimes, NGOs are anti-government or anti-MNCs, trying to address societal and environmental issues that they feel are unsatisfactorily addressed. Take the Exxon case as an example.

Exxon, world's second-largest corporation, is building a 660-mile pipeline from the oil fields of Chad, in the geographic heart of Africa, to the coast of Cameroon. The pipeline, three feet under ground, will cut through forests and farmlands as it makes its way to the sea. Besides local governments to deal with, Exxon has to confront various NGOs for the environmental concerns. Under pressure for activists, Exxon has been forced to take on the unlikely role of development agency, human-right promoter, de facto local government, and even environmental watchdog.

Using the Internet and mass media as cudgels, NGOs such as Greenpeace, Human Rights Watch, and Friends of the Earth, have grown increasingly adept at singling out multinationals. The oil company offers a particularly ripe target. Companies like Exxon are big, which NGOs readily translate as "bad." Exxon has highly visible brands, making it vulnerable to boycotts at the pump. The oil company cannot choose where oil deposits are located, which means that it increasingly operates in countries with unsavory rulers, sensitive environments, and impoverished populations. And its power tends to dwarf that of its host countries. Exxon's 2001 revenues were $191.6 billion, compared with Chad's GDP of $1.4 billion.

The solution is a complex, four-way agreement between Exxon, the host governments, activists and the World Bank. In keeping with its mission of alleviating poverty, the World Bank would lend $93 million to the governments of Chad and Cameroon so they could participate as equity investors in the project. By standing between Exxon and its worst critics, and between Exxon and the troublesome host governments, the World Bank could serve as a moral buffer, providing Exxon with invaluable political insurance. While reassuring people on its skills and technology, Exxon has helped oversee a $1.5 million initiative in which the oil company has built schools, funded health clinics, dug wells, advised local entrepreneurs, fielded an AIDS-education van, and distributed 32,000 anti-malarial mosquito nets. It has also paid for prostitute focus groups, gorilla habitat studies, even ritual chicken sacrifices.

Between 1993 and 1999 there were already 145 meetings involving 250 NGOs and Exxon had agreed to 60 changes in the pipeline's route. It also promised to help create an environmental foundation, two national parks in Cameroon, and an "Indigenous Peoples Plan" for the Pygmies, local minorities in Africa. And Exxon will offer compensation to owners of every mango tree, bean plant and cotton field, on a plant's expectancy, annual yield, local fruit prices, and so forth.

To complicate matters for Exxon, the demands of Western NGOs often conflict directly with the wishes of locals. The NGOs want Cameroon's rain forests untouched; local farmers plead for Exxon to clear them with chain saws. The NGOs want roads routed around village; villagers sneak out at night to move road markers closer to their homes and stores, so that they will have more compensation money to improve their life.

It still remains a question whether the local Chad government could be trusted with Exxon's oil money. Although the World Bank will retain its right to cut off all loans and future aid to Chad, nothing can stop its leader to live high on the hog, pay his army, and say to heck with the other seven million people. Last time the $25 million was paid to Chad's President, he used $4.5 million to buy weapons.

With the "help" of NGOs, the World Bank, and chicken sacrifice, Exxon is practicing an unfamiliar way of doing business. If the experiment succeeds, observers say, it could rewrite the rulebook for how multinationals operate worldwide. The traditional way of doing business, getting the oil out of the ground without getting involved in politics, human rights, and the environment, just is not tenable anymore.

Source: Jerry Useem, "Exxon's African Adventure," *Fortune*, April 15, 2002, pp. 50–58.

Exxon case presented in **Global Perspective 5-3** vividly illustrates the social pressures from NGOs affecting government and corporate policies.

How should a manager evaluate the opportunities and risks a country presents? Obviously this depends upon too many factors to discuss them all. A manager should certainly consider the political history of the country, as well as the history of similar industries within the country. In the following section we will discuss a number of factors that international managers should consider when determining the economic and political risks associated with a country.

Managing the Political Environment

International managers must manage the political environment in which the international firm operates. This means, first and foremost, learning to follow the customs of the country in which the firm is operating. But managing the political environment also means knowing which facets of the foreign country must be carefully monitored, and which can be manipulated. If managed correctly, the political environment could become a marketing support system, rather than an inhibitor, for the foreign company.[53]

In order to make informed decisions, the marketing manager must understand the political factors of the country, and also must understand the national strategies and goals of the country. The political factors in a country include: the political stability, the predominant ideology toward business (and foreign business in particular), the roles that institutions have in the country (including the church, government agencies, and the legal systems), and the international links to other countries' legal and ideological structures.[54]

In order to be welcomed in a host country, the foreign firm has to offer some tangible benefits that the host government desires. Thus, it is critical that a manger recognize what the host country government's motivations and goals are. Most international business activities offer something to all parties involved. If the host country is actively pursuing job creation goals, then a foreign firm that can offer jobs has leverage for obtaining concessions against other problems. The manager will want to understand what national policies are being pursued, and what policy instruments the government typically uses to promote its interests (see **Exhibit 5-2**).

It is important to carefully assess the political power structure and mood in a country before making decisions regarding business operations. By evaluating various environmental factors (see **Exhibit 5-3**), marketing managers can arrive at a more thorough understanding of the likelihood of various problems or opportunities in a country. As shown in **Exhibit 5-4**, managers can also purchase or subscribe to country risk ratings provided by various risk analysis agencies such as the PRS Group's

EXHIBIT 5-2
GOVERNMENT POLICY AREAS AND INSTRUMENTS

	Policy Areas					
Policy Instruments	*Monetary*	*Fiscal*	*Trade*	*Foreign Investment*	*Incomes*	*Sectoral*
Legal	• Banking reserve levels	• Tax rates • Subsidies	• Government import controls	• Ownership laws	• Labor laws	• Land tenure laws
Administrative	• Loan guarantee • Credit regulation	• Tax collection	• Import quotas • Tariffs • Exchange rates and controls	• Profit repatriation controls • Investment approvals	• Price controls • Wage controls	• Industry licensing • Domestic content
Direct market operations	• Money creation	• Government purchases	• Government imports	• Government joint ventures	• Govern-ment wages	• State-owned enterprises

Source: Adapted from James E. Austin, Managing in Developing Countries: Strategic Analysis and Operating Techniques (New York: Free Press, 1990), p. 89.

[53]Michael G. Harvey, Robert F. Lusch, and Branko Cavarkapa, *"A Marketing Mix for the 21st Century," Journal of Marketing Theory and Practice*, 4 (Fall 1996), pp. 1–15

[54]James E. Austin, *Managing in Developing Countries: Strategic Analysis and Operating Techniques* (New York: Free Press, 1990).

EXHIBIT 5-3
COUNTRY RISK ASSESSMENT CRITERIA

Index Area	*Criteria*
Economic Risk	• GDP Per Capita • Real Annual GDP Growth as Annual percent Change • Annual Inflation Rate as Annual percent Change • Budget Balance as percent of GDP • Current Account as percent of GDP
Financial Risk	• Foreign Debt as percent of GDP • Foreign Debt Service as percent of Exports of Goods and Services • Current Account as percent of Exports of Goods and Services • International Liquidity as Months of Import Cover • Exchange Rate Stability as percent Change
Political Risk	• Government Stability • Socioeconomic Conditions • Investment Profile • Internal Conflict • External Conflict • Corruption • Military in Politics • Religious Tensions • Law and Order • Ethnic Tensions • Democratic Accountability • Bureaucracy Quality

Source: The PRS Group, *International Country Risk Guide*, http://www.prsgroup.com/, accessed July 20, 2009.

EXHIBIT 5-4
EXAMPLES OF COUNTRY RISK RATINGS (70 SELECTED COUNTRIES RANKED BY COMPOSITE OVERALL RATING, AS OF JULY 2008)

Rank	*Country*	*Composite Risk Measure*	*Economic Risk*	*Financial Risk*	*Political Risk*
1	Norway	91.8	88.5	47.5	47.5
3	Brunei	88.5	83.5	46.0	47.5
3	Switzerland	88.5	88.5	43.5	45.0
4	Finland	87.5	92.5	37.0	45.5
6	Singapore	87.0	84.5	43.5	46.0
6	Sweden	87.0	88.5	40.5	45.0
8	Denmark	86.0	86.0	43.0	43.0
8	Germany	86.0	86.5	42.0	43.5
9	Netherlands	85.5	86.0	41.0	44.0
11	Canada	85.0	86.0	42.0	42.0
11	Kuwait	85.0	77.5	44.5	48.0
12	Austria	84.8	88.0	38.0	43.5
13	Botswana	84.0	76.0	49.0	43.0
15	Taiwan	83.8	80.0	45.0	42.5
15	United Arab Emirates	83.8	79.0	42.0	46.5
17	Belgium	83.3	82.5	40.5	43.5
17	Ireland	83.3	89.5	38.0	39.0
18	Bahrain	82.0	72.5	42.0	49.5
19	Japan	81.8	77.5	46.0	40.0
20	South Korea	81.3	78.5	41.0	43.0
21	Australia	80.5	86.5	34.0	40.5
22	Chile	79.8	78.5	40.0	41.0
23	Saudi Arabia	79.5	68.5	45.0	45.5
24	Malaysia	79.3	73.5	43.0	42.0

(Continued)

EXHIBIT 5-4
(CONTINUED)

Rank	*Country*	*Composite Risk Measure*	*Economic Risk*	*Financial Risk*	*Political Risk*
25	United Kingdom	78.8	80.0	40.5	37.0
26	China	78.5	67.5	48.0	41.5
27	France	78.0	78.5	38.5	39.0
28	New Zealand	77.8	83.5	33.0	39.0
29	Portugal	77.5	83.0	36.5	35.5
30	Italy	77.3	80.5	37.0	37.0
32	Mexico	76.8	74.0	41.0	38.5
32	Russia	76.8	66.5	44.5	42.5
33	United States	76.5	81.0	32.0	40.0
34	Poland	76.3	80.5	34.5	37.5
35	Slovenia	75.8	77.5	35.5	38.5
36	Spain	75.5	78.5	35.0	37.5
37	Costa Rica	73.8	72.5	40.0	35.0
39	Morocco	73.5	70.5	40.5	36.0
39	Peru	73.5	62.5	43.0	41.5
40	Kazakhstan	73.3	75.5	36.0	35.0
41	Croatia	72.5	73.5	34.0	37.5
42	Greece	72.0	74.5	33.0	36.5
44	Estonia	71.8	76.0	32.5	35.0
44	South Africa	71.8	68.0	37.5	38.0
47	Argentina	71.5	66.0	38.0	39.0
47	Hungary	71.5	75.0	34.0	34.0
47	Iran	71.5	56.5	46.0	40.5
49	Brazil	71.0	66.5	37.5	38.0
49	Israel	71.0	61.5	38.0	42.5
50	Philippines	70.0	62.0	38.5	39.5
51	Indonesia	69.0	59.0	40.5	38.5
52	Vietnam	68.8	66.5	40.0	31.0
53	Ghana	68.5	67.0	38.5	31.5
54	Thailand	68.5	59.0	41.5	36.5
55	Ukraine	68.5	69.0	37.0	31.0
56	Cuba	67.8	58.0	40.0	37.5
57	Armenia	67.5	59.5	40.0	35.5
58	India	67.3	60.5	43.5	30.5
59	Venezuela	67.0	49.5	46.0	38.5
60	Colombia	65.3	58.5	36.0	36.0
61	Nigeria	64.8	43.5	46.5	39.5
62	Turkey	63.5	59.5	32.5	35.0
63	Bangladesh	62.8	50.0	40.0	35.5
64	Nicaragua	61.5	66.0	33.5	23.5
65	Ethiopia	59.5	49.5	39.5	30.0
66	Lebanon	58.5	57.0	31.5	28.5
67	Sudan	54.5	44.0	34.0	31.0
68	Iraq	53.0	36.0	36.0	34.0
69	Zimbabwe	40.5	41.0	23.5	16.5
70	Somalia	39.3	23.5	33.0	22.0

Note: Lower scores represent higher risk (highest risk = 1, lowest risk = 100)

Source: Compiled from the PRS Group, *International Country Risk Guide*, http://www.prsgroup.com/, accessed July 20, 2009.

International Country Risk Guide, the Economist Intelligence Unit (EIU), Business Environment Risk Intelligence (BERI), and Business Monitor International (BMI).

Regardless of categories employed in their risk ratings, there are three general types of risks involved in operating in a foreign country: risks associated with changes in company ownership, risks associated with changes in company operations, and risks associated with changes in transfers of goods and money. Changes in ownership structure are usually due to dramatic political changes, such as wars or coups d'état.

A company may face the expropriation or confiscation of its property, or it may face the nationalization of its industry. **Expropriation** refers to foreign government's takeover of company goods, land, or other assets, with compensation that tends to fall short of their market value. **Confiscation** is an outright takeover of assets without compensation. **Nationalization** refers to foreign government's takeover for the purpose of making the industry a government-run industry. In nationalization, companies usually receive some level of compensation for their losses.

To reduce risk of expropriation or confiscation of corporate assets overseas, many companies use joint ventures with local companies or adopt a domestication policy. Joint ventures with local companies imply shared activities and tend to reduce nationalistic sentiment against the company operating in a foreign country. **Domestication policy** (also known as **phase-out policy**) refers to a company gradually turning over management and operational responsibilities as well as ownership to local companies over time.

However, these risks have been reduced in recent years as many countries have realized the need for international support in order to receive the loans and investment they need to prosper. Consequently, the number of privatizations of once government-owned industries has increased in the last decade.[55] It is well known that government-owned companies generally do not measure up to the performance standard of private companies.[56]

Other changes in operating regulations can make production unprofitable. For example, local-content requirements may force a company to use inputs of higher cost or inferior quality, making its products uncompetitive. Price controls may set limits on the sales price for a company's goods that are too low to recover investments made. Restrictions on the number of foreign employees may force a company to train local citizens in techniques that require years of specialization.

Shifts in regulations on the transfer of goods and money can also dramatically affect the profitability of operating in a country. These changes include exchange rate restrictions or devaluations, input restrictions, and output price fixing. If a country is experiencing a shortage of foreign capital, it may limit the sale of foreign currencies to companies that need to buy some inputs from abroad or repatriate profits back home. Faced with such foreign exchange restrictions, companies have developed creative, if not optimal, means to deal with the foreign exchange restrictions. **Countertrade** is a frequently used method that involves trading of products without involving direct monetary payments. For example, in order to expand its operations in Russia, the Russian subsidiary of PepsiCo needed to import bottling equipment from the United States. However, the Russian government did not allow the company to exchange rubles for dollars, so it exported Russian vodka to the United States to earn enough dollars to import the needed equipment. As a result of the countertrade arrangement, PepsiCo is now considered the most widely available western consumer product in the Commonwealth of Independent States (ex-Soviet states). Firms that use countertrade are also shifting away from short-term marketing motives, such as disposing of surplus, obsolete, or perishable products, to long-term marketing motives such as establishing relationships with new partners, gaining entry to new or difficult markets, and accessing networks and expertise.[57]

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[55]Douglas L. Bartley and Michael S. Minor, "Privatization in Eastern Europe: A Field Report," *Competitiveness Review*, 6 (2), 1996, pp. 31–43; and John Nellis, "Time to Rethink Privatization in Transition Economies," *Finance & Development*, 36 (June 1999), pp. 16–19.

[56]Lien-Ti Bei and Cian-Fong Shang, "Building Marketing Strategies for State-Owned Enterprises against Private Ones Based on the Perspectives of Customer Satisfaction and Service Quality," *Journal of Retailing & Consumer Services*, 13, January 2006, pp. 1–13.

[57]Dorothy Paun and Aviv Shoham, "Marketing Motives in International Countertrade: An Empirical Examination," *Journal of International Marketing*, 4 (3), 1996, pp. 29–47.

TERRORISM AND THE WORLD ECONOMY

Terrorism used to be considered a random political risk of relatively insignificant proportions. However, it seems to have gradually escalated in the last decade or so.[58] It culminated on September 11, 2001 in New York City and Washington, D.C., when massive terrorist attacks occurred. No one can ever forget what happened that day in the United States. Americans and the rest of the world were stunned, not only by the terror attacks, but also by the vulnerability revealed. By attacking the World Trade Center and the Pentagon, the symbol of the financial and economic center and the military power, respectively, terrorists also disrupted the U.S. economy and affected the global market as well. The cost of the attack is hard to believe. An IMF study identified the direct loss as totaling about $21.4 billion, or about 0.25 percent of the U.S. GDP.[59] Other studies' estimates are much higher.[60] Short-term lost economic output was estimated as $47 billion and lost stock market wealth at $1.7 trillion.[61] At least 125,000 workers were laid off for 30 days or longer, and according to a Milken Institute study, Metropolitan areas in the U.S. lost as much as 1.6 million jobs in 2002 because of the attacks.[62] Long-term costs of security spending and anti-terrorist activities can also be significant.

The tighter security measures after September 11 affects international trade tremendously. Security check causes delays in shipments of goods and raising concerns among businesses that reply on just-in-time delivery. In the United States after the attack, because of the security check at the Canadian border, Ford Motor and General Motors experienced periodic parts shortages which delayed production for hours, steel makers slowed production, and office-supply stores in the New York area ran out of ink and paper.

Similarly, The Middle East crisis, with over hundreds of Israelis killed and thousands wounded, has had a big impact on Israel's economy and foreign investment. The Bank of Israel reported that Israel's balance of payments worsened by $1.9 billion in 2001 due to the deteriorating security situation, including a loss of $1.7 billion in tourism revenue. Because international investors are less willing to visit or make fact-finding trips to Israel, Israeli firms find it much more difficult to raise funds abroad. The whole economy shrank in 2001, with GDP falling by 0.6 percent, compared to a 6.4 percent increase in 2000.[63]

The worsened Middle East crisis, the September 11 terrorist attacks on the United States, and subsequently the Iraq war have caused tremendous concern about future oil supply for economic security. Since Arab oil supplies look shakier than ever, U.S. policy makers and oil companies are working on oil pipelines in Africa and other parts of Asia. An oil pipeline currently under construction from Baku through Georgia to the Turkish port of Ceyhan is a vital project for oil security.[64] Oil pipelines in some parts of Africa are also facing frequent attacks from terrorists. For example, actions of insurgents in recent years have led to a significant reduction of oil production in Nigeria. Thousands of foreign workers have been compelled to leave the country, and two oil-refining

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[58] Masaaki Kotabe, "Global Security Risks and International Competitiveness," *Journal of International Management*, 11 (December 2005), pp. 453–56.

[59] International Monetary Fund, "How Has September 11 Influenced the Global Economy," *World Economic Outlook*, (December 2001), p. 16.

[60] Jim Saxton, "The Economic Costs of Terrorism Pose Policy Challenges," Joint Economic Committee Press Release, United States Congress, www.house.gov/jec/, May 1, 2002.

[61] Peter Navarro and Aron Spencer, "September 11, 2001: Assessing the Costs of Terrorism," *Milken Institute Review*, (Fourth Quarter 2001), p. 20.

[62] Ross Devol, et. al., "The Impact of September 11 on U.S. Metropolitan Areas," *Milken Institute Research Report*, (January 2002).

[63] "The Cost of Terrorism," *Jerusalem Post*, (March 24, 2002), p. 6.

[64] Background note: Georgia, U.S. Department of State, Bureau of European and Eurasian Affairs, February 2008.

factories have been closed. In the middle of 2007 regular attacks of insurgents had resulted in the large reduction of Nigeria oil export volume by 25 percent.[65]

Even two massive terrorist bombings in Bali, Indonesia on October 12, 2002 and on October 1, 2005 affected many nationalities ranging from Australia to South Africa and from Ecuador to Sweden. The majority of the dead in the first attack was Australians. Australians always thought that given their country's relatively geographically isolated location, they were immune to terrorism. Now even Australian firms as well as tourists have to think twice about where to invest and travel, respectively.[66] According to the new National Counterterrorism Center, there was a tremendous increase in terrorist attacks in 2004, with 651 significant strikes worldwide. The growing threat today is from the so-called "global jihad movement," a mixed group inspired, but not directed, by Osama bin Laden. This group, in particular, is carrying out most of the terrorist attacks against U.S. and allied interests.[67]

As recently as 2006, the U.S. government, sensitive about Middle Eastern terrorism, entered a heated dispute over port security issues resulting from the proposed purchase of five major U.S. commercial port operations by Dubai Ports World, a United Arab Emirates-owned company and one of the most globally efficient port operators.[68] Eventually, the U.S Congress introduced legislation to delay the sale. Clearly, economic efficiency cannot be pursued devoid of international politics.

Terrorist activities and local military skirmishes in various parts of the world disrupt not only international movement of supplies and merchandise but also international financial flow as well as tourism. They threaten the smooth functioning of international marketing activities we had taken for granted in the last thirty years. International marketers should be aware that global strategy based on coordination of various value-adding activities scattered around the world as envisioned in the 1980s and 90s may need to be replaced (at least on a case-by-case basis) by more locally- and regionally-based strategy that require increased levels of local procurement and local marketing for the sake of political correctness and local sensitivity.[69]

INTERNATIONAL AGREEMENTS

International politics has always been characterized by the predominance of strong ideological links, centered around, and dominated by, a relatively small number of large powers. After World War II, those ideological links were centered around the two contending superpowers: the United States and the former Soviet Union. Recently, however, the hierarchical structure of world politics has been challenged by two processes.

First, the true independence of previously colonial countries has led to a much larger set of nations playing relatively independently on the international stage, entering into contracts and relations with new political and economic partners. Second, the loosening of the tight bipolarity in world politics, combined with the relative decline of the United States as the economic superpower in the free world and the breakup of the Soviet Union that had once led the communist world, has created an increased level of ambiguity in geopolitical stability.[70]

While most nations guard their independence by maintaining the ability to produce critical products domestically, citizens around the world have learned to expect and

[65] "In Nigeria Insurgents Have Damaged Oil Pipeline and Have Killed 11 Militarians," http://www.world-terrorism.org/items/date/2008/05, accessed September 1, 2008.

[66] The Bomber Will Always Get Through," *Economist*, October 8, 2005, pp. 12–13.

[67] Lisa Stein, "The Week," *U.S. News & World Report*, May 9, 2005, pp. 14–18.

[68] "Big Problem, Dubai Deal or Not," *New York Times*, February 23, 2006.

[69] Masaaki Kotabe, "To Kill Two Birds with One Stone: Revisiting the Integration-Responsiveness Framework," in Michael Hitt and Joseph Cheng, ed., *Managing Transnational Firms*, New York: Elsevier, 2002, 59–69.

[70] Tom Nierop, *Systems and Regions in Global Politics—An Empirical Study of Diplomacy, International Organization and Trade, 1950–1991* (New York: Wiley, 1994).

demand the lifestyle that international trade provides. Thus, domestic politics cannot be isolated from international politics. Political actions in one country will eventually influence the actions of other countries. For example, Mexico's recent decision to devalue its currency caused U.S. exports to Mexico to decrease. If the industries that are harmed by the decrease in sales have enough political force, they might ask the U.S. government to pressure Mexico to invest in strengthening its currency or face trade repercussions.

Not only do nations react to each other's actions, they develop relationships that determine their future actions. They form networks for achieving mutual goals, and they develop political and trade histories and dependencies that influence their perceptions of the world. Thus, the international political environment is determined by a dynamic process of the interactions of players, all of whom are pursuing their own interests and working together for mutual interests. Coordination is required, for example, in order to establish and maintain a trade embargo as a viable alternative to military force. Similarly, coordination is required to avoid harmful currency devaluations or the financial insolvency of governments. The level at which governments rely on each other and are affected by each other's actions also leads to regular conflicts and tensions. Indeed, history has shown that a war—an ultimate form of international conflicts and tensions—is less likely to occur between the two countries, the more trade they engage in with each other.[71]

In the United States, the Congress, not the president, is in charge of international trade negotiations. As a legislative process, any decision-making on trade-related issues tends to be slow, and the U.S. government's inaction sometimes becomes a bottleneck to international trade negotiations. As a result, the U.S. government may lose credibility in such negotiations. If the Congress sees the benefit of faster trade negotiations, it may grant fast-track trade authority to the President. **Fast-track trade authority** gives the U.S. President a free hand in directly negotiating trade deals with foreign governments. Although ex-President Clinton did not get a fast-track trade authority, President George W. Bush was granted this authority in 2002.[72] Similarly, Mexico, whose trade volume with the United States and Canada has more than tripled since the implementation of NAFTA in 1994, considered granting president Vicente Fox fast track trade authority to impose a 40 percent tariff on fresh apples imported from the United States. Mexico accused the United States of selling the fruit at an unfair price, hurting domestic growers.[73]

The roles of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization that succeeded GATT in 1995 were explained earlier as part of the economic environment in Chapter 2. We limit our discussion to two major international agreements that have shaped and will reshape the political economies of the world.

Group of Seven (G7), Group of Eight (G8), and Group of Eight plus Five (G8+5)

The **G7** is an economic policy coordination group made up of political leaders from Canada, England, France, Germany, Italy, Japan, and the United States. The G7 began during the economic crises of the mid-1970s. The G7 countries continued to play a major role in world economy. For example, during a recent G7 meeting in Washington, D.C. in September 2005, soaring oil prices emerged as the topic dominating the discussion among finance ministers from the Group of Seven industrialized countries. The Bush administration called for measures that would increase oil supply and stem supply disruptions, while some in Europe called for measures to reduce consumption. There was a clear difference mirroring trans-Atlantic disputes over issues such as global warming. Other issues on the table at the meeting were debt relief for developing countries and the U.S. budget deficit.[74]

71 Edward D. Mansfield, *Power, Trade, and War* (Princeton, NJ: Princeton University Press, 1994).
72 "Fast-Trace Authority: Don't Underestimate its Clout," *Business Week*, August 12, 2002, p. 35.
73 Ginger Thompson, "Mexico: Apple Dumping Duties," *New York Times*, August 10, 2002, p. 3.
74 "Oil Likely to Be Focus of G-7 Meeting," *Wall Street Journal*, September 22, 2005, p. A8.

Russia joined the G7 in 1997, and the group consisting of the original G7 and Russia is known as the **G8**. Heads of state, senior economic ministers, and heads of central banks typically meet once a year to further economic coordination. G7 meetings have primarily dealt with financial and macroeconomic issues (such as the Asian and Latin American financial crisis), but since Russia's participation, the G8 has included some politically sensitive issues such as an effort to make arrangements for the reconstruction of Kosovo—and indeed of the Balkan states as a whole—after the Kosovo conflict. Recently, as a result of a remarkable economic and democratic transformation, Russia has demonstrated its potential to play a full and meaningful role in addressing the global problems with the seven industrialized nations. The Group of Eight industrialized nations, in a G8 summit meeting in Calgary, Canada in June 2002, agreed to have Russia become the group's president and host the summit meeting in 2006.[75]

AFP/Getty Images, Inc.

Group of Eight (G8) leaders met at the Toyako Summit in Japan in July 2008 to tackle a number of impending issues including climate change, the food crisis, and oil supply stability.

In 2005, a new Group of Eight plus Five (G8+5) was formed when Tony Blair, then-Prime Minister of the United Kingdom, in his role as host of the 31st G8 summit at Gleneagles, Scotland, invited the leading emerging countries (Brazil, China, India, Mexico and South Africa) to join the talks. This enlargement aimed to form a stronger and more representative group that would inject fresh impetus into the trade talks at Doha, and the need to achieve a deeper cooperation on climate change. Following the 33rd G8 summit Heiligendamm 2007, German chancellor Angela Merkel announced the establishment of the "Heiligendamm Process," through which the full institutionalization of the permanent dialogue between the G8 countries and the 5 major emerging economies, which deals with the biggest challenges the global economy is facing today, would be implemented.[76]

The most recent 34th G8 summit was held in Hokkaido Tokyo, Japan, in July 2008. Although it was originally expected to find common ground on climate change, the global economy and a host of political crises, the leaders of the G8 actually rose to the challenges posed by the three Fs—food, fuel, and the financial credit crunch, and little effort was made to resolve the contradiction between calls for larger oil supplies and the promise of a low-carbon future.[77]

[75] "G8: Russia To Lead G8, Host Summit in 2006," *Dow Jones Newswire*, June 27, 2002.

[76] "Heiligendamm Process", GLOBE INTERNATIONAL, http://www.globeinternational.org/index.php, accessed September 1, 2008.

[77] "Key Agreements at G8 Summit," *Economic Times*, July 8, 2008; "The G8 Summit in Hokkaido: They Came, They Jawed, They Failed to Conquer," *Economist*, July 12, 2008, p. 44.

Wassenaar Arrangement

Wassenaar Arrangement was founded in 1995 is a multilateral export control agreement on conventional arms and dual-use goods and technologies. It is essentially a successor to the Cold-War era COCOM (the Coordinating Committee for Multilateral Controls). COCOM was founded in 1949 to stop the flow of Western technology to the former Soviet Union. Australia, Japan, and the NATO countries (except Iceland) are members. For example, even when U.S. franchises were already operating in the former Soviet Union, it was illegal to export personal computers for them to use! The initial emphasis of COCOM was on all technology products. Subsequently, the focus shifted to various types of dual-purpose hardware and software technology products —that is, products that could be used for civilian as well as military purposes. Two trends, however, started exerting pressure on the policies adopted by COCOM. First, technologies that had primarily military applications were increasingly finding more civilian applications. Satellites, computers, and telecommunication technologies were prime examples of this trend. Second, the trend of economic liberalization in the newly industrializing and developing countries put further competitive pressures on Western companies to share technologies that were until then privy to the Western world. U.S. firms were particularly adversely affected. Many U.S. companies, including the large telecommunications companies, complained to the government that the restrictions were outdated and that they were losing valuable contracts to competitors from countries without such restrictions.

In 1992, COCOM reevaluated its mission and loosened restrictions on exports of computers, telecommunications equipment, machine tools, and other materials that might assist the newly independent nations of Eastern Europe and the former Soviet Republics in their effort to develop market-driven economies. Due to the changed political and economic environment, the COCOM agreement was terminated in 1994 and replaced by the **Wassenaar Arrangement** of 1995. However, the spirit of the committee still lives on. The new group of 40 countries includes not only the original COCOM members but also Russia and a few other ex-Soviet republics. Unlike COCOM, recommendations by the group to restrict sensitive exports to specified countries are not binding on the members. Two issues of primary importance for being considered within this multilateral system are nuclear technologies and missile (especially ballistic missile) technologies. Today, the United States and some other industrialized countries forbid the export of such generally available technology as software for encoding electronic messages and semiconductor manufacturing equipment. For example, in 2000, the Japanese government imposed an export control on Sony's PlayStation 2 (PS2) electronic game console. PS2's 128-bit central microprocessor developed by Sony and Toshiba has twice the raw number-crunching power of Intel's most advanced Pentium chip used in professional desktop computers. When coupled with a video camera, PS2 could make an ideal missile-guidance system! The biblical prophesy promising peace to those who turn their swords to ploughshares seems very optimistic in today's world of dual-usage technologies, known as DUTs. Such provocations led the Japanese government to designate the machine a "general-purpose product related to conventional weapons". Under Japan's Foreign Exchange and Foreign Trade Control Law, this requires anyone wishing to take more than 50,000 yen (a little more than $400) worth of such equipment out of Japan to get permission from the Ministry of Economy, Trade and Industry. Violators trying to sneak loads of PS2s abroad could face up to five years in jail.[78] Now think for a moment: Sony's PlayStation 3 (PS3) introduced in 2006, is several times more powerful than PS2, and is capable of surpassing 250 gigaflops per second, rivaling the best mid-1990s supercomputer.[79]

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[78] "War Games," *Economist*, April 22, 2000, p. 60; and Richard Re, "Playstation2 Detonation," *Harvard International Review*, 25 (Fall 2003), pp. 46–50.

[79] "Super Cell," *Forbes*, February 14, 2005, p. 46.

INTERNATIONAL LAW AND LOCAL LEGAL ENVIRONMENT

International marketing managers should understand two legal environments—the legal environment in each country in which they do business, and the more general international legal environment. At a macro level, international law and the bodies that evaluate it affect high-level international disputes and influence the form of lower-level arbitration and decisions. Local laws and legal systems directly determine the legal procedures for doing business in a foreign country. Local laws also determine the settlement of most international business conflicts—the country whose laws are used is determined by the jurisdiction for the contract.

International Law

International law, or "the law of nations," may be defined as a body of rules that is binding on states and other international persons in their mutual relations. Most nations and international bodies have voluntarily agreed to subjugate themselves to some level of constraint for the purpose of living in a world in which order, and not chaos, is the governing principle. In short, international law represents "gentlemen's agreements" among countries.

Although, technically speaking, there is no enforceable body of international law,[80] international customs, or treaties, and court decisions establish a defined international legal environment. International bodies and policies exist for arbitrating cases that cannot be settled fairly in any given country.

International law comes from three main sources—**customs**, international **treaties**, and national and international **court decisions**. Customs are usages or practices that have become so firmly accepted that they become rules of law. For example, nations have historically claimed sovereignty over the resources in their offshore continental shelves. This historical practice has developed into a consensus that amounts to an international law. Custom-based laws develop slowly.

Treaties and international contracts represent formal agreements among nations or firms that set down rules and obligations to govern their mutual relationships. Treaties and contracts are only binding on those who are members to them, but if a great number of treaties or contracts share similar stipulations, these may take on the character of a customer-based law or a general rule.

National courts often make rulings in cases that apply to international issues. When these rulings offer an unusually useful insight into the settlement of international cases, or when they develop into a series of interpretations consistent with other nations' courts, then national rulings may be accepted as international laws. If the issue of conflict is one where a national court is not acceptable to one or both parties, international courts and tribunals may rule. International tribunals may be turned to for **arbitration** if the parties agree to let the case be tried. The International Court of Justice was established by the United Nations to settle international conflicts between nations, not between individual parties (such as firms) across national boundaries. However it must be again noted that international court rulings do not establish precedent, as they might in the United States, but rather, apply only to the case at hand.

Local Legal Systems and Laws

Legal systems and the laws they create differ dramatically in countries around the world. Many legal systems do not follow the common law system followed in the United States. We discuss a number of different legal systems and the types of laws that govern contracts and business in each system. We also discuss the issue of jurisdiction, which determines the critical issue of what courts, and what laws, are used in deciding a legal question. For most business issues, international law is primarily a question of which

[80] The government of a sovereign nation stipulates its laws with policing authority. Since no supra-national government exists, no supra-national (i.e., international) laws are binding. Although the United Nations is the most comprehensive political body, made up of more than a hundred member nations, it is not a sovereign state, and therefore, does not have enforceable laws that the member nations have to abide by other than voluntarily.

national laws apply and how to apply them to cases involving international contracts, shipping, or parties.

The laws that govern behavior within a country, as well as the laws that govern the resolution of international contractual disputes, are primarily local, or municipal, laws. Foreign subsidiaries and expatriate employees live within the legal bounds of their host countries' legal systems. Although U.S. embassy property is considered U.S. territory no matter where it is located, companies and their employees must live within the local country laws. The inability of the U.S. government in 1994 to change the Singapore government's punishment by caning of Michael Fay, an American teenager charged of vandalism there, illustrates a clear example of the sovereignty of each country's laws.[81] The international marketing manager must be aware of the laws that will govern all business decisions and contracts.

Business Practices and the Legal System. Businesses face a myriad of legal issues every day. Questions relating to such issues as pricing policies and production practices must be clearly answered in order to avoid legal rapprochement and punishment. Choices relating to legal industry constraints and various regulations on product specifications, promotional activities, and distribution must be understood in order to function efficiently and profitably. Legal systems in each country deal with these questions differently. For a brief summary of legal issues facing companies, see **Exhibit 5-5**.

For example, in many parts of the world, automobiles with engines larger than a 2,000 cc displacement, face a much stiffer commodity tax than those with smaller engines. In Germany, there is a Rabattgesetz, or rebate law, that businesses cannot give special prices to select customers. This law also prevents retailers from discounting more than 3 percent from an advertised price. This makes it extremely difficult for e-commerce retailers, especially auction sites. Other German laws prevent online shops like Amazon.com from discounting book prices and block sales of prescription drugs and health products online.[82] In some countries it is illegal to mention a competitor's

EXHIBIT 5-5
LEGAL ISSUES FACING THE COMPANY

Type of Decision	*Issue*
Pricing decisions	Price fixing Deceptive pricing Trade discount
Packaging decisions	Pollution regulations Fair packaging and labeling
Product decisions	Patent protection Warranty requirements Product safety
Competitive decisions	Barriers to entry Anticompetitive collusion
Selling decisions	Bribery Stealing trade secrets
Production decisions	Wages and benefits Health and safety requirements
Channel decisions	Dealers' rights Exclusive territorial distributorships

Source: Adapted from Kotler, Philip and Gary Armstrong, *Principles of Marketing*, 8th ed. (Englewood Cliffs, N.J.: Prentice Hall), 1998.

[81]"Singapore's Prime Minister Denounces Western Society," *Wall Street Journal* (August 22, 1994), p. A8.

[82]Neal E. Boudette, "Germany's Primus Online Faces Legal Challenges," *Wall Street Journal*, January 6, 2000, p. A17.

name in an advertisement. In some countries that follow Islamic law, it is even illegal to borrow money or charge an interest! However, businesses need financial resources to grow; thus they must learn how to acquire the resources they need within the legal limits established by the country in which they are operating. For example, in Pakistan, importers and exporters of raw materials rely on a technique that is known as *murabaha* to avoid the ban on interest. In this arrangement, a bank buys goods and sells them to a customer who then pays the bank at a future date and at a markup agreed upon by the bank and its customer. In Indonesia, credit card companies such as Visa and MasterCard receive collateral assets, such jewelry and cattle, which they can sell, from card users instead of charging interest.[83]

In recent years, some countries have started raising legal requirements for environmental protection. In Japan, the famed just-in-time delivery system, such as the one practiced by Toyota and 7-Eleven Japan, has been criticized as causing traffic congestion and air pollution. Laws are being considered to reduce the just-in-time practices.[84] **Green marketing** has become fashionable in an increasing number of countries. It is marketers' reaction to governments' and concerned citizens' increased call for reduction of unnecessary packaging materials and increased recycling and recyclability of materials used in the products. Recent developments in the European Union threaten to utilize environmental standards to control internal and external trade in consumer products. In many parts of Asia, consumer awareness and appreciation of environmental protection is also making green issues a crucial part of firm's marketing strategy.[85] Marketers who do not conform may be restricted from participation. Meanwhile, those marketers who do meet the requirements enjoy the benefits of improved product development capabilities, although such capabilities may not automatically translate into improved market share.[86]

Regulations on E-Commerce. Local business laws also affect the use of the Internet. While there are no measurable restrictions for e-commerce in the United States, it is not the case in foreign countries. For example, in Germany, there are strict regulations over providing "digital signatures" to ensure security when making purchases over the Internet.[87] Likewise, France has regulated that the use of "cookies," software or hardware that identifies the user, should only be allowed when consent is granted.[88] Britain has a set of e-commerce laws designed to protect consumers. Interestingly, however, one study shows that almost half of the UK's top 50 retailers are flouting these laws. For example, one website failed to contain an appropriate data protection consent form. Another website informed users that their personal details would be passed onto other firms unless they sent an e-mail opting out. Both are in direct violation of the British laws. With so much business being done over the Internet, it is disconcerting that major retailers are not meeting the letter and the spirit of the laws.[89]

[83]Clement M. Henry, ed., "Special Issue: Islamic Banking," *Thunderbird International Business Review*, 41 (July/August and September/October 1999); Ahmed Al Janahi and David Weir, "How Islamic Banks Deal with Problem Business Situations: Islamic Banking as a Potential Model for Emerging Markets," *Thunderbird International Business Review*, 47 (July/August 2005), pp. 429–45. For broader regulatory issues on Islamic finance, an excellent treatise is found in Mohammed El Qorchi, "Islamic Finance Gears Up: While Gaining Ground, the Industry Faces Unique Regulatory Challenges," *Finance and Development*, 42 (December 2005), pp. 46–49.

[84]Eiji Shiomi, Hiroshi Nomura, Garland Chow, and Katsuhiro Niiro, "Physical Distribution and Freight Transportation in the Tokyo Metropolitan Area," *Logistics and Transportation Review*, 29 (December 1993), pp. 335–43.

[85]"Green Marketing Makes its Asian Debut," *Media: Asia's Media & Marketing Newspaper*, April 3, 2008, p. 22.

[86]William E. Baker and James M. Sinkula, "Environmental Marketing Strategy and Firm Performance: Effects on New Product Performance and Market Share," *Journal of the Academy of Marketing Science*, 33 (Fall 2005), pp. 461–75.

[87]"Germany Moves Digital Signatures to Next Level," *Journal of Internet Law*, February 2002, p. 23.

[88]John Leyden, "Online Data Protection Incites Worry," *Network News*, May 5, 1999, p. 4.

[89]"Half of Top 50 UK Retailers are Breaking Online Trading Laws," *Computer Weekly*, February 13, 2003, p. 18.

Types of Legal Systems. Four principal legal "systems" are used in the majority of counties: common law systems, code law systems, and Islamic law systems. **Common law** systems base the interpretation of law on prior court rulings—that is, legal precedents and customs of the time. The majority of the states in the United States follow common law systems (Louisiana is an exception). **Code (written) law** systems rely on statutes and codes for the interpretation of the law. In essence, there is very little "interpretation" in a code law system—the law must be detailed enough to prescribe appropriate and inappropriate actions. The majority of the world's governments rely on some form of code law system. **Islamic law (Sharia)** systems rely on the legal interpretation of the Koran and the words of Mohammed. Unlike common and code law systems, which hold that law should be man-made and can be improved through time, Islamic legal systems hold that God established a "natural law" that embodies all justice. Finally, **socialist laws**, developed in the ex-Soviet Union after the Russian Revolution of 1917 and later assimilated by other communist states, are distinguished from other legal systems by the influence of state ownership of the means of production, the pervasive influence of the Communist Party, and the ties between the legal system and national central planning. Since the breakup of the Soviet Union, socialist laws have mostly faded from world political systems, except in countries such as Cuba and North Korea.

Examples of Different Laws. Legal systems address both criminal and civil law. Criminal law addresses stealing and other illegal activities. **Civil law** addresses the enforcement of contracts and other procedural guidelines. Civil laws regulating business contracts and transactions are usually called **commercial law**. International businesses are generally more concerned with differences in commercial laws across different countries. For example, who is responsible if a shipper delivers goods that are not up to standards and the contract fails to address the issue? What if the ship on which goods are being transported is lost at sea? What if goods arrive so late as to be worthless? What if a government limits foreign participation in a construction project after a foreign company has spent millions of dollars designing the project?

Sometimes the boundary between criminal and civil law will also be different across countries. For example, are the officers of a company liable for actions that take place while they are "on duty"? When a chemical tank leak in Bhopal, India, killed more than 3,000 Indian citizens in 1984, it was not immediately clear whether the officers of Union Carbide were criminally liable. Since then, some 20,000 people have died from the contamination. It was seven years later in 1991 that the Bhopal court finally issued an arrest warrant for the former CEO of Union Carbide, now living in the United States. Subsequently, in 2001 Dow Chemical acquired Union Carbide. In that same year, the same court in Bhopal rejected an attempt by the Indian government to reduce homicide charges to negligence and stepped up demands that the U.S. extradite the former Union Carbide CEO to stand trial. The issue still lingers on to this day.[90]

EXHIBIT 5-6
THE NUMBER OF LAWYERS PER 100,000 RESIDENTS

United States	370.4
Britain	175.4
Germany	158.7
France	66.7
Japan	16.9

Source: Compiled from "Panel Eyes 3-Fold Increase in Legal Professionals by 2020," *Japan Economic Newswire*, February 3, 2001.

Cultural Values and Legal Systems. In Japan, legal confrontations are very rare. As shown in **Exhibit 5-6**, Japan's population of lawyers is low, which makes it difficult to obtain evidence from legal opponents. Also, rules against class-action suits and contingency-fee arrangements make it difficult to bring suit against a person or company. There are disadvantages to Japan's system, but it supports the cultural value of building long-term business ties based on trust.

In the United States, there is a strong belief in the use of explicit contracts and a reliance on the legal system to resolve problems in business. In other countries, such as China, a businessperson who tries to cover all possible problems or contingencies in a

[90] "Dow Chemical: Liable for Bhopal?" *Business Week*, June 9, 2008, pp. 61–62.

contract may be viewed as untrustworthy. Chinese culture values relationships (known as *guanxi*) and therefore relies more heavily on trust and verbal contracts than does U.S. culture.[91] In Brazil, however, there is a value system different from both the United States' explicit contractual agreement and China's mutual trust and verbal contract. The Brazilian value system is known as *Jeitinho*, in which people believe that they can always find a solution outside the legal contract on a case-by-case basis.[92] If a culture does not respect the value of following through on an obligation, no legal system, whether written or verbal, will afford enough protection to make doing business easy.

Jurisdiction

Because there is no body of international law in the strictly legalistic sense, the key to evaluating an international contract is by determining which country's laws will apply, and where any conflicts will be resolved.

Planning Ahead. By far the easiest way to assure what laws will apply in a contract is to clearly state the applicable law in the contract. If both a home country producer and a foreign distributor agree that the producer's national laws of contracts will apply to a contract for the sale of goods, then both can operate with a similar understanding of the legal requirements they face. Similarly, to assure a venue that will interpret these laws in an expected manner, international contracts should stipulate the location of the court or arbitration system that will be relied upon for resolving conflicts that arise.

If contacts fail to provide for the jurisdiction of the contract, it is not so clear which laws apply. Courts may use the laws where the contract is made. Alternatively, courts may apply the laws where the contract is fulfilled.

Arbitration and Enforcement. Due to the differences in international legal systems, and the difficulty and length of litigating over a conflict, many international contracts rely on a pre-arranged system of arbitration for settling any conflict. Arbitration may be by a neutral party, and both parties agree to accept any rulings.

However if one of the parties does not fulfill its contracted requirements and does not respond to or accept arbitration, there is little the injured party can do. There is no "international police" to force a foreign company to pay damages.[93]

ISSUES TRANSCENDING NATIONAL BOUNDARIES

ISO 9000 and 14000

In a bid to establish common product standards for quality management, so as to obviate their misuse to hinder the exchange of goods and services worldwide, the International Standards Organization (based in Geneva, Switzerland) has instituted a set of process standards. Firms who conform to these standards are certified and registered with International Standards Organizations. This common standard is designated **ISO 9000**. The ISO 9000 series was developed by its Technical Committee on Quality Assurance and Quality Management between 1979 and 1986 and was published in 1987. The series has been adopted widely by companies in the United States. The adoption of the ISO 9000 standards by member countries of the European Union has spurred widespread interest in companies worldwide to obtain this certification if they intend to trade with the European Union.

One of the reasons for the spurt of interest in ISO 9000 is the decision by the European Union to adopt ISO standards; the other main reason is the acknowledgment of the importance of quality by companies worldwide. It must be highlighted that ISO

[91] See, for example, Don Y. Lee and Philip L. Dawes, "Guanxi, Trust, and Long-Term Orientation in Chinese Business Markets," *Journal of International Marketing*, 13 (2), 2005, pp. 28–56; and Yi Liu, Yuan Li, Lei Tao, Ying Wang, "Relationship Stability, Trust and Relational Risk in Marketing Channels: Evidence from China," *Industrial Marketing Management*, 37 (June), 2008, pp. 432–46.

[92] Fernanda Duarte, "Exploring the Interpersonal Transaction of the Brazilian Jeitinho in Bureaucratic Contexts," *Organization*, 13 (July), 2006, pp. 509–27.

[93] Gerald Aksen, "Reflections of an International Arbitrator," *Arbitration International*, 23 (2), 2007, pp. 255–59.

9000 is not only concerned with standardized systems and procedures for manufacturing, but for all the activities of firms. These activities include management responsibility, quality systems, contract reviews, design control, document control, purchasing, product identification and tracing, (manufacturing) process control, inspection and testing, control of nonconforming products and necessary corrective actions, handling, storage, packaging and delivering, recordkeeping, internal quality audits, training, and servicing.

With the growing adoption of the ISO 9000 standards by firms worldwide, an ISO 9000 certification has become an essential marketing tool for firms. Firms that have it will be able to convince prospective buyers of their ability to maintain strict quality requirements. Firms that do not have ISO 9000 certification will increasingly be at a disadvantage relative to other competitors, not only in Europe but also in most parts of the world.

Over the past decade, the need to pursue "sustainable development" has been at the center of discussion of environmental issues and economic development. Attainment of sustainable development was articulated as a goal in 1987 by the World Commission on the Environment and Development (World Commission), a body established by the United Nations. The World Commission defined sustainable development as development that "meets the needs of the present without compromising the ability of future generations to meet their own needs." Sustainable development was the focus of discussion at the United Nations Conference on the Environment and Development held in Rio de Janeiro in 1992, and its attainment was articulated as a goal in the Environmental Side Agreement to the North American Free Trade Agreement (NAFTA). In 1996, the International Organization for Standardization (ISO) named the attainment of sustainable development as a major goal in its new ISO 14000 Series Environmental Management Standards. The ISO 9000 standards is a forerunner to and served as a model for the ISO 14000 series.

The **ISO 14000** standards are receiving significant amounts of attention from business managers and their legal and economic advisors. Business managers view ISO 14000 as a market-driven approach to environmental protection that provides an alternative to "command and control" regulation by government. Businesses view implementation of ISO 14000 as a means to "self-regulate," thereby minimizing their exposure to surveillance and sanctions by the United States Environmental Protection Agency and its state-level counterparts. For example, ISO 14000 is already strengthening chemical companies' relations with plant communities by providing third-party audits of a plant's environmental systems. It is an efficient way to show the community that companies are making environmental improvements. Therefore, any person or organization interested in environmental protection or business management should become familiar with the provisions and potential ramifications of ISO 14000.[94]

Intellectual Property Protection

Intellectual property refers to "a broad collection of innovations relating to things such as works of authorship, inventions, trademarks, designs and trade secrets."[95] Intellectual property rights broadly include patents, trademarks, trade secrets, and copyrights. These ideas typically involve large investments in creative and investigative work to create the product, but fairly low costs of manufacturing. As such they are amenable to being duplicated readily by imitators. Imitation reduces the potential returns that would have accrued to the innovator, thereby limiting its ability to appropriate the large investments made. With increasing movements of goods and services across borders,

[94]V. Kanti Prasad and G. M. Naidu, "Perspectives and Preparedness Regarding ISO-9000 International Quality Standards," *Journal of International Marketing*, 2 (2), 1994, pp. 81–98; and Morgan P. Miles, Linda S. Munilla, Gregory R. Russell, "Marketing and Environmental Registration/Certification: What Industrial Marketers Should Understand About ISO 14000," *Industrial Marketing Management*, 26 (July), 1997, pp. 363–70.

[95]Subhash C. Jain, "Intellectual Property Rights and International Business," in Masaaki Kotabe and Preet S. Aukakh, ed., *Emerging Issues in International Business Research*, Northampton, MA: Edward Elgar Publishing, 2002, pp. 37–64.

the potential loss of revenues to innovator firms, most of which reside in industrialized countries, is significant.

Few topics in international business have attracted as much attention and discussion in recent years as intellectual property rights.[96] In 2007, the Organization for Economic Cooperation and Development (OECD) released a report estimating the annual value of the international, physical trade of counterfeited consumer products at approximately $200 billion. This equals around 2 percent of the entire world trade and exceeds the GDP of 150 countries.[97] Apart from hurting legitimate businesses and trade, intellectual property infringement leads to the loss of government tax revenue.

Piracy is most rampant in software industry. For example, according to the Business Software Alliance, a global anti-piracy watchdog group, 35 percent of the software installed in 2006 on personal computers (PCs) worldwide was obtained illegally, amounting to nearly $40 billion in global losses due to software piracy. In percentage terms, Central/Eastern Europe topped the piracy rate at 68 percent of all software used, followed by Latin America at 66 percent, Middle East/Africa at 60 percent, Asia Pacific at 50 percent, the European Union at 36 percent, and North America at 22 percent.[98] More concerning is the counterfeiting of medicines, which threatens public safety and poses a growing threat around the world. Between 2000 and 2006, the Food and Drug Administration saw an eightfold increase in the number of new counterfeit drugs cases. In developing countries with weak regulatory systems, approximately 10 percent to 30 percent of all medicines could be counterfeit. Worldwide sales of counterfeit drugs are forecast to reach $75 billion by 2010.[99]

Various anti-counterfeiting tools and technologies are developed by firms to aid others' anti-counterfeiting efforts, or to enhance their own. Hewlett-Packard's Specialty Printing Systems, for instance, has expanded its offerings to the pharmaceutical industry with the introduction of a new ink cartridge that allows individual capsules or tablets to be marked. Eastman Kodak Co. developed a Traceless System for anti-counterfeiting on its branded rechargeable lithium-ion digital camera batteries supplied by Sanyo Electric. With "forensically undetectable" markers put on printed materials, product packaging or product components, the system can help fighting against counterfeiting as only handheld Kodak readers can detect the markers. Also among the firms deploying this anti-counterfeiting technology are DonRuss Playoff and Liz Claiborne. However, in spite of anti-counterfeiting tools and technologies, litigation, as well as legislation that we will discuss later in this section, piracy is still rampant around the world.[100]

Now with the convenient online access, it is even more difficult to ensure that copyright rules are not violated in the cyberspace. Recently, Google's books online was criticized by American publishing organizations for breaching copyright laws.[101] Google aims to put 15-million volumes online from four top U.S. libraries by 2015—the libraries of Stanford, Michigan, and Harvard Universities, and of the New York Public Library. The critics worry that if the people can read a book online for free they would not bother purchasing it. As easy as a click to download music online to listen to offline, a recent court ruling clearly states that even though the copyright of music has lapsed, reproducing and distributing the music is a breach to the copyright law. New York's highest court found Naxos guilty of illegally releasing

[96]Clifford J. Shultz III and Bill Saporito, "Protecting Intellectual Property: Strategies and Recommendations to Deter Counterfeiting and Brand Piracy in Global Markets," *Columbia Journal of World Business*, 31 (Spring 1996), pp. 19–27.

[97]Andreas Geiger, "A View From Europe: The High Price of Counterfeiting, and Getting Real about Enforcement," *theHill.com*, April 30, 2008.

[98]*2007 Global Piracy Study*, Business Software Alliance, http://www.bsa.org/, accessed September 20, 2008.

[99]Drew Buono, "Counterfeit Drugs a Growing Worldwide Danger," *Drug Store News*, June 23, 2008, pp. 60–62.

[100]Jill Jusko, "Counterfeiters Be Gone," *Industry Week*, July 2008, pp. 67–68.

[101]A settlement agreement was reached in 2008. If interested, see http://books.google.com/booksrightsholders/agreement-contents.html.

classical recordings by (the late) Yehudi Menuhin and others, because such recordings were still covered by the common law.[102]

Counterfeiting is not restricted to poor countries, either. Milan, Italy, for example, is a leading producer of counterfeit luxury products; the U.S. state of Florida is an international haven for fake aircraft parts; and Switzerland is a big player in pharmaceutical counterfeits production with almost 40 percent of fake medicines seized by the EU. According to the analyst, there is a globalized trend of counterfeiting, like manufacturing. Increasingly, all countries of the World Trade Organization (WTO) are required to implement **Trade Related Aspects of Intellectual Property Rights** (TRIPS) to execute intellectual property protection and companies are joining together to fight against the violations.[103] Revisit Chapter 2 for TRIPS.

Patent. A patent, if granted, offers a patent holder a legal monopoly status on the patented technology and/or process for a certain extended period (usually 15-21 years depending on a country). Patent laws in the United States and Japan provide an example of the differences in laws across countries and their implications for corporations.[104] The most significant difference between the two countries is on the **''first-to-file''** and **''first-to-invent''** principles. While most countries follow the ''first-to-file'' principle, only the United States (along with the Philippines) follows the ''first-to-invent'' principle. In the majority of countries, the patent is granted to the first person filing an application for the patent. In the United States, however, the patent is granted to the person who first invented the product or technology. Any patents granted prior to the filing of the patent application by the ''real'' inventor would be reversed in order to protect rights of the inventor. The difference between the two principles is no small matter. See **Global Perspective 5-4** for far-reaching implications.[105]

The marketing implications of this difference for U.S. companies as well as foreign companies are significant. To protect any new proprietary technologies, U.S. companies must ensure that their inventions are protected abroad through formal patent applications being filed in various countries, especially the major foreign markets and the markets of competitors and potential competitors. For foreign companies operating in the United States, the implications are that they must be extremely careful in introducing any technologies that have been invented in the United States. A ''first-to-file'' mentality could result in hasty patent applications and significant financial burden in the form of lawsuits that could be filed by competitors that claim to have invented the technology earlier.

In some extreme situation, governments have broken patent law for public health reasons. For example, Brazil's government, after signing intellectual property protection agreement, announced in August 2001 its plans to break a patent for a drug used to treat AIDS despite the international patent held by Roche, the drug's Swiss-based pharmaceutical company. Federal officials said they were unsuccessful in talks with Roche to lower the prices the country paid for nelfinavir, a drug blocking the HIV virus from replicating itself and infecting new cells.[106] The Brazilian government is not the only one to grab a company's patent rights in the interest of public health. Scared by the

[102] ''Court Secures Classical Copyright,'' *BBC News*, http://news.bbc.co.uk/2/hi/entertainment/4415829.stm, April 6, 2005.

[103] ''Imitating property is theft,'' May 15, 2003, p. 52; Quality Brands Protection Committee, Chinese Association of Enterprise with Foreign Investment, http://www.qbpc.org.cn/en/about/about/factsheet, accessed February 10, 2006. http://news.bbc.co.uk/2/hi/business/4123319.stm; and Drew Buono, ''Counterfeit Drugs a Growing Worldwide Danger,'' *Drug Store News*, June 23, 2008, pp. 60–62.

[104] Masaaki Kotabe, ''A Comparative Study of U.S. and Japanese Patent Systems,'' *Journal of International Business Studies*, 23 (First Quarter 1992), pp. 147–168.

[105] Forty-one nations, including the United States, the European Union, and Japan, reached a basic agreement to draft a treaty for standardizing the patent approval process based on the first-to-file principle in September 2006. If it goes smoothly, the treaty could be adopted as early as 2007. See ''Japan, U.S., Others Agree to Craft 1st-to-File Patent Pact,'' *NikkeiNet Interactive*, http://www.nni.nikkei.co.jp, September 26, 2006.

[106] ''Brazil to Break Patent, Make AIDS Drug,'' *CNN.com*, http://www.cnn.com/2001/WORLD/americas/08/23/aids.drug0730/index.html, August 23 2001.

GLOBAL PERSPECTIVE 5-4

TWO WORLDS APART: THE "FIRST-TO-INVENT" PRINCIPLE VERSUS THE "FIRST-TO-FILE" PRINCIPLE

A diplomatic conference to discuss the initial draft of patent harmonization treaty was convened by the World Intellectual Property Organization (WIPO) in May 2002. Most neutral observers would suggest that U.S. domestic politics is one principal impediment to the conference's success. In the United States, the ***first*** to ***invent*** wins the patent, while in the rest of the world a patent is awarded to the ***first*** to ***file*** an application. The conference examined the virtue of the U.S. "first-to-invent" principle vis-à-vis the "first-to-file" principle espoused in the rest of the world. The conference's recommendation involved changing the law to award patents to the "first to file" instead of to the "first to invent," which has guided the awarding of U.S. patents since Thomas Jefferson looked at the first ones filed in 1790.

Under current U.S. law, an individual applicant for a patent must prove that he had the idea first, not simply that he won the race to the courthouse. He can assert his priority to the invention at any time; he is entitled to a patent if thereafter he has not "suppressed, abandoned, or concealed" the invention. The U.S. system was established to protect the inventor who lacks the resources to keep up a stream of patent applications merely to invoke their priority. Not surprisingly, the system is championed today by resource-poor universities and independent inventors.

Supporters of the "first-to-file" system, largely lawyers and corporations, argue that it would better serve the public because it is simpler and conforms to the systems in the rest of the world. Moreover, it would spur inventors to file for patents earlier and to disclose their inventions sooner, thus speeding the progression from idea to finished product. Many supporters also note that most U.S. companies are equipped to act on a first-to-file basis, since they typically apply for patents as soon as inventions are produced. With the adoption of the first-to-file system, this date would also affect patent rights abroad, and thus provide greater reliability for U.S. patents worldwide.

Many are apprehensive about such a change. The principal objection to the first-to-file system is that it fosters premature, sketchy disclosure in hastily filed applications, letting the courts work things out later. Although unlikely, it leaves open the possibility of someone stealing the profits of an invention from the true inventor by beating him to the courthouse steps. In the end, the Patent Office could be deluged with applications filed for defensive purposes, as is the case in Japan where this phenomenon is called "patent flooding."

Sensitive to these criticisms, the commission recommended several other reforms to ensure fairness in implementing the "first-to-file" proposal. These reforms include issuing a provisional patent application at reduced cost while the patent itself is undergoing examination, and establishing a grace period for public disclosure without affecting patentability. Most importantly, the commission suggested adopting the rule of "prior-use right," allowing users of inventions to continue their use under certain conditions, even after a patent on the invention is obtained by another party.

The effect of "first to file" vs. "first to invent" may be best illustrated by the case of the laser, a discovery generally credited to physicist Charles Townes, who won a Nobel Prize for elucidating the principle of the maser, the theoretical father of the laser. Townes owned the patent on the device. Years later, Gordon Gould, a former graduate student at Columbia University, where Townes taught physics, proved by contemporary notebooks and other means that he had developed the idea long before Townes patented it in 1958.

Gould could not have brought his case to the courts in foreign countries that give priority to the first to file. In the United States, however, the court accepted Gould's evidence of priority and awarded him the basic patents to the laser in 1977 and 1979, ruling that Townes and his employer, at the time AT&T Co., had infringed on Gould's idea. Patlex Corp., of which Gould is a director, now collects fees from laser users throughout the world.

Source: Lee Edson, "Patent Wars," *Across the Board*, 30, April 1993, pp. 24–29; and Q. Todd Dickinson, "Harmony and Controversy," *IP Worldwide*, September 2002, pp. 22–24.

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anthrax outbreaks in the United States, Canada's health ministry decided that public health came first. It commissioned a generic drug company to make a million doses of ciprofloxacin, a drug used to treat one of the nastier forms of the disease whose patent belongs to German drug giant Bayer.[107]

Copyright. Copyrights protect original literary, dramatic, musical, artistic, and certain other intellectual works. Copyright protection lasts 50 years in the European Union countries and Japan, compared with 95 years in the United States.[108] The

[107] "Patent Problems Pending," *Economist*, October 27, 2001, p. 14.

[108] "Copyright Revisions Have Japan's Majors Jumping into the Vaults," *Billboard*, April 18, 1998, p. 52; and "Companies in U.S. Sing Blues As Europe Reprises 50's Hits," *New York Times*, January 3, 2003, Late Edition, p. A1.

difference in the lengths of period of copyright protection could cause tremendous price differences between countries for those products whose copyrights expired in the EU or Japan but are still effective in the United States. This issue will be discussed in detail in the "Gray Markets" section of Chapter 17.

A computer program is also considered a literary work and is protected by copyright. A copyright provides its owner the exclusive right to reproduce and distribute the material or perform or display it publicly, although limited reproduction of copyrighted works by others may be permitted for fair use purposes. In the United States, the use of the copyright notice does not require advance permission, or registration with, the Copyright Office. In fact, many countries offer copyright protection without registration, while others offer little or no protection for the works of foreign nationals.[109]

In the United States, the **Digital Millennium Copyright Act** (DMCA) was passed in 1998 to address a growing struggle in the cyberspace between industries supplying digital content and those arguing against strict enforcement of copyright on the Internet. The DMCA bans any efforts to bypass software that protects copyrighted digital files. Similar laws have been passed in other countries as well. For example, selling "mod" (modification) chips, a device used to play copied games, tinkering with a game console to play legally and illegally copied software, is a practice that has turned into a legal landmine for the video game sector. In 2004, Sony filed a lawsuit against David Ball, a British national, in Britain's High Court for selling thousands of mod chips called Messiah 2 for Sony's PlayStation 2 games consoles. He also published information explaining how to install the chips in PlayStation 2 consoles. He was found guilty of violating all counts of UK copyright law.[110]

Trademark. A trademark is a word, symbol, or device that identifies the source of goods and may serve as an index of quality. It is used primarily to differentiate or distinguish a product or service from another. Trademark laws are used to prevent others from offering a product or service with a confusingly similar mark. In the United States, registration is not mandatory, since "prior use" technically determines the rightful owner of a trademark. However, because determining who used the trademark prior to anyone else is difficult and subject to lawsuits, trademark registration is highly recommended. In most foreign countries, registration is mandatory for a trademark to be protected. In this sense, the legal principle that applies to trademarks is similar to the one that applies to patents: the "first-to-use" principle in the United States and the "first-to-file" principle in most other countries. Therefore, if companies are expected to do business overseas, their trademarks should be registered in every country in which protection is desired (see **Global Perspective 5-5** for the extent to which U.S. firms could legally protect their own copyright and trademark used by other firms abroad).

Trade Secret. A trade secret is another means of protecting intellectual property and fundamentally differs from patent, copyright, and trademark in that protection is sought without registration. Therefore, it is not legally protected. However, it can be protected in the courts if the company can prove that it took all precautions to protect the idea from its competitors and that infringement occurred illegally by way of espionage or hiring employees with crucial working knowledge.

International Treaties for Intellectual Property Protection

Although patent and copyright laws have been in place in many countries for well over a hundred years, laws on trademarks and trade secrets are of relatively recent vintage, having been instituted in the late nineteenth century and beginning of the twentieth century.[111] The laws are essentially national so there are many

[109]Subhash C. Jain, "Intellectual Property Rights and International Business," in Masaaki Kotabe and Preet S. Aukakh, ed., *Emerging Issues in International Business Research*, Northampton, MA: Edward Elgar Publishing, 2002, pp. 37–64.

[110]"Game Over for Mod Chip Dealer," *Managing Intellectual Property*; September 2004, pp. 113–14.

[111]Bruce A. Lehman, "Intellectual Property: America's Competitive Advantage in the 21st Century," *Columbia Journal of World Business*, 31 (Spring 1996), pp. 8–9.

GLOBAL PERSPECTIVE 5-5

COULD U.S. FIRMS ALWAYS PROTECT THEIR OWN COPYRIGHT AND TRADEMARK USED BY OTHER FIRMS ABROAD? THE ANSWER IS CLEARLY NO!

Infringement of intellectual property rights is not confined to the United States. Inadequate protection of intellectual property rights in foreign countries could also result in copyrights and trademarks illegally used abroad making their way back to the United States. In many industrialized countries, it is possible to stem illegally used copyrights and trademarks from entering the home country. For example, in the United States, the U.S. Customs Service provides protection to copyrights and trademarks.

Prior to receiving U.S. Customs protection, copyrights and trademarks have to be registered first with the U.S. Copyright Office and the U.S. Patent and Trademark Office, respectively. Then for U.S. Customs protection, each copyright and trademark must be recorded at the U.S. Customs Service Office. The fee is $190. Although there are no standard application forms, the application requirements for recording a copyright and a trademark are listed in Section 133.1–133.7 of the U.S. Customs regulations. An application should include the following information: (1) a certified status copy and five photocopies of the copyright or trademark registration, (2) the name of its legal owner, (3) the business address of the legal owner, (4) the states or countries in which the business of the legal owner is incorporated or otherwise conducted,(5) a list of the names and addresses of all foreign persons or companies authorized or licensed to use the copyright or trademark to be protected, (6) a list of the names and addresses of authorized manufacturers of goods, and (7) a list of all places in which goods using the copyright or bearing the trademark are legally manufactured. Although it is not necessary to submit a separate application for protection of each copyright or trademark, the filing fee of $190 still applies to each and every copyright or trademark being recorded with the Customs Service. Additional information can be obtained by contacting the U.S. Customs Service at the Intellectual Property Rights Branch, Franklin Court, 1301 Constitution Avenue, N.W., Washington, D.C. (Ph. 202-482-6960).

Unfortunately, the U.S. Patent and Trademark Office has little or no legal recourse when it comes to U.S. copyrights or trademarks used by foreign companies outside the United States. For example, in Brazil, America Online's famous "aol.com" domain is legally owned by StarMedia Network, a small Internet services Brazilian company in the fast-growing Latin American market. America Online (AOL) had sued StarMedia Network alleging trademark infringement and contested the Brazilian provider's use of the domain name "aol.com.br." However, the Brazilian court ruled in May 1999 that since Brazil's America Online registered the name first, it would not have to surrender the domain name to its US rival. As a result of the Brazilian court's ruling in favor of StarMedia Network, its shares rose 74 percent in its first day of trading. AOL was then forced to market its Brazilian services under "br.aol.com".

Although no other news leaked on a possible out-of-court settlement on StarMedia's "aol.com.br" versus AOL's "br.aol.com," recent news articles suggest that AOL may have eventually purchased the right to use "aol.com.br" for an undisclosed sum of money (which would not come cheap).

The decision may touch off concerns about international cybersquatting as many Internet dotcom companies begin to launch overseas operations, only to find that country-level version of the domain name is already registered. For example, the AOL domain had been registered in about 60 countries in addition to Brazil, and not all of these registrations were madeby the American company.

Source: Maxine Lans Retsky, "Curbing Foreign Infringement," Marketing News (March 31, 1997), p. 10; "Brazilian ISP Prevails in AOL Lawsuit," a news report provided by "LatPro.com ejs@LatPro.com, May 31, 1999; "No Free Ride," *Latin Trade*, May 2001, p. 54; and "AOL Latin America Launches Upgraded Wireless E-Mail in Brazil, Mexico and Argentina," *World IT Report*, February 17, 2002, p. N.

international treaties to help provide intellectual property protection across national boundaries. Some of the most important treaties are the Paris Convention, Patent Cooperation Treaty, Patent Law Treaty, European Patent Convention, and Berne Convention.

Paris Convention. The Paris Convention for the Protection of Industrial Property was established in 1883, and the number of signatory countries currently stands at 140. It is designed to provide "domestic" treatment to protect patent and trademark applications filed in other countries. Operationally, the convention establishes rights of priority that stipulate that once an application for protection is filed in one member country, the applicant has twelve months to file in any other signatory countries, which should consider such an application as if it were filed on the same date as the original application.[112] It also means that if an applicant does not file for protection in other signatory countries within a grace period of twelve months of original filing in one country, legal protection could not be provided. In most countries, other than the United States, the ''first-to-file'' principle is used for intellectual property protection. Lack of filing within a grace period in all other countries in which protection is desired could mean a loss of market opportunities to a competitor who filed for protection of either an identical or a similar type of intellectual property. The two new treaties, explained below, are further attempts to make international patent application as easy as domestic patent application.

Patent Cooperation Treaty. The Patent Cooperation Treaty (PCT) was established in 1970, amended in 1979 and modified in 1984. It is open to any signatory member country to the Paris Convention. The PCT makes it possible to seek patent protection for an invention simultaneously in each of a large number of countries by filing an ''international'' patent application. The patent applicant can file an international patent application with his or her national patent office, which will act as a PCT ''Receiving'' Office, or with the International Bureau of World Intellectual Property Organization (WIPO) in Geneva. If the applicant is a national or resident of a contracting State that is party to the European Patent Convention, the Harare Protocol on Patents and Industrial Designs (Harare Protocol) or the Eurasian Patent Convention, the international application may also be filed with the European Patent Office (EPO), the African Regional Industrial Property Organization (ARIPO) or the Eurasian Patent Office (EAPO), respectively.[113]

Patent Law Treaty. The Patent Law Treaty (PLT), adopted in Geneva in June 2000, comes as the result of a World Intellectual Property Organization (WIPO) initiative. Its aim is to harmonize the formal requirements set by patent offices for granting patents, and to streamline the procedures for obtaining and maintaining a patent. Initially, PLT will apply to all European Union countries, the United States, Japan, Canada, and Australia. Eventually it will include virtually all countries in the world. While the PLT is only concerned with patent formalities, many of the provisions will prove extremely useful when the PLT comes into force for a large number of states, providing speedier and less costly procedures for years to come.[114]

European Patent Convention. The European Patent Convention is a treaty among 25 European countries (as of January 1, 2003) setting up a common patent office, the European Patent Office, headquartered in Munich, Germany, which examines patent applications designated for any of those countries under a common patent procedure and issues a European patent valid in all of the countries designated. The European Patent Office represents the most efficient way of obtaining protection in these countries if a patent applicant desires protection in two or more of the countries. The European Patent Convention is a party to the Paris Convention, and thus recognizes the filing date of an application by anyone in any signatory country as its own priority date if an application is filed within one year of the original filing date. The European Patent Office receives the application in English. The application will be published 18 months after the filing, consistent with the ''first-to-file'' principle. Once a patent is approved, registrations in, and translations into the language of, each designated country will be required. The European Patent Convention does not supersede any signatories' pre-existing national patent system. Patent applicants still

[112] World Intellectual Property Organization, *Paris Convention for the Protection of Industrial Property*, http://www.wipo.int/treaties/en/ip/paris/, accessed February 20, 2006.
[113] World Intellectual Property Organization, *International Protection of Industrial Property-Patent Cooperation Treaty*, http://www.wipo.int/pct/en/treaty/about.htm, accessed February 20, 2006.
[114] Q. Todd Dickinson, ''Harmony and Controversy,'' *IP Worldwide*, September 2002, pp. 22–24.

EXHIBIT 5-7
RATINGS FOR THE LEVEL OF INTELLECTUAL PROPERTY PROTECTION IN VARIOUS COUNTRIES (MINIMUM = 0 . . . 10 = MAXIMUM)

Country	*Patents*	*Copyrights*	*Trademarks*	*Trade Secrets*
Argentina	3.8	5.7	7.1	4.4
Brazil	3.3	5.2	3.3	3.3
Canada	8.1	7.7	9.0	7.8
Chile	5.7	5.7	7.6	7.8
China	2.4	2.9	6.2	3.3
Germany	8.6	8.6	9.0	10.0
India	3.3	5.7	3.8	3.3
Israel	7.1	7.1	8.6	8.9
Mexico	3.3	7.6	3.8	3.3
New Zealand	7.1	8.1	9.5	7.8
Philippines	7.1	6.2	7.6	7.8
Singapore	7.1	6.7	8.6	5.6
South Korea	3.3	4.8	3.8	3.3
Thailand	2.4	4.8	6.7	5.6
United States	9.0	8.1	9.0	7.8

Source: Adapted from Belay Seyoum, "The Impact of Intellectual Property Rights on Foreign Direct Investment," *Columbia Journal of World Business*, 31 (Spring 1996), p. 56.

should file and obtain separate national patents, if they would prefer national treatment (favored over pan-European treatment by individual national courts).[115]

Berne Convention. The Berne Convention for the Protection of Literary and Artistic Works is the oldest and most comprehensive international copyright treaty. This treaty provides reciprocal copyright protection in each of the fifteen signatory countries. Similar to the Paris Convention, it establishes the principle of national treatment and provides protection without formal registration. The United States did not join the Berne Convention until 1989.[116]

Although there are separate laws to protect the various kinds of intellectual property, there appears to be a strong correlation between the levels of intellectual property in various countries. Exhibit provides some of the results of a 1996 academic study based on survey questionnaires administered to experts/practitioners in the various countries.

A feature that corporations as well as individual managers have to deal with is the growing importance of intellectual property as a significant form of competitive advantage. The laws to deal with this issue are neither uniform across countries, nor are they extended across national boundaries (outside of the government pressure). Even if they are similar, the implementation levels vary significantly. Essentially, protection of intellectual property requires registration in all the countries in which a firm plans to do business. Managers need to be cognizant of this and take proactive measures to counteract any infringements.

The most recent development in international copyright protection is the WIPO Copyright Treaty, which entered into force in March 2002, addressing the copyright protection in the Internet era. This treaty updates and supplements the Berne Convention by protecting the rights of authors of literary and artistic works distributed within the digital environment. The treaty clarifies that the traditional right of reproduction continues to apply in the digital environment and confers a right holder's right to control on-demand delivery of works to individuals.[117]

[115]Martin Grund and Stacy J. Farmer, "The ABCs of the EPC 2000," *Managing Intellectual Property*, April 2008, pp. 85–88.
[116]Nancy R. Wesberg, "Canadian Signal Piracy Revisited in Light of United States Ratification of the Free Trade Agreement and the Berne Convention: Is This a Blueprint for Global Intellectual Property Protection?" *Syracuse Journal of International Law & Commerce*, 16 (Fall 1989), 169–205.
[117]Amanda R. Evansburg, Mark J. Fiore, Brooke Welch, Lusan Chua, and Phyllis Eremitaggio, "Recent Accessions to WIPO Treaties," *Intellectual Property & Technology Law Journal*, 16 (August 2004), p. 23.

Further Developments. In 2007 a select handful of the wealthiest countries began a treaty-making process to create a new global standard for intellectual property rights enforcement, the Anti-Counterfeiting Trade Agreement (ACTA). ACTA is spearheaded by the United States, the European Commission, Japan, and Switzerland—those countries with the largest intellectual property industries. Other countries invited to participate in ACTA's negotiation process are Canada, Australia, Korea, Mexico, and New Zealand. Noticeably absent from ACTA's negotiations are leaders from developing countries who hold national policy priorities that differ from the international intellectual property industry.[118]

At the 34th G8 summit held by Japan in July 2008, the eight leaders in their document on the "World Economy" called for finalizing negotiations of the much-debated ACTA by the end of the year. The summit also declared patent harmonization a topic of high importance, asking for accelerated discussions of the Substantive Patent Law Treaty (SPLT), a proposed international patent law treaty aimed at harmonizing substantive points of patent law. In contrast with the Patent Law Treaty which only relates to formalities, the SPLT aims at going far beyond formalities to harmonize substantive requirements such as novelty, inventive step and non-obviousness, industrial applicability and utility, as well as sufficient disclosure, unity of invention, or claim drafting and interpretation.[119]

Antitrust Laws of the United States

The antitrust laws of the United States[120] need to be highlighted as the U.S. government makes extraterritorial applications of its antitrust laws, affecting both U.S. and foreign businesses not only in the United States but also in foreign countries. The U.S. antitrust laws have their foundation in the Sherman Antitrust Act of 1890, the Clayton Act of 1914, the Federal Trade Commission Act of 1914, and the Robinson Patman Act of 1936. U.S. antitrust laws have been, from the beginning, concerned with maximizing consumer welfare through the prevention of arrangements that increase market power without concurrently increasing social welfare through reduced costs or increased efficiency.

The Sherman Act specifically forbade every contract, combination, or conspiracy to restrain free and open trade, but it was soon argued that the law was intended to punish only unreasonable restraints. In the *Standard Oil* case of 1911, the courts ruled that an act must be an unreasonable restraint of trade for the Sherman Act to apply. Toward this end, a distinction developed between (1) cases in which a rule of reason should apply, and (2) cases considered to be *per se* violations of the law.

The Clayton Act strengthened the U.S. antitrust arsenal by prohibiting trade practices that were not covered by the Sherman Act. It outlawed exclusive dealing and price discrimination. Both are subject to the rule of reason—that is, they are unlawful only if the effect may be to substantially lessen competition. This concept even applies to "any imaginary threat to competition, no matter how shadowy and insubstantial" as being reasonably probable of restraining trade.[121]

Concurrent with the enactment of the Clayton Act, Congress created the Federal Trade Commission (FTC) and empowered it to enjoin unfair methods of competition in commerce. Prior to the FTC, violations of antitrust laws were the jurisdiction of the Antitrust Division of the Justice Department. Since 1914, the organizations have pursued dual enforcement of the antitrust laws with considerable, though some argue inefficient, overlap. The Justice Department focuses largely on criminal price-fixing

[118] "The Anti-Counterfeiting Trade Agreement (ACTA)," *IP Justice*, http://ipjustice.org/, accessed September 10, 2008.

[119] William New, "G8 Governments Want ACTA Finalized This Year, SPLT Talks Accelerated," Intellectual Property Watch, http://www.ip-watch.org/, July 9, 2008; and "Substantive Patent Law Harmonization," World Intellectual Property Organization, http://www.wipo.int/patent-law/en/harmonization.htm, accessed February 28, 2009.

[120] This section draws from Masaaki Kotabe and Kent W. Wheiler, *Anticompetitive Practices in Japan: Their Impact on the Performance of Foreign Firms* (Westport, CT: Praeger Publishers, 1996).

[121] Robert H. Bork, *The Antitrust Paradox* (New York: Basic Books, 1978), p. 48.

and merger review. The FTC, which does not handle criminal cases, concentrates about 60 percent of its total resources on merger review.

The U.S. antitrust laws were originally aimed at domestic monopolies and cartels, although the act expressly extends coverage to commerce with foreign nations. In the 1940s, the prosecution of Alcoa (*United States vs. Aluminum Company of America*, 148 F. 2d 416 1945) resulted in a clear extension of U.S. antitrust laws to activities of foreign companies, even if those actions occur entirely outside the United States as long as they have a substantial and adverse effect on the foreign or domestic commerce and trade of the United States.

Successful extraterritorial enforcement, however, depends on effective jurisdictional reach. Detecting, proving, and punishing collusion and conspiracy to restrain trade among foreign companies is extremely difficult. From gathering evidence to carrying out retribution, the complexity of nearly every aspect of antitrust litigation is compounded when prosecuting a foreign entity. Issues of foreign sovereignty and diplomacy also complicate extraterritorial antitrust enforcement. If a foreign entity's actions are *required* by their own government, that entity is exempt from prosecution under U.S. law. Prior to the 1990s and the demise of the Soviet Union, U.S. trade and economic matters were typically a lower priority to defense and foreign policy concerns. This was particularly true with Japan. In nearly every major trade dispute over steel, textiles, televisions, semiconductors, automobiles, and so on, the Departments of State and Defense opposed and impeded retaliation against Japanese companies for violations of U.S. antitrust laws. A strong alliance with Japan and the strategic geographic military locations the alliance provided were deemed to be of more importance than unrestricted trade. This arrangement helped Japanese companies improve their competitive position.

The extraterritorial application of U.S. antitrust laws has recently been subject to considerably more debate. In 1977 the Antitrust Division of the Justice Department issued its *Antitrust Guidelines for International Operations*, which, consistent with the precedent established in the Alcoa case, reaffirmed that U.S. antitrust laws could be applied to an overseas transaction if there were a direct, substantial, and foreseeable effect on the commerce of the United States. The Foreign Trade Antitrust Improvements Act of 1982 again reiterated this jurisdiction. There has been controversy, however, over the degree of U.S. commerce to which jurisdiction extends.

The 1977 Justice *Guidelines* suggested that foreign anticompetitive conduct injuring U.S. commerce raises antitrust concerns when either U.S. consumers or U.S. exporters are harmed. In a 1988 revision of the *Guidelines*, the reference to exporters was omitted. Later, in 1992, U.S. Attorney General William Barr announced that Justice would take enforcement action against conduct occurring overseas if it unfairly restricts U.S. exports, arguing that anticompetitive behavior of foreign companies that inhibits U.S. exports thereby reduces the economies of scale for U.S. producers and indirectly affects U.S. consumers through higher prices than might otherwise be possible.

Critics argue that comity concerns and the difficulties in gathering evidence and building a case around conduct occurring wholly within a foreign country make it unrealistic for the Justice Department to attempt such an extraterritorial application of U.S. laws. Perhaps the gravest concern, however, is that the policy may lead to prosecution of foreign business methods that actually promote U.S. consumer welfare, for it is predominantly believed in the U.S. economic and legal community that antitrust laws should be concerned solely with protecting consumer welfare. U.S. public opinion has also traditionally and strongly supported the government's role as the champion of consumer rights against commercial interests. U.S. antitrust laws have always reflected this grassroots backing. Such a tradition has not existed in Japan, and the development of antitrust laws there has been quite different.

Fully cognizant that there were many small- and medium-size firms with exportable products that were not currently exporting, in 1982, the U.S. Congress passed the Export Trading Company legislation (ETC Act), which exempted these firms from antitrust laws, to encourage them to improve their export performance by joining forces. Patterned after practices in Germany and Japan, the ETC Act also permits banks to own and operate export trading companies (ETCs) so that the export trading companies will have better access to capital resources, as well as market information through their banks.[122] As a result, the ETC Act assists in the formation of shippers' associations to reduce costs and increase efficiency, covers technology–licensing agreements with foreign firms, and facilitates contact between producers interested in exporting and organizations offering export trade services. However, those trading companies are not allowed to join forces in their importing businesses, hence they are called export trading companies. In reality, many manufacturing companies import raw materials and in-process components from abroad and export finished products using those imported materials. Japanese trading companies handle both exports and imports, and have many manufacturing companies as captive customers for both exports and imports. However, in the United States, those trading companies certified as ETCs under the ETC Act may not fully exploit economies of scale in their operations, as they cannot collectively handle manufacturing firms' imports.

Antitrust Laws of the European Union

Besides the United States' antitrust forces, other countries have an organization that settles antitrust cases. The European Union (EU) is no exception. While the EU does not apply its antitrust laws extraterritorially outside the region, its laws are applied not only to EU-member country companies but also to foreign companies as long as their corporate action has antitrust implications within the EU community.

In 2000, the European Commission indicated that it was prepared to block the merger of EMI Group and Time Warner, Inc. unless they came up with concrete proposals to allay concerns that the size of the joint venture will allow it to limit access to its copyrights and raise prices. In September 2000, in an effort to save their proposed music join venture Warner-EMI, which would be by far the largest music publisher, the two companies submitted to the European Commission a new set of antitrust remedies involving sales of music labels and copyrights. They also offered to sell several catalogs of songs to reduce their huge market shares in music publishing.[123] Similarly, Microsoft faces a tough time in Europe although it prevailed in the United States against the government's efforts to unbundle its code. In 2004, the European regulators forced the company to remove the Media Player software from its Windows operating system. The EU also requested the company to release more of its Windows code to competitors. Further, the EU can levy fines of up to 10 percent, roughly $3.2 billion, of the company's revenue.[124]

To do business in Europe, foreign companies must comply with EU antitrust law, just as European companies must abide by U.S. antitrust law to do business in the United States. In 2001, the European Union formally blocked General Electric's $43-billion purchase of Honeywell International—the first time a proposed merger between two U.S. companies has been prevented solely by European regulators. The veto by the EU's 20-member executive commission was widely expected after the U.S. companies failed to allay European fears that the deal would create an unfairly dominant position in markets for jetliner engine and avionics. The deal had already secured regulatory approval from U.S. antitrust authorities but was blocked by EU.[125]

U.S. Foreign Corrupt Practices Act of 1977

Among the many corrupt practices that international marketers face, bribery is considered the most endemic and murky aspect of conducting business abroad.

[122] Charles E. Cobb, Jr., John E. Stiner, "Export Trading Companies: Five Years of Bringing U.S. Exporters Together: The Future of the Export Trading Company Act," *Business America*, 10 (October 12, 1987), pp. 2–9.

[123] Philip Shishkin and Martin Peers, "EMI Group and Time Warner Submit Concessions to Allay Antitrust Worries," *Wall Street Journal*, September 20, 2000.

[124] "Microsoft Detaches Windows from Media Player in Europe," *Wall Street Journal*, January 25, 2005, p. B3.

[125] Syed Tariq Anwar, "EU's Competition Policy and the GE-Honeywell Merger Fiasco: Transatlantic Divergence and Consumer and Regulatory Issues," *Thunderbird International Business Review*, 47 (September/October 2005), pp. 601–26.

However, special care must be taken to identify and accommodate the differences between international markets and those in the United States. Laws may vary widely from country to country, and these laws may on occasion conflict with one another, although international organizations such as the International Monetary Fund, the Organization of Economic Cooperation and Development (OECD), have increased global efforts to combat corrupt business practices.[126] Several countries in the Asia-Pacific Economic Cooperation (APEC) also joined the OECD Convention criminalizing foreign commercial bribery in 1997.[127] Bribery is a means for one party to get from another party (at the cost of a third party) some special treatment that would otherwise not normally be obtainable. However, what constitutes bribery may also differ, depending on local customs and practices.

In order to create the level playing field for U.S. companies to do business abroad and to establish a high ethical standard to be followed by foreign countries, the United States passed the **Foreign Corrupt Practices Act** (FCPA) in 1977. The FCPA was designed to prohibit the payment of any money or anything of value to a foreign official, foreign political party, or any candidate for foreign political office for purposes of obtaining, retaining, or directing business. For example, in 2005, Monsanto Chemical was fined $1.5 million for violating the FCPA by making illegal cash payment to a senior Indonesian Ministry of Environment official a few years earlier.[128] The long arm of the U.S. law even reaches into the offices of Germany's most important company, Siemens. Because its shares are listed on the New York Stock Exchange and it has extensive operations in the United States, Siemens is subject to the FCPA. Siemens or its employees face accusations that they used bribes to sell medical equipment in China and Indonesia, close deals to provide sell telecom gear to the Hungarian and Norwegian armed forces, and win a power plant contract in Serbia, to name a few examples. Munich prosecutors, who uncovered evidence that Siemens used bribes to land contracts around the globe, have already extracted $290 million in fines. With $1.9 billion in questionable payments made to outsiders by the company from 2000 to 2006, Siemens is the biggest FCPA case—foreign or domestic—of all time. And the U.S. authorities see the Siemens case as a splendid opportunity to show they are serious about pursuing foreign companies that violate U.S. anti-corruption laws.[129] The FCPA sets a high ethical standard for U.S. firms doing business abroad, but it basically cannot keep foreign firms (in spite of the rare example of its reaching into Siemens mentioned above) from engaging bribery and other anticompetitive acts in foreign countries.

The FCPA, although silent on the subject, does not prohibit so called "facilitating" or "grease" payments, such as small payments to lower-level officials for expediting shipments through customs or placing a transoceanic telephone call, securing required permits, or obtaining adequate police protection—transactions that simply facilitate the proper performance of duties. These small payments are considered comparable to tips left for waiters. While some companies find such payments morally objectionable and operate without paying them, other companies do not prohibit such payments but require that employees seek advice in advance from their corporate legal counsel in cases where facilitating payments may be involved.[130]

The FCPA does not prohibit bribery payments to nongovernmental personnel, however. Nor does the United States have laws regulating other forms of payment that approach extortion. What constitutes bribery or extortion also becomes less transparent, and international marketers' ethical dilemma increases (see **Global Perspective 5-6**). From an ethical point of view, the major questions that must be answered are:

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[126] Carolyn Hotchkiss, "The Sleeping Dog Stirs: New Signs of Life in Efforts to End Corruption in International Business," *Journal of Public Policy & Marketing*, 17 (Spring 1998), pp. 108–15.

[127] Madeleine K. Albright, "APEC: Facing the Challenge," *U.S. Department of State Dispatch*, 8 (December 1997), pp. 3–5.

[128] "Bribe Costs Monsanto $1.5 million," *Chemical & Engineering News*, January 17, 2005, p. 28.

[129] Jack Ewing, "Siemens Braces for a Slap from Uncle Sam," *BusinessWeek.com*, November 15, 2007.

[130] Mary Jane Sheffet, "The Foreign Corrupt Practices Act and the Omnibus Trade and Competition Act of 1988: Did They Change Corporate Behavior?" *Journal of Public Policy and Marketing*, 14 (Fall 1995), pp. 290–300.

GLOBAL PERSPECTIVE 5-6

CULTURAL RELATIVISM/ACCOMMODATION—SELLING OUT?

The following is an excerpt from an anonymous source circulating via e-mail on the GINLIST:

Cultural accommodation is an essential element in successful international and cross-cultural relationships. The question faced by the U.S. multinationals is whether to follow the advice, ''When in Rome, do as the Romans do.'' Foreign firms operating in the U.S. are faced with a similar question, ''When in America, should you do as the Americans do?'' How far does an individual or a company go to accommodate cultural differences before they sell themselves out? . . . I will attempt to answer this question by looking at issues involving my personal core values, bribery and gift giving, and how these relate to the definitions presented. I will also discuss trust and credibility and how these qualities relate to the subject and present a case for marketplace morality. I will conclude by presenting what I feel is the answer to the question posed above.

The primary issue . . . is one of cultural relativism and its place in cross-cultural encounters. Cultural relativism is a philosophical position which states that ethics is a function of culture. . . . Ethical relativism is the belief that nothing is objectively right or wrong, and that the definition of right or wrong depends on the prevailing view of a particular individual, culture, or historical period.

Cultural or ethical relativists will find themselves in a constant state of conflict within their own society. By definition, it would be impossible to reach an agreement on ethical rights and wrongs for the society. An ethical relativist believes that whatever an individual (any individual) believes to be right or wrong is in fact correct. The only cultural norm would be one of chaos since it would be impossible to hold anyone accountable to a prevailing or arbitrary ethos due to the accepted fact that all is relative and all is correct by definition.

As an example, imagine trying to hold Hitler's Nazi government accountable for their crimes during World War II from this perspective. If ethics is relative and that right and wrong are defined by the prevailing view of a particular individual, culture, or historical period, then Hitler's policies of racial purification were ethically correct. However, according to my ethical beliefs (and those of the world's representatives who presided over the Nuremburg Trials), that conclusion is completely unacceptable. There are some things that are moral and ethical absolutes. . . .

As we adapt to the differences in cultures, each individual and culture must still determine where the line is (which defines) the clear violations of moral absolutes. In pursuing this objective, understanding who we are and what we stand for are essential in identifying the sell-out point. We must come to terms with our core values and how they match up with both the company ethos and that of the host and home countries. . . .

It is interesting to note the Catch 22 that an international company can find itself in on this subject. In reference to China, if the company tries to avoid the appearance of a bribe by not participating in a culture's gift giving custom and just say ''thanks,'' they may be seen as using the ''verbal thanks as getting out of their obligation.'' The international manager must not only understand and respect the cultural subtleties, but know how to find the limits of the ethical behavior. One specific limit put in place by the U.S. Government is the Foreign Corrupt Practices Act (FCPA). This Act was passed in reaction to a ''rash of controversial payments to foreign officials by American business in the 1970s.'' The Act specifically calls for ''substantial fines for both corporations and individual corporate officers who engage in the bribery of foreign government officials.''

U.S. firms are restricted from bribing; however, many companies in other countries engage in this practice routinely. American firms allege that restricting them from this practice puts them at a serious disadvantage to other nations' firms. In the short term, this may be true. Consider what would happen if every firm bribed. The cost of a project would be driven up so high that the country itself could no longer afford it. The bribe is not free and is always paid either by a higher contract price or through shortcuts in quality and material which may result in serious social costs. Consider a freeway overpass or a bridge not built to adequate safety standards or with poor quality materials. The result could be a collapsed bridge, resulting in loss of both life and property. The bribe also undermines the competitive process so that the purchaser pays more than the competitive price and erodes the trust in the public officials and the firm.

Is there a morality separate from the individual and from the culture? . . . A multinational corporation doing business in societies with differing moral norms must subscribe to a morality of the marketplace which is based on trust and credibility. Violating such norms would be self-defeating. Companies engaging in business practices that result in a loss of trust or credibility will eventually lose their share of the market . . .

A person who approaches the world from a cultural relativist perspective will change his or her position and standards depending on the prevailing view of the culture or sub-culture that person is in. Trust and credibility can neither be built nor retained from such a position. International or domestic businessmen want to know who they are dealing with. They want to know if they can trust the person and/or company they are about to join together with. . . .

Where is the line drawn that separates accommodation from selling out? In a large part it depends on the individual's value system, since what they're selling out on is really their own core values, trust, and credibility. There are moral absolutes, which, if violated, are always examples of stepping across the line.

Source: An anonymous source, distributed via e-mail on GINLIST, October 11, 1994.

1. Does such an act involve unfairness to anyone or violate anyone's right?
2. Must such an act be kept secret, such that it cannot be reported as a business expense?
3. Is such an act truly necessary in order to carry on business?

Unless the first two questions are answered in the negative and the third is answered in the positive, such an act is generally deemed unethical.[131] It is advised that multinational firms maintain good "corporate citizenship" wherever they do business, since long-term benefits tend to outweigh the short-term benefit gained from bribes for the same reasons just mentioned—for example, corporate contributions to humanitarian and environmental causes, such as the Save the Rain Forest project in Brazil, and moral stands on oppressive governments, such as two European brewers, Carlsberg and Heineken, pulling out from Burma to protest this Asian country's dictatorship regime.[132]

SUMMARY

When doing business across national boundaries, international marketers almost always face what is perceived to be political and legal barriers. It is because that government policies and laws can be very different from country to country. In most cases, a foreign company has to accept a host country's government policies and laws, as they are usually outside its control. Some large multinational firms, if backed by their home country government, may sometimes influence the host country's policies and laws. However, such an extraterritorial interference may have negative consequences in the long run for a short-term gain.

Despite various international agreements brought about by such international organizations as WTO, G8, and COCOM, which collectively strive toward freer and more equitable world trade, every nation is sovereign and maintains its special interests, which may occasionally clash with those of the international agreements. Although the world has been moving toward a freer trade and investment environment, the road has not necessarily been smooth. When considering entry or market expansion in foreign countries, their country risks need to be assessed. Multinational firms need to be aware of political risks arising from unstable political parties and government structure, changes in government programs, and social pressures and special interest groups in a host country. Political risks are further compounded by economic and financial risks. When disputes arise across national boundaries, they will most likely have to be settled in one country. Therefore, careful planning for establishing the jurisdictional clause in the contract is needed before the contract is entered into.

Although government policies and the laws of a country usually affect business transactions involving that country, increased business activities transcending national boundaries have tested the territoriality of some policies and laws of a country. The United States frequently applies its laws, such as antitrust laws and the Foreign Corrupt Practices Act, outside its political boundary to the extent that U.S. businesses are affected or to the extent that its legal value system can be extended. On the other hand, despite the importance of intellectual property in international business, protection of intellectual property in foreign countries is granted essentially by registration in those countries. International marketing managers should be aware that usually, domestic protection cannot be extended beyond their national boundary.

KEY TERMS

Fast-track trade authority
"First-to-File" patent principle
"First-to-Invent" patent principle
Berne Convention
Capitalism
Civil law
COCOM (The Coordinating Committee for Multilateral Controls), see also Wassenaar Arrangement
Code (written) law
Commercial law
Common law
Confiscation
Copyright
Countertrade
Domestication (phase-out) policy
European Patent Convention
Export license
Expropriation
Foreign Corrupt Practices Act of 1977
G7
G8
G8+5
Green marketing
Home country
Host country
Islamic law
ISO 9000
ISO 14000
Nationalization
Non-tariff barriers
Paris Convention

[131] Richard T. De George, *Business Ethics*, 4th ed. (Englewood Cliffs, N.J.: Prentice Hall, 1995), pp. 511–12.
[132] "Brewer Decides to Pull Out of Its Business in Burma," *Wall Street Journal*, July 12, 1996, p. A8A.

REVIEW QUESTIONS

1. Describe with examples the role of governments in promoting national interests pertaining to business activities.
2. What different types of trade controls influence international business? What are their intended objectives?
3. How do host country macroeconomic and fiscal policies affect foreign company operations?
4. What are the factors that international managers should consider in determining the economic and political risks associated with a country?
5. International law is derived from three sources. What are these three? Compare and contrast them.
6. Briefly describe the various types of local legal systems. How do differences in these legal systems affect international business?
7. Enumerate some of the legal issues that international business managers need to take cognizance of in host countries.
8. Describe the various types of barriers to international trade and investment.

DISCUSSION QUESTIONS

1. The term, bribery, sounds bad. How about kickbacks, tips, contingency fees, consultation fees, etc? Terms vary, objectives to be accomplished by not-so-easy-to-define payments vary, and to whom such payments are made varies. Personal income levels vary from country to country, and thus the level of financial incentive provided by such payments vary. Also, as you learned from Chapter 4, cultural value systems vary; thus the degree of legality, or social acceptability, varies for such payments. In general, "facilitating" payments–legal or illegal aside–tend to be used more often in countries characterized by high levels of power distance, uncertainty avoidance, and collectivism than in other countries. As debated also in **Global Perspective 5-6**, could there be some things that are moral and ethical absolutes when it comes to payment of money to someone in the third party to influence and/or facilitate business transactions in your favor? How about the U.S. standard, as stipulated in the Foreign Corrupt Practices Act of 1977? The United States is a country characterized as having low levels of power distance and uncertainty avoidance and a high level of individualism—the opposite of those countries indicated above. Discuss how you would like to address this issue.

2. Various foreign companies operating in Russia, especially in the oil and gas exploration business, have had to face the vagaries of Russian legislation, which changes frequently, making it difficult to plan activities. Besides being heavily taxed, foreign firms have had to face a change in export duties of crude oil over a dozen times in the past few years. Yet most companies continue to negotiate for making investments worth billions of dollars. Discuss some of the possible reasons for the actions of these companies. Companies take various steps to manage political risk. If you were representing a company negotiating investments in Russia, what steps would you take to manage (and/or reduce) the political risk associated with these investments?

3. The following examples highlight the impact of differences in laws and social norms on various aspects of the marketing program. What are the implications of such differences for using standardized product or advertising strategies (or using standardized advertising themes)?

   a. Pepsi International's humorous global ad campaign fronted by model Cindy Crawford, which includes the use of a Coke can, will not be seen in Germany because German regulations forbid the use of comparative advertising.

   b. Advertising laws in China have restricted the use of Budweiser posters, featuring young attractive women in Budweiser swimsuits, by Anheuser-Busch to bars and stores with adult clientele only. Furthermore, when Anheuser-Busch wanted models to wear swimsuits for a beer festival, the mothers of the models used insisted on the girls wearing T-shirts beneath the swimsuits.

   c. An Austin, Texas-based designer of computer games wants to market a game that involves humans fighting against aliens from different planets. One aspect of the game is that if the humans are shot, blood is shown to come out of their bodies. German laws, however, do not permit any depiction of red blood in computer games. The company wants to market this game in Germany, which is a huge market. One suggestion the company is working on is the use of an alternate color to depict human blood. However, it risks the prospect of making the game less realistic—"What would children make out of green liquid coming out of the human figure on being shot?"

4. KFC, a fast-food operator, faced immense resistance from some politically active consumer groups when it opened its operations in India. One group proclaimed that opening KFC outlets in the country would propagate a "junk-food" culture. Others proclaimed that this was "the return of imperialistic powers" and was an attempt to "Westernize the eating habits" of Indians. Overzealous local authorities in the city of Bangalore used a city law restricting the use of MSG (a food additive used in the chicken served by KFC) over a certain amount as a

pretext for temporarily closing down the outlet, despite the fact that the authorities did not even have the equipment to measure the MSG content in the proportions stated in the law. In the capital city of New Delhi, a KFC outlet was temporarily closed down because the food inspector found a "house-fly" in the restaurant. While both of these issues got resolved through hectic consultations with these consumer groups and through legal orders issued protecting the interests of the outlets, they do reflect how political and social concerns of even a small segment of the population can adversely affect the operations of companies in foreign markets. If you were the country manager of KFC in India, what steps would you have taken to avoid these problems?

5. The entertainment industry has been warring for years to combat computers and the Internet to copy and transmit music and movies. The biggest winner has been consumers who pay very little or nothing to get their favorite movies due largely to the Internet sector's innovations. There are over 12,000 cases with the entertainment industry suing individual users. Recently, The U.S. Supreme Court ruled in favor of copyright holders and against two companies that distribute peer-to-peer (P2P) software, which allows users to share files online with others. Tens of millions of Internet users regularly use P2P to exchange music and, to a lesser extent, films. It seems that with continuous technology introduction, free downloads will continue to increase. The real challenge for content providers is to use new technology to create value for customers and to make those who fail to use legitimate content feel bad about it. Do you think entertainment companies should craft ways to use innovative technology to realize their wares in ways that will also allow copyright to be protected? Since the Internet has no virtual borders, what should entertainment companies do to secure their global market, especially in those countries that have weak intellectual property protection?

6. An extension of the antitrust laws into the arena of international trade has taken the form of anti-dumping laws, which have been enacted by most Western countries, and which are increasingly being enacted by developing countries. On the surface, most of the anti-dumping laws across the various countries seem to be similar to each other. However, since much of the content of these laws is open to interpretation, the results of these laws could vary significantly. The bottom line for the initiation of any anti-dumping investigation is that if a foreign manufacturer gets an "undue" advantage while selling its products (either through pricing its products higher in other protected markets or through government subsidies) in another country relative to the domestic manufacturer and hurts the domestic industry, the company is resorting to unfair competition and should be penalized for it. While large firms are relatively more aware of the nuances of anti-dumping laws, and have the resources, especially legal ones, to deal with this issue, it is the smaller firms, which often depend on governmental export assistance in various forms, that are the most susceptible to being penalized.

One of your friends is planning to start exporting an industrial product to various countries in Europe. To help finance his export endeavor, he plans to utilize concessional export credit provided by the U.S. government to small exporters. This product is highly specialized, and caters to an extremely small niche market. Europe is a large market for this product. There are only two other manufacturers of this product, both based in Europe. One of these manufacturers is a $100-million company, which manufactures various other products besides the product in question. What would be your advice to your friend in terms of the significance of antidumping laws? What specific steps, if any, would you encourage your friend to take, especially in context of his limited financial resources?

7. Unfortunately, intellectual property law cannot protect the business everywhere. For example, there is a flood of cheap imitations of Japanese motorcycles on the Chinese market, and Honda Motor finally had to release in China a line of inexpensive 125cc motorcycles in 2002, even though manufacturing motorcycles at such low prices will mean a drastic change in Honda's normal policy of making high-priced, high-quality products. By some estimates, 7 million out of 10 million motorcycles produced in China every year are imitations. Do you think all companies should lower their prices to protect themselves from local imitations and fake products? What kind of suggestions would you make to a high-end brand manager if the brand were going to a developing country with less strict government controls on imitation products?

SHORT CASES

CASE 5-1

COCA-COLA IN INDIA

Coca Cola has had a glorious past selling cola all over the world. In fact, the "Coke" brand is one of the most well-known in the world and it carries with it an image of American culture. But Coke's experience in the emerging Indian market has always been especially challenging due to the protectionist political and legal environment.

Today, the Indian economy is gradually opening its doors to foreign companies in various industrial sectors. But when Coke first stepped into the Indian market, it acquired a significant market share and was a popular drink in the market. It was then forced to exit India in 1977 when the government at that time demanded that Coca-Cola reduce its stake in its wholly owned Indian subsidiary to 40 percent. Since then, India has revised its attitude toward foreign investment in a major way and Coca-Cola once again entered India in 1994 after staying away from this largely populated and thus attractive market for many years. This time around, though, Coca-Cola fully owns its subsidiary and when it returned to the Indian market, it also acquired some local cola and soft drinks brands, including Thumbs Up, which had over 59 percent market share and a great distribution network. Coca-Cola's biggest rival, Pepsi had already carved its niche in the market with more than 25 percent market share.

While things went smoothly for a while after Coke's re-entry into India, it soon started run-ins with the regional political bodies. Coca-Cola had set up a $12 million plant in Plachimada, a rural town in the southern state of Kerala in India in 2000. But four years later, in 2004, the company had to shut it down, at least temporarily to begin with. The start of 2002 witnessed the anti-Coke 'Coca Cola, Quit Plachimada, Quit India' movement. It began when people who were living close to the plant noticed that water in their wells was drying up or becoming polluted, acidic and therefore not drinkable. Never having faced this water situation before, all fingers pointed toward the newly established Coke plant, which extracted considerable quantities of ground water on a daily basis for its operations. A small local protest that started off with less than a hundred people, exploded into a nationwide agitation. Soon, social activists and nationalists, who were against foreign firms and privatization, joined in. Before long, the campaign against Coca-Cola had found supporters from all over the world including the U.S., Sweden and France.

The local political body in the area, known as the Panchayat, which had initially laid out the red carpet for the Coca-Cola plant refused to renew HCCBPL's (Hindustan Coca Cola Beverages Private Limited) license in 2003. The state government also chipped in and joined the dispute. Eager to fight back, Coca-Cola approached the High Court in India, but the court ruled that water, being common property, could not be excessively used by one body. By the year 2004, the controversy had erupted to such an extent that Kerala state government ordered that the company stop using the ground water. Shortly thereafter, Coca Cola was forced to suspend production at the plant.

As a result of this incident and other incidents in India where researchers found that its beverages contained high levels of pesticides that were potentially harmful to human beings, Coca-Cola lost millions in the Indian market. In September 2003, a legal notice was issued to the company's headquarters in Atlanta, the U.S. by the Joint Parliamentary Committee in India asking the company to immediately suspend sales in India or then it would sue the company for $10 billion for selling dangerous drinks. A similar notice was given to Pepsi as well. They were also expected to recall any already sold products. Coca-Cola overcame this particular setback eventually but it did not in any way make its survival in the Indian market any easier. Its new product launches in India such as the vanilla flavored Coke drink and others such as its energy drink Shock proved to be debacles. However, Coca-Cola is not giving up in India this time. It is hanging on with the hope that some day it will be able to win over the world's second largest population. Coca-Cola has responded to growing protests against it in India through a variety of corporate social responsibility initiatives, including the much-hyped Every Drop Counts campaign launched in 2007.

Source: Mark Thomas, "If Water Has Become a Scarce Resource, then the Americans Will Invade Wales and the PM Will Defend Them by Insisting that Wales Could Launch a Water-Borne Chemical Attack," *New Statesman*, February 16, 2004, p. 14; Terrence H. Witkowski, "Antiglobal Challenges to Marketing in Developing Countries: Exploring the Ideological Divide," *Journal of Public Policy & Marketing*, 24 (Spring 2005), pp. 7–23; and "Coke In India: A Not-So-Silent Spring," *Corporate Accountability International*, http://www.stopcorporateabuse.org/cms/page1764.cfm, June 2008.

USEFUL TWO VIDEO CLIPS MAY BE VIEWED AT WWW.UTUBE.COM:

1. Coca-Cola responsible for water depletion in India http://www.youtube.com/watch?v=U8OA_M-sMnw
2. Indians Protest Coca Cola Plant http://www.youtube.com/watch?v=wyFsodVUd-o&feature=related

DISCUSSION QUESTIONS

1. What should Coca-Cola do to appease the Indian government and ensure its survival in the market?
2. What effect will this case have on Coca-Cola's operations in India?
3. What lesson does this case have for other multinationals that want to enter the Indian market?

CASE 5-2

CAN I GET A BUD, PLEASE? WHICH BUD? CZECH OR AMERICAN?

The growing power of the European Union (EU) in recent times is proving beneficial to European firms but it is rubbing global trade bodies and a lot of U.S. multinational firms the wrong way. One U.S. firm that is particularly disconcerted is brewer Anheuser Busch. The reason being the recent (May 5, 2005) Protected Geographical Indication (PGI) status granted to a Czech beer brand, Budweiser Budvar by the EU. Anheuser-Busch claims the Czech product is making its way in international markets using Anheuser-Busch's original beer brand name Budweiser or 'Bud' as it is widely known. The Czech Republic is one of the EU's newest members, having entered the EU in May 2004.

The EU has reserved the PGI status for those products that can be identified by virtue of their place of origin and the indigenous process of manufacturing these products. There is a prestigious group of brands that enjoy this status and it includes German beer product Kolsh originating from the North Western part of Germany, Gruyere cheese from Switzerland and the well-known Cognac. There is another category of products that are assigned the title of Protected Designations of Origin (PDO) by the EU regulation 2081/92. Although the EU believes that this classification is what needs to be done to protect the identity of its region's popular products, the U.S. and even the World Trade Organization contend that this is just one more political weapon in the hands of the often protectionist EU countries against free trade. Furthermore, the Czech Republic is a new addition to the EU and compared to the other countries, is much smaller in size and bargaining power within the EU. According to this regulation, PGI products cannot be made or packaged anywhere except in their own region, after which they are named. In case of Budweiser Budvar beer, for example, it cannot be brewed or packaged anywhere except in its own specific region. If the company, in the future, decided to relocate to another region, its status would be likely to be revoked. For example, when UK-based Scottish & Newcastle closed down its oldest brewing plant in Newcastle due to a move to rationalize its operations, it was compelled to apply for its brand name Newcastle Brown to be revoked because it could no longer enjoy the PGI status.

Budejovicky Budvar (Budvar), which has brewed its beer in the Czech town of Ceske Budejovice (also known as Budweis) near Prague since before the beginning of the 20th century, has to be sold in the U.S. and some other regions outside of the EU as CzechVar. Budvar claims that it has been using its brand names. Including Budweiser, since times unmemorable, although Anheuser-Busch contends that it has used the same brand names since its establishment in 1876, several years before Budvar came into existence. Budvar argues that it has the sole right to the brand name due to the association with the region and the EU ruling merely brings additional support for this assertion.

Whereas in their early years of international operation, the two firms managed to carve out their areas and remain sellers in those markets, in recent times, global competition has heated up not only in technology intensive industries but also in the brewing industry and hence the firms found themselves stepping on each others' toes, thus initiating an intense struggle for market dominance. However, Anheuser-Busch's marketing issues with Budvar go back to 1906 when Budvar first entered the U.S. market, and extend to 40 different countries where the two firms and their respective brands, Budvar and Anheuser-Busch's Budweiser are embroiled in legal battles, making it a truly global marketing crusade for the same brand names, Bud, Budweiser and Budvar. Although Anheuser-Busch is larger and therefore assumed to be more powerful than the smaller Czech company, Budweiser has been losing out to Budvar in many of its markets. Anheuser-Busch brought action against Budvar using its trade name Budweiser in different international markets. To make it worse, the Czechs are winning some of the legal cases as well, the most recent one being Budvar's win in Cambodia and some years back in Switzerland, where Anheuser-Busch was prevented from marketing its products under the Budweiser brand names. Budvar lost its case against Anheuser-Busch in France a few years back. A surprising outcome of the legal case was in the UK where the court allowed both firms to market their products with the same brand names.

Industry experts contend that Budvar has a unique global marketing strategy in place, whereby it can piggyback on the free publicity gained for it by its dispute with Anheuser-Busch. The coveted PGI status is going to be a useful add-on to its marketing strategy because it is believed that consumers will now desire the beer for its authenticity and association with the Czech Republic and therefore perceive more value in purchase of the product. In order to emphasize its newfound eminence, Budvar is planning to stick blue and gold seals on its beer products. Budvar's latest twist to its marketing strategy is to promote its beer as a finer quality brew based on provenance, which some believe will take it a long way in sales irrespective of whether it wins in the courts or not. This is in contrast to Anheuser-Busch's strategy in global markets to promote its Budweiser brands as more of familiar, general brand.

The trademark war between Budvar and Anheuser-Busch has been going on for decades and given that neither company is ready to back down, the battle will probably go on for another few decades as both firms enter new markets and try to acquire market share.

Source: James Curtis, "Provenance or Protectionism?" *Marketing*, May 11, 2005, p. 16; and various other sources.

DISCUSSION QUESTIONS

1. How important is it for Anheuser-Busch to market its products under their original brand names in different countries?
2. If you were asked to be the judge in this case, whom would you side with and why?
3. Since the legal battle between Anheuser Busch and Budvar seems to be never ending, how could the firms possibly settle this matter outside of court?
4. What alternative strategies could both firms adopt in foreign markets in which both of them compete?

CASE 5-3

How Two Companies Handled a Politically Sensitive Crisis Situation

Burger King and McDonald's recently experienced crises in politically sensitive areas of the world. The following is how those two global hamburger chains handled the similar volatile political situations.

BURGER KING

In the face of a boycott threat by Arab and Muslim groups in late 1999, Burger King Corp. decided to revoke a franchise agreement for a restaurant in the Israeli-occupied West Bank. Burger King maintained that the decision to cancel the agreement with its Israeli franchisee, Rikamor Ltd., was the result of Rikamor's breach of contract. Rikamor told Burger King that the restaurant would be located in Israel proper, not the disputed West Bank. Rikamor has been asked to remove the Burger King name from the restaurant, although the chain has no power to force the restaurant to close. A statement released by Burger King said it had made it clear that it "would not approve Rikamor opening restaurants in the West Bank at this sensitive time in the peace process." Now backed by Jewish settlers who long for brand-name legitimacy, Burger King's Israeli franchisee swore to fight the fast food giant's break with a branch in a West Bank Jewish settlement. Angry Israeli settlers called for a worldwide boycott of Burger King restaurants and a halt to Israeli-Palestinian peace talks, after the chain canceled its franchise in Maale Adumim, a Jewish settlement near Jerusalem. Burger King said its decision was purely commercial and that it does not take sides in the Arab-Israeli peace process. Israel captured the West Bank in 1967, and Jewish settlements, located throughout the territory, are at the center of the Middle East conflict. Palestinians say the West Bank settlements are illegal.

MCDONALD'S

At the outset of the NATO's air war against Yugoslavia (now known as Serbia-Montenegro) during the Kosovo Crisis in 1999, McDonald's, as a quintessential American trademark, was forced to temporarily close its 15 restaurants in Yugoslavia due to vandalism by angry Serbian mobs. But when local managers re-opened the doors shortly after, they accomplished an extraordinary comeback using an unusual marketing strategy. They put McDonald's U.S. citizenship on the back burner. To help overcome animosity toward an American icon, the local restaurants promoted the McCountry, a domestic pork burger with paprika garnish. As a national flourish to evoke Serbian identity and pride, they produced posters and lapel buttons showing the golden arches topped with a traditional Serbian cap called the sajkaca. They also handed out free cheeseburgers at anti-NATO rallies. The basement of one restaurant in the Serbian capital even served as a bomb shelter. Now that the NATO-led war against Yugoslavia is over, many Serbians do not associate McDonald's with the United States but rather as their own.

Different companies may have different corporate philosophies. If you had been in charge of international operations for either Burger King or McDonald's, how would you have addressed these political crises?

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