

MAP 3.1 China: The Inscrutable Market

With more than 1.3 billion consumers and a labor force of just over 800 million workers, China is attractive to foreign investors. One of every five people in the world lives in China, but the population is unevenly distributed. Approximately 50 percent of Chinese citizens live on just 8.2 percent of the country's total land. Even so, maintaining centralized control over the nation's political and legal affairs has traditionally been difficult. The vast distances between seats of authority helps local officials evade the watchful eye of faraway bosses.



than 100 times the scale, resulting in an economic transformation that carries over 1,300 times the force of change than seen during the Industrial Revolution. MNEs are responding in kind: Ford plans to double its production capacity in China to 1.2 million vehicles by 2015, its most rapid expansion anywhere in 50 years; GE relocated its 115-year-old X-ray division from Wisconsin to Beijing; Yum! now looks to China for half its global sales and 40 percent of its operating profits. Bluntly put, "You are not a global player unless you are in China."¹⁰

THE COMPLICATION OF REALITY

Notwithstanding the hype and its hyperactive performance, complications tarnish China's appeal. Its political and legal systems make business operations a nebulous, frustrating process. In a nutshell, China practices "State Capitalism" whereby the government manipulates market activities to achieve political goals. Consequently, MNEs doing business in China often find themselves at a disadvantage. Ambitious Western firms such as Exxon Mobil, ABB, Caterpillar, and Vodafone purchased big stakes in Chinese companies. Political problems and legal difficulties short-circuited their plans. Eventually, like many others, they sold their stakes and reset their strategies.¹¹

China's rapid emergence aggravates long-running idiosyncrasies. The resulting mix of ancient and contemporary outlooks creates many grey areas. Some observers argue that, when it comes to doing business in China, the number one rule is to throw away the rulebook. Sage foreign investors abandon the notion that Western ideas automatically work in China. The principle of forming a corporation "for any valid business purpose" does not exist there. Incorporating in China requires telling the government—in

excruciating detail—who you are, what you want to do, how you plan to do it, how much you intend to invest, and how many jobs you will create. MNEs endure protracted negotiations in obtaining permission to open local operations. At each stop of the long march, national, provincial, and local officials ask how the investment encourages capital formation, promotes exports, creates jobs, and transfers technology. If you hit the right targets, only then does the government green-light your project.

DRAGONS AND SNAKES

As in China, centralized governments worldwide determine the path and pace of local economic development. China, however, poses a particularly tough case given that its political and legal systems impose many time-consuming tasks. Moreover, China tends to stack the odds against foreigners who are bold enough to forge ahead in the face of an elaborate government bureaucracy and a fledgling legal system.¹² “If the great invention of European civilization was a legal system,” quipped an observer, “then China’s was bureaucracy.”¹³

Exasperated investors blame China’s treacherous terrain on a bureaucratic system that regulates activity based more on arbitrary agendas than objective standards. Connections, not competencies, often matter more. Those who believe that economics should determine the efficient means of generating prosperity see this as illogical. Still, it is utterly logical to Chinese leaders who regard state control of business activity as the most reliable path toward harmonious prosperity—and, one mustn’t forget, staying in charge of the show.

Foreign investors navigate often-mysterious political channels. The long-running conflict between central and local Chinese authorities further confuses issues. The vastness of the country means that local officials, whether headquartered in the smallest village or the largest city, are often left alone by their comrades in Beijing. Certainly, there are national laws, but how they move from Beijing to the provinces is a different story. “The center,” notes one observer, often “has no control over the provinces. When it sends people to investigate illegal pirating of CDs, local governors block access to the factories.”¹⁴ As Chinese folklore warns, “The mightiest dragon cannot crush the local snake.” This proverb captures the spirit of the enduring power struggle within China. Essentially, even though the central authorities in Beijing may appear to be all-powerful, the politics of powerful local fiefdoms often subvert their authority.

PRECISE LAWS OR AMBIGUOUS GUIDELINES?

China had no formal legal system in 1978 when it launched one of the greatest campaigns of legal reform in history. Ongoing developments have stabilized what had been an unpredictable, periodically chaotic legal environment. Still, China faces such ongoing challenges as legislative gaps, hazy interpretation, lax enforcement, and philosophical disagreements. Legislation is chock-full of ambiguities, says one Beijing-based lawyer, who thinks it will take 10 to 15 years to iron out many wrinkles.¹⁵ Some are less optimistic, comparing the state of the Chinese legal system with that of the United States in the 1920s—then an antiquated composite of statutes and codes that took several decades to modernize.

Others note that, in the case of the Chinese system, even bigger problems reflect a difference in the concept of legality in that society. Western legal systems rest on the rule of law and its doctrine of legitimate regulations transparently administered by public officials who are held accountable for their just enforcement. In contrast, China practices the philosophy of the rule of man, seeing the right of the “man” (once in the person of the Emperor, today in the form of the CCP) to act free of checks and balances. Besides being the law, the CCP is seen as above the law and given the legitimacy bestowed upon it by its ostensible “mandate from heaven.”¹⁶ Rarely does the Chinese criminal court end with anything other than a guilty verdict. Rather, explained an FBI Special Agent and legal attaché at the U.S. Embassy in Beijing, “there is really no rule of law here . . . they (CCP) make a decision ahead of time to make a point.”¹⁷

THE LEGALITY OF ILLEGALITY

China’s legal practices combined with the growing pains of its novel legal institutions and evolving political norms challenges MNEs. A sensitive tripwire is the theft of intellectual property—patents, trademarks, copyrights, and so on. MNEs complain that relentless, widespread, and sophisticated robbery of their

intellectual property fuels China's economic surge. Aggressive estimates link nearly a third of the Chinese economy to piracy.¹⁸

The FBI estimates that American companies lose hundreds of billions annually to counterfeiting. China continues to be the number one source country for counterfeit and pirated goods seized; in just the U.S., Chinese counterfeits accounted for 62 percent or \$124.7 million of the total domestic value of seizure.¹⁹ U.S. authorities, noting the rarity of legal punishment, charge Chinese officials with tolerating, if not encouraging, pirates.²⁰ Still, countries wage battle. The United States, for instance, has frequently appealed to various transnational institutions about China's "inadequate enforcement" of intellectual property regulations.²¹

What accounts for China's status as the world's premier counterfeiter? Analysts point to a mix of its quest to catch the West, collectivist orientation, rule-of-man legacy, and dubious enforcement of ambiguous laws—conditions that create a political and legal morass. Noted an observer, "We have never seen a problem of this size and magnitude in world history... There's more counterfeiting going on in China now than we've ever seen anywhere."²² Problems threaten to escalate. Government policies have "left a deep impression on companies that intellectual property is there for anyone to use it." Local and provincial authorities rely heavily on pirates to power local economic growth. Moreover, China excels in making high-quality knockoffs. As some say in Shanghai, "We can copy everything except your mother."²³

WHERE TO NOW?

Inevitably, investors question how an opaque single-party political system bolstered by a murky legal environment can protect their rights. Some believe that external institutions will improve transparency. China's 2001 ascension to the WTO, for example, required it to accept rules on all sorts of business matters, including tariffs, subsidies, and intellectual property. And, granted, China has steadily amended its legal codes to comply with WTO standards. However, the struggle is not a shortage of regulations. Rather, China's sluggish enforcement, even in cases of outright violation, is the primary problem.

Despite intimidating political difficulties and confusing legal questions, legions of foreign investors fall sway to the siren call of China. Whether driven by bright forecasts, confidence in continued progress, or desperation to ride this megatrend, companies leave the sanctuary of predictable markets for the distinctive ways of the Middle Kingdom. Then, once they clear immigration and cross the modern-day Rubicon, they face the daunting task of interpreting China's political and legal systems. ■

CRN
Case Review Note

QUESTIONS

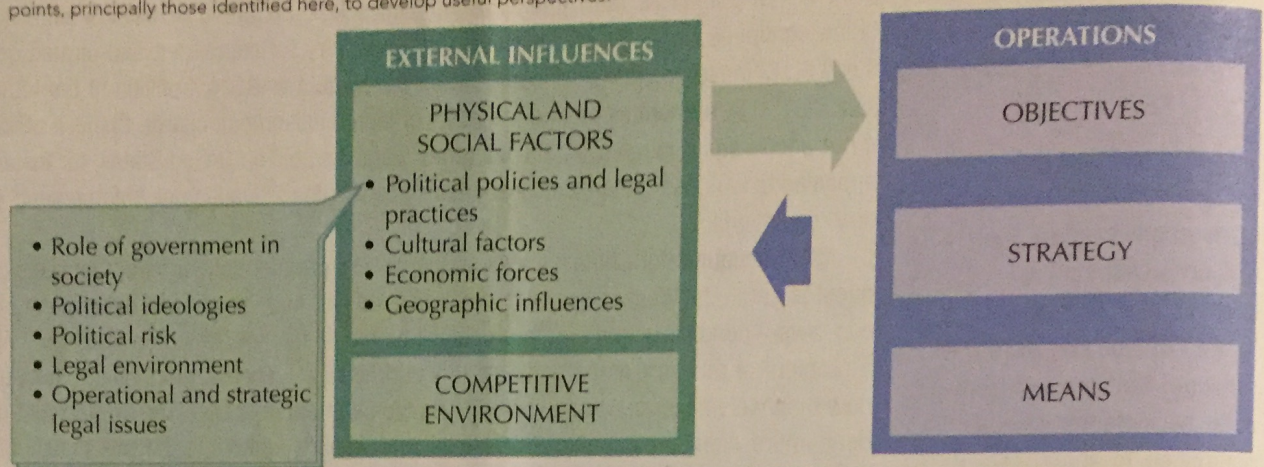
- ★ 3-1. Identify three compelling economic reasons to invest in China. Then identify three compelling political reasons to avoid doing so. Recommend a criterion one could use to trade off the opportunities of operating in China versus the risks of doing so.
- ★ 3-2. What sort of operational safeguards would you advise a company to adopt in order to better manage the risks of China's legal environment?

INTRODUCTION

Chapter 2 showed that the cultural issues facing international businesses differ from those facing domestic firms. This chapter carries the analysis forward, emphasizing that once a company leaves its home country it operates in markets with different political and legal systems. Some countries are similar; Australian companies would not find many surprises in New Zealand, for instance. In other cases, the differences are profound; an ill-prepared U.S. company would encounter shocks in Russia. Navigating among countries requires that MNEs study how political and legal circumstances overlap and differ. Determining where, when, and how to adjust business practices without undermining the basis for success is an enduring challenge.

FIGURE 3.1 Political and Legal Factors Influencing International Business Operations

The political and legal environments are broad-stroke concepts that defy straightforward classification. Nevertheless, managers emphasize key points, principally those identified here, to develop useful perspectives.



Managers study political and legal environments in order to adjust company activities to local circumstances.

Consider that a domestic company operates in a single national environment in which institutional policies are reasonably predictable. Operating internationally exposes its managers to diverse and conflicting pressures from wide-ranging groups in different nations. Variations increase the challenge of interpreting different philosophies, laws, and attitudes on political freedom, property rights, and legal responsibility. Consequently, effective managers begin with the realization that when it comes to politics and laws, countries' different ideas result in different political and legal environments. They position themselves to compete by understanding these differences, rather than ignoring or, worse, resisting them.

No matter where an MNE goes, the prevailing politics and laws affect its options and operations. China's political and legal environments, for example, require MNEs to rethink the best ways to acquire resources, make investments, adapt operating modes, and manage risk. Figure 3.1 identifies the political principles and legal outlooks that define a nation's business environment. This chapter will discuss how they influence the prevailing political ideology, shape the role of government, moderate the degree of political risk, and define the legal system.

THE POLITICAL ENVIRONMENT

Our opening profile of China shows that its evolving political and legal systems create a thriving business environment. Tens of thousands of foreign investors have entered its market, opened operations, managed activities, and earned profits. Still, the political system imposes hardships while the legal system complicates attempts to right wrongs. This situation is not unique to China. The interplay of political ideologies, conceptions of political freedom, legacies of legality, presumptions of fairness, and exercise of power makes for challenging political environments around the world.

Consider Russia, home to 142 million people. The world's largest country in terms of territory, it possesses vast natural resources and has a government that looks to foreign MNEs to help modernize its energy-dependent economy. Still, foreign investors face high hurdles. An executive at Swedish retailer IKEA explained that the Russian political environment is "a bit of a roller coaster... [Y]ou don't know exactly what will happen tomorrow."²⁴ The roster of horror stories features well-known names. Authorities arbitrarily confiscated products of Motorola, charged PwC Russia with tax evasion on flimsy evidence, and arguably expropriated Yukos.²⁵ Doing business in Russia means you had better be "big enough to defend yourself against bureaucratic attacks [and]... ready to hold your nose when elections are rigged and political opposition is crushed."²⁶ Ironically, Prime Minister Vladimir Putin has promised a "dictatorship of the law," an approach that appeals to the majority of Russians

who prefer strong leadership to vibrant democracy.²⁷ Others, however, see Russia trapped in lawlessness and legal nihilism. Accordingly, Transparency International rated Russia 133 out of 176 nations in its Corruption Perceptions Index.²⁸

These sorts of situations require executives evaluate, monitor, and forecast the dimensions and dynamics of foreign political environments. They study how government officials exercise authority, legislate policies, regulate enterprise, and punish wrongdoers. They monitor how politicians are elected and whether and how they depart. They assess whether the rule of law or of man prevails. They gauge whether freedom is a practical ideal or a wishful abstraction. Then, based on their analyses, they forecast business scenarios, always mindful that political stability rewards investment while political uncertainty penalizes it.²⁹

Whether targeting Afghanistan, Zimbabwe, or any of the more than 200 markets in-between, managers study a nation's **political system**—namely, the structural dimensions and power dynamics of the government that (1) specify institutions, organizations, and interest groups and (2) define the norms and rules that govern political activities. The mission of a political system is clear-cut: integrate different groups into a functioning, self-governing society. Likewise, its test is sustaining society in the face of divisive viewpoints. Success supports peace and prosperity, as we see in Sweden, Botswana, and Australia. Failure leads to instability, insurrection, and, ultimately, disintegration of the sort seen in Somalia, Afghanistan, and Libya.

The goal of the political system is integrating the diverse elements of a society.

The test of a political system is uniting society in the face of divisive viewpoints.

CONCEPT CHECK

Chapter 2 showed that culture moderates the practices of international business. Many points of interpretation, both from an academic and managerial perspective, follow from the interplay of collectivism or individualism in a country.

INDIVIDUALISM VERSUS COLLECTIVISM

Explaining the similarities and differences of political systems has intrigued a long line of thinkers, beginning with Plato and Confucius and moving on to Herodotus, Machiavelli, Smith, Rousseau, Marx, Gandhi, and Friedman.³⁰ Each wrestled with enduring philosophical issues: How should society balance individual rights versus the needs of the community to sustain a rational, righteous, and harmonious system? What is the basis of the state's authority over its citizens? Should society guarantee individual freedom in the pursuit of economic self-interest? Does society fare better when individual rights are subordinated to collective goals? Should society champion equality or institute hierarchy? Are individual rights inalienable or conferred by the collective? Engaging these and like-minded questions anchors interpretation of the political systems in terms of **individualism** versus **collectivism**.

INDIVIDUALISM

Individualism champions the primacy of the rights and role of the individual. Collectivism refers to the primacy of the rights and role of the group.

The doctrine of individualism emphasizes the primacy of individual freedom, self-expression, and personal independence (think of the declaration that we all have “certain inalienable Rights, that among these are Life, Liberty and the pursuit of Happiness”).³¹ It champions the exercise of one's ambitions while opposing regulations that overly constrain them. The government protects the liberty of individuals to act as they wish, as long their actions do not infringe upon the liberties of others.

The business implications of individualism are direct: every person has the right to make economic decisions largely free of rules and regulations. Countries with an individualistic orientation, such as Australia, Canada, Netherlands, New Zealand, the United States, and the United Kingdom, shape their marketplace with the idea of **laissez-faire**. Literally meaning, “leave it alone,” a laissez-faire approach holds that the government should not interfere in business affairs; rather, the market should operate according to the neoliberal principles of free market fundamentalism. Left to their own devices, people regulate themselves in promoting economic prosperity and act fairly and justly to maximize personal performance without threatening the welfare of society.

Gaps between philosophical ideals and opportunistic behaviors often fan an adversarial relationship between governments and businesses in individualistic societies. Recent events dramatize this circumstance. The global financial crisis of the last decade revealed

that some individuals and firms had maximized their interests at the expense of societal welfare. Long-running support of deregulation, privatization, and trade liberalization, advocated to maximize individual freedom of choice, ultimately proved destructive. Opportunistic behavior destabilized the marketplace and jeopardized system sustainability. In response, governments reset regulations to reduce market inefficiencies (such as deficient consumer knowledge or excessive producer power) that had given some individuals undue privilege. Ongoing market problems in such countries as Spain, Japan, Ireland, Greece, Portugal, and the United States push governments to restrain the individualism of free markets in order to protect the collective welfare.

COLLECTIVISM

Collectivism stresses that the needs of society take precedence over the needs of the individual.

The doctrine of collectivism emphasizes the primacy of the collective—e.g., a group, party, community, class, society, or nation—over the interests of the individual. No matter the importance of those who comprise it, the whole of the collective is ultimately greater than the sum of its individual parts. Today, we see collectivism in a range of countries, including Argentina, China, Vietnam, Japan, South Korea, Egypt, Brazil, Taiwan, and Mexico.

Collectivism in the business world holds that the ownership of assets, the allocation of resources, the structure of industries, the conduct of companies, and the actions of managers share a common goal: improve the welfare of all members of society. Business decisions are made by the group for the benefit of the group. Political systems that exhibit a collectivist orientation hold that government regulates the market to promote social equality, labor rights, income equality, and workplace democracy so that the “welfare of the nation takes precedence over the selfishness of the individuals.”³² In extreme cases, such as Venezuela or Saudi Arabia, political leaders severely limit property rights and regulate the mass media in order to control the business environment.

POLITICAL IDEOLOGY

A political ideology encapsulates the doctrine of political behavior and change. It outlines the procedures for converting ideas into actions.

The orientation toward individualism or collectivism fundamentally shapes a nation’s political system and, hence, its **political ideology**. In theory, an ideology is an integrated vision that defines a holistic conception of an abstract ideal and its normative thought processes. For example, the ideal of freedom carries with it ideas about related principles, doctrines, goals, practices, and symbols. A political ideology stipulates how society ought to govern itself and outlines the methods by which it will do so.

In the United States, the liberal principles of the Democratic Party and the conservative doctrine of the Republican Party define their respective political ideologies—i.e., the former favors collectivist measures such as progressive taxation and strict environmental standards whereas the latter champions individualistic measures such as consumer choice and minimal regulation. Japan has a similar situation: its Democratic Party advocates social liberalism and its Liberal Democratic Party advocates conservatism. No matter the specific cause, an effective political ideology moves beyond describing a vision of a better, brighter future. Put simply, it specifies the means to achieve that ideal.

Japan and the United States, like many other countries, have political parties that list smaller memberships than do the main parties. Consequently, most nations are pluralistic in which different political groups champion competing ideologies.³³ **Pluralism** also arises when two or more groups in a country differ in terms of language (Belgium), class structure (United Kingdom), ethnic background (South Africa), tribal legacy (Afghanistan), or religion (India).

A pluralistic system requires that officials negotiate policies. The bargaining process between competing groups dictates that politics follow multiple, shifting lines. Multi-criteria compromise, not single-minded consensus, is the order of the day. The resulting ambiguity complicates decision making for MNEs. Pluralism requires that managers assess the interplay

Pluralism holds that there are multiple opinions about an issue, each of which contains part of the truth, but none that contain the entire truth. Progress depends on negotiation and compromise.

among groups. Often, companies try to influence policy formulation. In the United States, for example, some companies fund political action committees that support preferred candidates or influence the legislative process.

SPECTRUM ANALYSIS

Figure 3.2 outlines a **political spectrum**. By specifying a basic conceptual structure, spectrum analysis guides the assessment of a complex issue—in this case, political ideology. Configuring ideologies along the central axis lets us model different ones relative to the others. The starting point is specifying credible ideas to anchor the endpoints. When those are reasonably set, we then position the others.

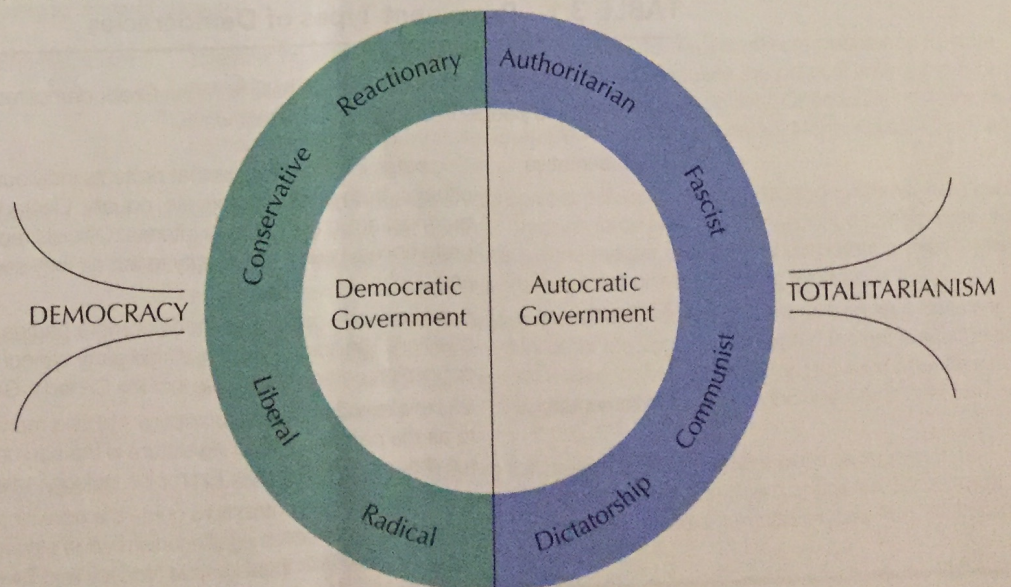
Determining the standard of “reasonably set” can prove difficult. The world exhibits a diversity of potential ideologies: anarchism, conservatism, secularism, environmentalism, liberalism, feminism, nationalism, socialism, theocracy, and so on. Cultural perspectives also moderate interpretation of such choices. From a Western perspective, for example, one commonly sees the endpoints defined as conservative versus liberal interpretations of democracy—i.e., Republican versus Democrat. Other endpoints command greater relevance in other contexts. A political spectrum in an Islamic country, such as Iran or Saudi Arabia, is likely bounded by theocracy versus secularism to reflect the role of the clergy in the government. In the case of Taiwan, parties that endorse Chinese reunification oppose those that champion Taiwanese independence. In Belgium, ends would reflect the ethnic and socioeconomic tensions between the Dutch-speaking Flanders region and the French-speaking Walloon region. In Canada, it would be inclusive nationalism versus Bloc Québécois’s call for the sovereignty of predominantly French-speaking Québec.

Although initially confusing, a common denominator integrates the diversity of political ideologies: namely, its vision of **political freedom**. This ideal originated in the practice of politics in ancient Greece and has since been inseparable from interpreting political action. Political freedom reflects the degree to which fair and competitive elections occur, the extent to which individual and group freedoms are guaranteed, the legitimacy ascribed to the rule of

Political freedom measures the degree to which fair and competitive elections occur, the extent to which individual and group freedoms are guaranteed, the legitimacy ascribed to the rule of law, and the existence of freedom of the press.

FIGURE 3.2 The Political Spectrum

In practice, purely democratic and totalitarian systems are exceptions. Looking around the world, one sees many variations. For example, democratic systems range from radical on one side (advocates of extreme political reform) to reactionary (advocates of a return to past conditions). Likewise, totalitarian systems emphasize different degrees of state control. Fascism aims to control people’s minds, souls, and daily existence, whereas authoritarianism confines itself to political control of the state.



law, and the existence of freedom of expression. As ideologies differ, so too do interpretations of the ideal degree of freedom. Rather than an inalienable right, freedom is open to debate. As a result, the matters of where, how, and why a company invests and how it manages operations are alienable freedoms, subject to the ideology that anchors and influences the political system.

With these ideas in mind, Figure 3.2 sets the political spectrum, with democracy, with its call to preserve, protect, and defend political freedom, anchoring one endpoint and totalitarianism, with its call to control, constrain, and, suppress political freedom, the other.³⁴ The ideologies that fall between these endpoints interpret political freedom differently. Liberal ideologies, for instance, advocate the right of individuals; authoritarianism subordinates individual freedoms to the welfare of the collective. In the former, managers have many investment and operating options; in the latter, they have far fewer. Similar examples only reinforce our chief point: Freedom is the distinguishing characteristic of political ideologies. Some stress its primacy, others oppose it. Throughout all, MNEs study its implications to their decisions.

Each political ideology in Figure 3.2 is notable; we lack the space to stipulate each one here. However, understanding the ideals and means of the two endpoints, democracy and totalitarianism, helps one interpret the others.

DEMOCRACY

Abraham Lincoln held that **democracy** is a government "of the people, by the people, for the people." Modern-day democracies translate this ideology into the principles that all citizens are politically and legally equal, entitled to freedom of thought, opinion, belief, speech, and association, and command sovereign power over public officials.³⁵ A democratic government protects personal and political rights, civil liberties, fair and free elections, and independent courts of law.³⁶ These principles and practices institutionalize political freedoms and civil liberties that, by endorsing equality, liberty, and justice, support individualism.

Different legacies shape the performance of democracy in a nation. More practically, the scale and scope of modern society imposes logistical constraints, particularly when population size makes it impossible for all voters to participate directly. Table 3.1 shows that countries respond with different types of democracies. Notwithstanding variance, all advocate the authority of the many over the few. The future may see a resurgence of direct democracy. Evolving technologies increasingly support a virtual assembly of citizens who express their votes directly through electronic signature gathering or online polling processes.

TABLE 3.1 Prominent Types of Democracies

The elemental definition of democracy hails from the Greek <i>dēmokratía</i> : "rule by the people." As we see here, the rule of the people is practiced in different ways.	
Representative	Originates in a constitution that protects individual freedoms and liberties. The law treats all citizens, both public and private, equally. Elected representatives hold ultimate sovereignty but must act in the people's interest. Officials represent voters and, while mindful of voters' preferences, have the authority to act as they see fit. Examples include the United States and Japan.
Multiparty	A political system whereby three or more parties govern, either separately or as part of a coalition. The leadership of a single party cannot legislate policy without negotiating with opposition parties. Examples include Canada, Germany, Italy, and Israel.
Parliamentary	Citizens exercise political power by electing representatives to a legislative branch referred to as the parliament. The legislature is the source of legitimacy for the various ministers that run the executive branch. Examples include India and Australia.
Social	Applies democratic means to guide the transition from capitalism to socialism. The government promotes egalitarianism while also regulating capitalism's tendency toward opportunism. Examples include Norway and Sweden.

Democracy calls for participation by citizens in a fair and just decision-making process.

Democracy and individualism are intrinsically related and mutually reinforcing; individualism legitimates principles of democracy and democracy supports standards of individualism.

A totalitarian system consolidates power in a single agent who then controls political, economic, and social activities.

Totalitarianism and collectivism are intrinsically related and mutually reinforcing; collectivism legitimates principles of totalitarianism and totalitarianism supports standards of collectivism.

Business Implications In a democracy, MNEs invest and operate based on economic, not political, standards. Business environments promote commerce, expand trade, and streamline exchange, both within and across countries. The signaling devices of market activities, not bureaucratic regulation, organize a productive business environment. Managers and consumers are free to do as they see fit. In political terms, freedom sanctions rights and liberties; in economic terms, it legitimates profits and prosperity. Brazil, India, Indonesia, and Turkey provide cases in point. Their belief in central planning run by a strong state had led to stagnant if not failing economies 20 years ago. Now these countries are converting the energy of their emerging democracy into dynamic business environments.³⁷

TOTALITARIANISM

A **totalitarian system** subordinates the individual to the interests of the collective. A single agent in whatever form, such as an individual, a committee, an assembly, a junta, or a party, monopolizes political power and uses it to regulate many, if not all, aspects of public and private life. The agent believes it has noble intentions, protecting people from the hazards of individual choice.³⁸ Fair game includes regulating residents' occupation, income level, interests, religion, and even family structure.³⁹

A totalitarian government eliminates dissent through indoctrination, persecution, surveillance, propaganda, censorship, and violence. It tolerates few, if any, ideas, interests, or activities that run counter to state ideology.⁴⁰ There is no alternative for the simple reason that none is allowed to exist. In extreme situations, personal survival is linked to that of the ruling regime. Collectively, these conditions merge the interests of individuals with those of the state. Table 3.2 profiles types of totalitarian systems.

The dynamics of change in a totalitarian state highlight the means used to enforce its ideology. Rejecting preceding forms of society as corrupt, immoral, and beyond reform or redemption, a single leader advocates a new society that corrects wrongs, redresses injustice, and supports harmony. In place of private property, the state allocates power and status to reward supporters (who often monetize privileges through corruption). It uses propaganda, indoctrination, and incarceration to coerce citizens. State-controlled media filters

TABLE 3.2 Prominent Types of Totalitarianism

First recorded in reference to Italian fascism, "totalitario" stood for "complete, absolute, totalitarian" control by a dictatorial one-party state that regulates every realm of life. As we see here, the ruling agent can control society to different degrees.

Authoritarianism	Tolerates no deviation from state ideology. Day-to-day life reflects obedience to state authority; resistance incurs punishment. Officials regulate the political environment but pay less attention to the economic and social structure of society. Often lacks an ideology to politicize public and private life. Examples include Kazakhstan, North Korea, Chad, and Turkmenistan.
Fascism	Organizes a nation based on corporatist perspectives, values, and systems. Advocates a single-party state that controls, through force and indoctrination, people's minds, souls, and daily existence. Fascism calls for the merger of state and corporate power. There have been few fascist political systems; most prevailed during World War II.
Secular	A single-party government controls elections, tolerates dissent as long as it does not challenge the state, and suppresses other ideologies. The state does not prescribe an all-encompassing ideology. It grants limited individual freedoms provided one does not contest state authority or disrupt social harmony. Examples include China, Vietnam, and Venezuela.
Theocratic	Government is an expression of the preferred deity. Leaders claim to represent its interests on earth. Applies ancient dogma in place of modern principles. Strict social regulation and gender regimentation typically ensue. Examples include Iran, Afghanistan, and Saudi Arabia.

CONCEPT CHECK

Recall our discussion in Chapter 2 of "Behavioral Factors Affecting Business."

These variables change as people change—or as state authority influences them. Shaping people's behavior to support the state's interests leads an authoritarian government to manipulate norms, including work motivation, risk taking, communication practices, and consumption preferences.

Authoritarian parties often rely on shadowy politics, skewed elections, and nefarious security agencies.

information, state-controlled education filters ideas, and state-controlled courts, police, and security suppress dissent. The cumulative result is a "virtual mind prison" in which the leader and the state fuse—one conforms or is cast out.⁴¹

Although remote to citizens in Western democracies, forms of totalitarianism prevail throughout the world. Some 2.5 billion people—roughly one-third of the world's population—live under such rule, with another 1.5 billion people residing in less draconian but still authoritarian political systems.⁴² The citizens of such countries as Madagascar, Turkmenistan, Afghanistan, China, Iran, North Korea, and Saudi Arabia have few personal freedoms and civil liberties. The reemergence of powerful, single-party states worldwide reinforces totalitarianism: Russia suppresses individual freedoms through arbitrary governance; Venezuela restricts media that urge dissent; Iran corrupts its electoral process. Some see the political practices powering China's rise as endorsing authoritarianism.⁴³ Finally, leaders of such harshly governed countries increasingly display subtle finesse. Concludes Freedom House, "Our findings point to the growing sophistication of modern authoritarians. They are flexible; they distort and abuse the legal framework; they are adept at the techniques of modern propaganda."⁴⁴

Business Implications Managers in totalitarian systems face markets that are radically different from those in democracies. Private enterprise, if permitted, supports state control of economic activities. For instance, the Chinese government, under the direction of the CCP, owns and manages large swathes of the economy. The state is the majority owner of 99 of the 100 largest publicly listed Chinese companies, 39 of which are among the 500 biggest in the world.⁴⁵ Similarly, 129 huge conglomerates in finance, media, mining, metals, transportation, communication, and so on answer directly to the CCP. Likewise, China's provincial and municipal officials control thousands of medium-sized and smaller ones.⁴⁶ Add it all up and you have an authoritarian system that rejects many of the practices found in a democracy.

Managers operating in such markets adjust decision making to the intricacies of political activities. Bluntly put, the government's imperative is sustaining state power, and economics and markets are handy tools with which to do so. The situation affects all companies, but typically hits foreign investors hardest. The state favors local companies at the expense of foreign competitors, providing them with favorable financial assistance, special tax programs, relaxed work regulations, and other benefits.⁴⁷ The state's intent to value and allocate resources in manipulating market outcomes for political purposes creates complicated risks and rewards. For example, China requires foreign enterprises to tolerate, if not facilitate, setting up Communist Party cells in their local operations—indeed, some local governments require that private companies contribute a share of their payrolls to finance Party activities.⁴⁸ The cells are there to educate and supervise the companies to behave lawfully, fulfill their social responsibilities, promote harmonious labor relations, and maintain social stability.

In recourse, MNEs strike deals that would be unthinkable elsewhere. Consider General Electric's 50–50 joint venture with Aviation Industry, a Chinese military-jet maker, to produce avionics, the electronic brains of aircraft. The deal required GE to take the risky but potentially lucrative step of folding pieces of its global operations into partnerships with a state-owned enterprise. Such deals had earlier proved troublesome, souring over concerns that Chinese partners, after gaining access to Western technology and expertise, became potent new rivals.⁴⁹ Even so, seeing China as its "second home market," GE reasoned the cost of missing the fast-growing Chinese aviation industry exceeded the potential risks. As GE's vice chairperson noted, "Staying out of China in hopes of keeping our intellectual property safe is obviously not an option."⁵⁰

Freedom House identifies three types of political systems:

- Free.
- Partly free.
- Not free.

THE STANDARD OF FREEDOM

Freedom is a topic of enduring importance. Freedom House, an independent watchdog organization that promotes liberty worldwide, helps frame our interpretation. It stipulates, "Freedom is possible only in democratic political systems in which the governments are accountable to their own people; the rule of law prevails; and freedoms of expression,

MAP 3.2 Map of Freedom, 2013

Freedom House, classifying countries in terms of their degree of political freedom, identifies three types—Free, Partly Free, and Not Free. If you live in a country classified as “free,” you enjoy a broad range of political rights and civil liberties. If you are a citizen of a “partly free” nation, your share of rights and liberties ranges anywhere from average to just below average. If your homeland is “not free,” you enjoy few rights and liberties.

Source: Freedom House, “Map of Freedom 2013,” at www.freedomhouse.org.



association, and belief, as well as respect for the rights of minorities and women, are guaranteed.”⁵¹ Since 1972, Freedom House has annually assessed the state of political freedom around the world,⁵² applying measures derived from the Universal Declaration of Human Rights.⁵³ It identifies three types of systems:

- A “free” country exhibits open political competition, respect for civil liberties, independent civic life, and independent media. There are inalienable freedoms of expression, assembly, association, education, and religion. Examples include Australia, Brazil, India, and the United States.
- A “partly free” country exhibits limited political rights and civil liberties, corruption, weak rule of law, ethnic and religious strife, unfair elections, and censorship. Often, democracy is a convenient slogan for the single party that dominates within a façade of regulated pluralism. Examples include Guatemala, Pakistan, and Tanzania.
- A “not free” country has few to no political rights and civil liberties. The government allows minimal to no exercise of personal choice, relies on the rule of man as the basis of law, constrains religious and social freedoms, and controls a large share, if not all, of business activity. Examples include China, Russia, Saudi Arabia, Iran, and Vietnam.

Map 3.2 shows the distribution of freedom worldwide. In 2013, 90 countries were free (46 percent of all countries), 58 partly free (30 percent), and 47 not free (24 percent). Regarding population, approximately 3 billion people (43 percent of the global population) live in a free country, 1.6 billion (22 percent) partly free, and 2.5 billion (35 percent) not free.

TRENDS IN POLITICAL IDEOLOGIES

The second half of the twentieth century saw the steady diffusion of democracy. Between 1950 and 2009, the number of democratic political systems grew from 22 out of 154 countries (14 percent) to 90 out of 193 countries (47 percent). The number of nations that made

The Third Wave of Democratization refers to the third surge of democratically governed states in the 20th century. Ultimately, as this wave crested, the number of countries led by a democratic government significantly increased.

CONCEPT CHECK

In profiling "The Forces Driving Globalization" in Chapter 1, we noted the power of changing political situations. Until recently, we have witnessed the diffusion of democracy and the corresponding decline in totalitarianism. Growing acceptance of the legitimacy of democracy accelerated the expansion of international business.

Various forces powered past the Third Wave of Democratization:

- Failure of totalitarian regimes to deliver prosperity
- Improving communication technology
- Economic dividends of political freedom

CONCEPT CHECK

Chapter 1 identifies the "Expansion of Technology" as a driving force of globalization. Advances in telecommunications liberated the flow of information, thereby challenging and changing political attitudes in many countries.

the transition, particularly during the 1970s and 1980s, gave rise to the political phenomenon referred to as the **Third Wave of Democratization**.⁵⁴ During this period, more than 30 countries throughout Africa, Asia, Latin America, South America, and Eastern Europe abandoned totalitarianism for democracy. The quest for individual freedoms and civil liberties transformed the world. Societies began building fairer civic institutions, independent media, objective judiciaries, and stronger property rights.⁵⁵ As a result, today nearly half the world's population lives in a democracy of some sort. Put differently, today more people live in countries with democratic governments than at any time in history.

In doubling the number of democracies in two decades, the Third Wave of Democratization helped topple the Berlin Wall in 1989, demolish the Communist Bloc, and end the Cold War. Some saw the worldwide democracy surge symbolizing the "end of history." Specifically, the universalization of Western liberal democracy, reinforced by the market fundamentalism of capitalism, represented the endpoint of humanity's ideological evolution and the final stage of human government.⁵⁶

ENGINES OF DEMOCRACY

The reluctance of totalitarian structures to fade gracefully requires powerful change agents. Beginning in the mid-1970s, a confluence of events began building several engines that powered the Third Wave of Democratization. Notably:

Regime Legitimacy The failure of totalitarian regimes to deliver economic progress undermined their legitimacy. Aggrieved citizens, weary of long-declining standards of life, contested the right of officials to govern. The fall of the Berlin Wall punctuated this epic change. Formerly communist countries shifted from collectivism to individualism, thereby spurring citizens to demand greater political freedom and civil liberty.

Communication Innovations Improved communications eroded totalitarian states' control of information. Technologies integrated disenfranchised people into the global village. Once it took weeks, if ever, for word-of-mouth of protests to spread; now, improving connections circulated news within hours.⁵⁷ Images of resistance and rebellion had snowball effects on pro-democracy campaigns worldwide. On a micro scale, we see similar effects linking protests in Chinese factories. Specifically, labor unrest has become more commonplace in China, as factories operating in highly competitive markets press their workers to improve productivity. Workers linked via mobile phones and the Internet, increasingly aware of their rights and common cause, increasingly challenge perceived injustices.⁵⁸

Freedom's Consequences Freedom yielded economic dividends.⁵⁹ The median per capita gross domestic product, a measure of the standard of living, increased nearly sevenfold for free countries compared to not free countries. Growing wealth positively influences property rights, the rule of law, education opportunities, gender equality, media vigilance, and social tolerance.⁶⁰ Prosperity promoted the expansion of the middle class, whose burgeoning access to the uncensored news Thomas Jefferson's belief that "Information is the currency of democracy." Perhaps most critically, rising prosperity supported the political stability and faith in the future that anchors the democratic ideology.⁶¹

The multi-decade march toward greater political freedoms and expansive civil liberties fueled a belief in the inevitability of democracy—again, the so-called "end of history" scenario. For MNEs, this trend stabilized business environments, both at home and abroad. Growing stability encouraged them to expand their investment horizon to include markets that had previously been off-limits (notably, China, Russia, and Central and Eastern Europe). As a result, industries developed, middle classes emerged, globalization accelerated, and freedom flourished.

Thomas Jefferson reasoned, "Information is the currency of democracy." If so, then this satellite dish-covered exterior, atop a Kabul apartment's facade, plays a crucial role fortifying its performance.

Source: kzww/Shutterstock



Over the past seven years, long-running gains in political freedom have given way to wide-spread declines.

Several indicators show slowing adoption of democracy throughout the world.

The *Economist Intelligence Unit* identifies four types of political systems:

- Full democracy
- Flawed democracy
- Hybrid regime
- Authoritarian regime

DEMOCRACY: RECESSION AND RETREAT

Democracy retains appeal worldwide—preferred by people in most countries, its allure energized by growing wealth and education, its legitimacy worldwide solidified by an expanding middle class.⁶² Troubling data, however, question its momentum. Managers increasingly qualify their interpretation of political environments with the possibility that “history,” rather than ending, is just beginning.

A few years ago, longitudinal data on the slowing momentum of democracy indicated a “democracy recession.” Now, data indicate that democracy is in retreat worldwide. In 1989, 41 percent of nations had an electoral democracy; in 1999, it was 63 percent; in 2012, down to 60 percent.⁶³ Figure 3.3 indicates an ominous shift over the past few years. Gains in freedom have given way to declines in freedom. Sham elections, police crackdowns, kangaroo courts, and persecution of dissidents gain traction. All speak to the stance taken by President Lukashenka of Belarus, who declared on the heels of a rigged election victory, “there will be no more mindless democracy in this country.”⁶⁴ Worldwide, increasingly influential totalitarian regimes impose “forceful measures designed to suppress democratic reformers, international assistance to those reformers, and ultimately the very idea of democracy itself.”⁶⁵ As a result, 2013 marked the seventh consecutive year in which political freedom declined worldwide—the longest consecutive period of setbacks in nearly 40 years.⁶⁶

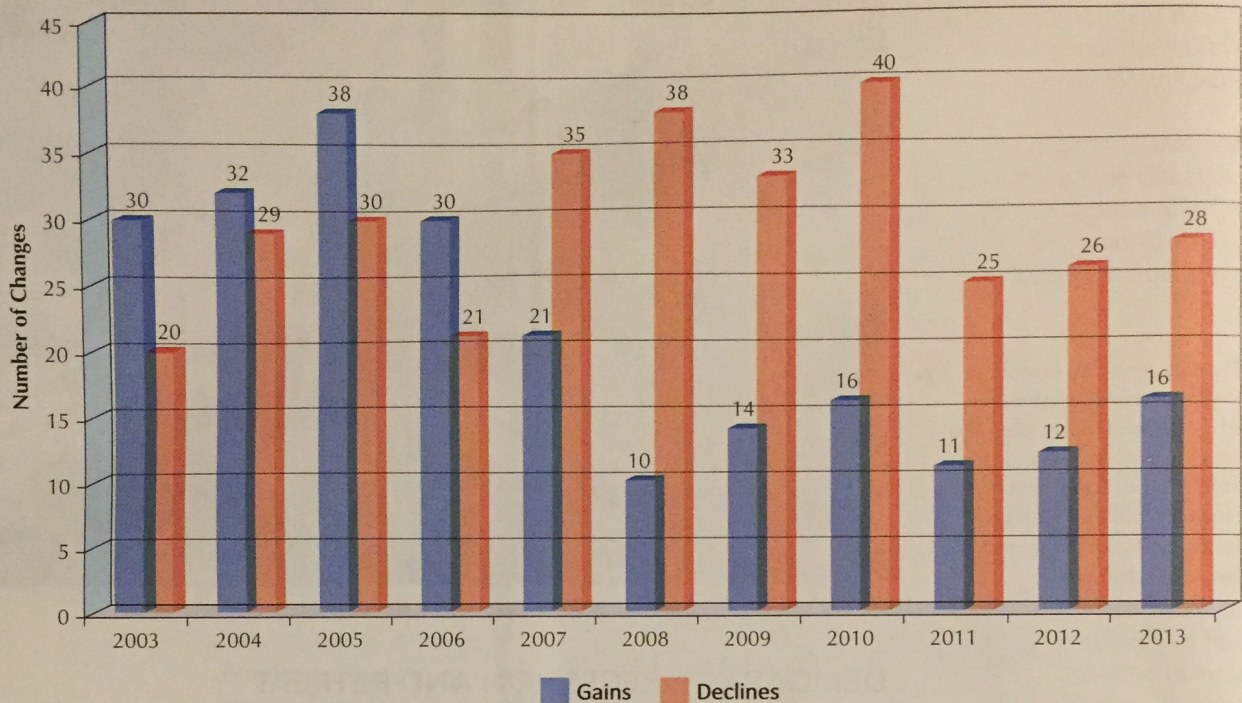
The State of Political Affairs The *Economist Intelligence Unit* (EIU) applies a broad measure to assess a nation’s “texture of democracy.” It notes that democracy, narrowly defined, is easily achieved—indeed, if merely holding elections were sufficient, virtually every country would qualify as a democracy. Rather, an effective democracy depends upon free and fair elections as well as supportive institutions and public attitudes that protect freedom. Assessing the “texture of democracy,” therefore, involves 60 indicators of a country’s electoral process and pluralism, civil liberties, government functioning, political participation, and political culture.⁶⁷ Countries are rated as either as a full democracy, flawed democracy, hybrid regime, or authoritarian regime.

The EIU evaluates democracy in 167 countries that, combined, are home to virtually the entire population of the world.⁶⁸ Analysis finds many are “democracies” in name only; just

FIGURE 3.3 Freedom in the World: Gains and Declines by Country, 2003–2013

The past decade shows a disturbing trend in the momentum of political freedom worldwide. Early on, gains in freedom exceeded declines. The past seven years have seen the opposite, with growing state authority reducing individuals' political freedom.

Source: Based on Freedom House, "Freedom in the World 2013: Democratic Breakthroughs in the Balance," www.freedomhouse.org.



25 are full democracies, while 53 are "flawed democracies." Nineteen of the full democracies are found primarily in the West, with the remainder scattered in Latin America, Eastern Europe, and Africa. Flawed democracies predominate in Latin America and Eastern Europe. The fragility of institutional structures, political participation, and democratic cultures within many of these countries has led to significant backsliding. Likewise, corruption, violence, and drug trafficking encourage authoritarianism.

Of the remaining 89 countries, the EIU rates 36 as "hybrid regimes" that mix democratic and authoritarian practices. Procedural irregularities often corrupt free and fair processes. Hong Kong, for example, exemplifies a hybrid regime that manifests many trappings of a democracy, including an effective judiciary, civil liberties, independent media, and political parties. Still, authoritarian tendencies are evident. Consider its electoral process. Its Chief Executive (effectively its President) is chosen not by Hong Kong's 7 million residents but by a 1,200-person "Election Committee." The sense of a rigged system of political freedom without democratic accountability radicalizes its politics.⁶⁹

Finally, 55 countries are judged authoritarian regimes. In many cases, they showcase institutions of democracy that are merely Potemkin designs. Day-to-day life displays the telltale marks of totalitarianism, including unfair elections, disregard of civil liberties, state-owned media, omnipresent state security, pervasive censorship, and a corrupt judiciary.

An Important Qualification Qualifying these results by demography adds some useful perspective. Like Freedom House, the EIU reports that about half of the world's population lives within some sort of democratic system. However, it notes that just 11 percent reside in countries with a functioning "full democracy." Furthermore, some 37 percent live in flawed democracies, 14 percent in hybrid regimes, and 38 percent in authoritarian regimes.⁷⁰ Westerners may presume that democracy prevails throughout the world, but presently only about one of every nine people lives in one.

AUTHORITARIANISM'S SURGE

In 1991, citizens in the former Soviet bloc countries celebrated the move from a single-party state to a multiparty political system. By 2009, support had fallen drastically, especially in poorer countries such as Ukraine, Hungary, and Lithuania.⁷¹ By 2012, belief in democracy continued deteriorating in the wake of the global financial crisis as most countries in the region saw declining democracy scores.⁷² Established democracies struggle as well. In the United States, the terrorist attacks of September 11, 2001, reset the standards of personal freedom, resulting in restrictions that raised questions about the moral authority of democratic ideals. Europe, meanwhile, struggles to preserve political freedom in the face of harsh austerity policies and the replacement of sovereign democratic processes with financial dictates from leaders of the EU and the European Central Bank.⁷³ Persistent economic struggles challenge the belief, strongly held since the fall of the Berlin Wall, that "freedom works."

Collectively, trends throughout the world show growing confidence in the authoritarian alternative, with countries growing skeptical of the virtues of a multiparty democracy and showing increasing interest in building single-party political systems. The EIU notes:

Authoritarian trends have become even more entrenched in the Middle East and much of the former Soviet Union. Democratization in Sub-Saharan Africa is grinding to a halt, and in some cases is being reversed. A political malaise in east-central Europe has led to disappointment and questioning of the strength of the region's democratic transition. Media freedoms are being eroded across Latin America and populist forces with dubious democratic credentials have come to the fore in a few countries in the region. In the developed West, a precipitous decline in political participation, weaknesses in the functioning of government, and security-related curbs on civil liberties are having a corrosive effect on some long-established democracies.⁷⁴

Powering the resurgence of totalitarianism are

- Strong states supporting strong performance
- Gaps in the principles and practices of democracy
- Economic insecurity following slowing growth
- Escalating debate of the meaning of democracy

Engines of Authoritarianism Several engines powered the Third Wave of Democratization. Likewise, the following forces promote totalitarianism today:

Political Economy of Growth Rising uncertainty questions the relationship between the level of economic development and democracy. The classic modernization hypothesis—that economic development is a pre-condition of democracy—is no longer universally accepted.⁷⁵ Consider China. Its economic performance since 1980 endorses its authoritarian, one-party system as an alternative to liberal, multiparty democracies. Concurrently, its model of a "people's democratic dictatorship" has steadily gained credibility worldwide.⁷⁶ For many poverty-stricken countries, patience with the not-yet-realized dividends of the "democracy advantage" thesis has worn thin. Some point to India, noting that its more than 60 years of nearly uninterrupted democratic governance rule has failed to improve health, education, or wealth for a majority of Indians.⁷⁷

Rhetoric Versus Reality Democracy setbacks in Italy, France, UK, Spain, and the US give pause to some 70 strategically significant countries at the political crossroads. If democracy can't work there, how could it work here, they wonder.⁷⁸ Charges of hypocrisy against Western countries (owing to incursions in Iraq, Libya, and Afghanistan, along with the implications of antiterrorist activities for political freedoms and civil liberties) jumble democratic ideals. Double standards in foreign policy (i.e., some autocratic countries can be friends, such as Saudi Arabia, whereas others are foes, like Venezuela) corrode the credibility of democracy promoters.⁷⁹ Consequently, fewer than one in five West Europeans trust political parties, while only one in three regards governments and parliaments as trustworthy.⁸⁰

Economic Problems The global financial crisis has complicated matters. High unemployment, slow growth, and rising debt, by threatening the middle class, has weakened belief in the effectiveness of democracy. Confidence in institutions has declined throughout the West. The International Labour Organization reports wavering belief that political policies in

democratic states lead to a fairer and better future.⁸¹ History shows that right-wing totalitarian movements generally draw popular support from the middle class seeking to preserve the status quo. Those who fall into poverty are politically hazardous. In the United States, for example, the worse the economy, the more people describe themselves as "right-wing."⁸² On the other hand, left-wing totalitarianism often develops from working class movements seeking to overthrow wealthy oppressors—think of the tension between the proletariat and bourgeois in Marxism. Unless reversed, unemployment, debt, and anxiety erode confidence that democracy works.⁸³

Who Defines Democracy? The legitimacy of Western notions of democracy travels poorly to societies with different ideals and institutions. Hu Jintao, former CCP chief and China's president, speaks of "democracy" with a different meaning from the one understood by Westerners. In his view, calls for multiparty democracy are taboo, opposition cannot officially organize, reform must obey the "correct political orientation," and "orderly" change must respect and preserve the authority of the CCP.⁸⁴ Similarly, Prime Minister Vladimir Putin, proclaiming himself "a true democrat," argues the West misinterprets the virtues of authoritarianism. He charges "some of the participants in the international dialogue believe that their ideas [of democracy] are the ultimate truth."⁸⁵ Western-style democracy, rather than promoting individual rights and civil liberties, is an ideological ruse that disguises vast inequalities. Likewise, Brazil's former President da Silva says that the primary advocates of Western-style democracy no longer speak for the world, having lost the moral authority to dictate solutions to developing countries.⁸⁶

The engines of totalitarianism, considered in the context of democracy's retreat, raise the question: Has democracy run its course? If so, as we consider in our "Looking to the Future" box, what then might become of political ideologies and how might MNEs respond?

Looking to the Future

Political Ideology and MNEs' Actions

Like you, managers wonder what a political map of the world might look like in the next decade. Will democracy spread? Will totalitarianism gain more ground? Will new ideologies arise? It is tempting to regard these questions as academic straw men, best left to the folks in ivory towers. The latest data indicate they are anything but. As faltering political freedom and resurgent authoritarianism accelerate democracy's retreat, countries reset marketplaces and MNEs adjust strategies. Trends highlight the contemporary political ideologies competing for supremacy—namely, the Washington Consensus, the Beijing Consensus, and the Clash of Civilizations. What, pray tell, might these mean to managers?

The Washington Consensus

Named after the close of the Cold War for the free-market, pro-trade, and pro-globalization policies promoted by the United States, the Washington Consensus advocates democracy, political freedom, rule of law, and human rights.⁸⁷ As Washington became

the global philosophical center in an America-dominated unipolar world, its idealized Consensus—promoted by executives, politicians, generals, journalists, and institutions—called upon countries to reform in ways that reflected the political economy of the United States. Powering this call was a set of interrelated beliefs: right-minded reform led to economic growth, which created a middle class that supported property rights, which in turn began institutionalizing the rule of law. Making those choices and implementing the necessary policies would institute, support, and sustain a legitimate democracy.

Successfully navigating this sequence, reasoned the United States, would build nations that steadfastly championed prosperity and peace. A world of nations practicing US-style pro-peace democracy arguably signified the endpoint of humanity's sociocultural evolution.⁸⁸ Ironically, promoting and protecting the Washington Consensus requires a powerful military; combined defense-related spending of more than \$1.1 trillion in the U.S. exceeds that of all other countries combined.⁸⁹

The Beijing Consensus

Alternatively, rather than the end of history, some say the growing appeal of the Beijing Consensus signals the next political era.⁹⁰ A euphemism for China's self-proclaimed "people's democratic dictatorship," this Consensus calls for a single-party system in which elected representatives, preapproved by the ruling party, oversee a nominal democratic system whose citizens, though granted the right to vote, cannot participate in decision making.⁹¹ Elections, while free, are not fair. The CCP aspires to rule by consent, preferring benevolent persuasion to the iron fist. Still, it swiftly suppresses those who challenge its authority. Spontaneity in a single-party system, no matter how apolitical, symbolizes protest. As CCP officials explain, "Stability trumps everything."⁹²

Unlike the ideologically interventionist Washington Consensus, the Beijing Consensus is ideologically agnostic. It prizes economic development and international trade as the means to generate growth, create wealth, and build a harmonious society. It uses fast-growing prosperity to subvert political choice, reasoning that people value higher wages, social stability, and economic security far more than political freedom. The Beijing Consensus does not pass judgment on another country's politics; in turn, it expects not to be judged. It advocates trade "with no strings attached" (which, in the case of the Washington Consensus, are democracy, freedom, human rights, and the rule of law). To this end, China invests throughout Asia, Africa, the Middle East, and South America free of demands for political reform.⁹³

China's policy of harmonious stability within a single-party state has gained credibility worldwide, particularly given its strong performance in the wake of the global financial crisis. Said one analyst, "[T]he 'China model' of authoritarian capitalism is gaining currency. Governments from Syria to Vietnam have sung its praises."⁹⁴ Some argue that state control that weds liberal economics with single-party authoritarian politics, rather than the union of liberal economics and multiparty democracy, now represents the superior political path to prosperity and harmony.

The Clash of Civilizations

Spreading democracy in the Arab world, which is regularly rated the world's least free region, has been a long-running goal of the West. Indeed, an aim of the Iraq War was to build the luminous "city upon a hill"

that would inspire peaceful democracy in the region. Efforts there, as well as pro-democracy movements in Tunisia, Egypt, Afghanistan, Libya, and elsewhere, have had limited success. Moreover, Western military involvement has raised questions about the legitimacy of democratic ideals throughout the region. Faltering institutions and changes in political sentiments hinder the transition to democracy in several Islamic nations, including Kuwait, Iran, Saudi Arabia, and the Palestinian areas.

Regional instability highlights the difficulty of promoting democratic political cultures, to say nothing of a functioning democracy. The discontent of the economically and politically disadvantaged, particularly among youth suffering extreme unemployment, mobilized the massive pro-democracy protests of the so-called Arab Spring. Although initially promising, study of the determinants and consequences of democratic transitions advise caution; violent uprisings struggle to institutionalize durable democratic change. Moreover, weak property rights and civil liberties continue constraining change, thereby thwarting democratic progress.⁹⁵

Productive economies in the oil-rich Persian Gulf also stall the spread of democracy; it no longer appears that democracy is a necessary condition for prosperity. Furthermore, oil-based revenue entrenches an autocracy by removing the need to levy taxes and thereby reducing state accountability. Consequently, moderate Arab leaders contend that the transition from totalitarianism to democracy is, at best, "a slow process." Hardliners, meanwhile, vilify democracy.⁹⁶

The reluctance of Islamic states to adopt democracy animates the "clash-of-civilizations" scenario. Irreconcilable cultural and religious differences between Islam and the West, goes this reasoning, will trigger a backlash against Western political ideals and their crystallization in the ideologically interventionist Washington Consensus.⁹⁷ Some speculate that an epic clash between oppositional civilizations will usher in a new political ideology based on cultural and religious ideals.

What's Next, Managers Ask?

Democracy's ongoing retreat questions long-cherished ideals. Managers study the direction that political ideologies might track. Will liberal democracy *à la* the Washington Consensus regain the commanding heights? Ongoing developments worldwide, led by an expanding middle class and supported by social networking channels, support that forecast.⁹⁸ Or will

the one-party trademark of the Beijing Consensus set political standards? China's growing involvement in receptive countries worldwide supports that projection. To that end, when recently asked, "How satisfied are you with the country's direction?" 83 percent of Chinese reported satisfaction versus 31 percent in the United States, 19 percent in France, 15 percent in Britain, and 7 percent in Japan.⁹⁹ Finally, if countries bypass the American Way or the Chinese Path, might a clash of civilizations give rise to new ideas of political freedom?¹⁰⁰ Ongoing tensions in hotspots worldwide do not bode well.

Whatever the scenario, history reminds us that it matters. The first and second waves of democratization (1828–1926 and 1943–1962, respectively) were followed by periods of freedom backlash, democracy retreat, and backslides into authoritarianism. The end of the second wave saw more than 20 countries revert from totalitarianism, symbolized by the ensuing

ideological war between Washington and Moscow. Hence, the question arises: Are we once again facing a cycle of transition and consolidation?¹⁰¹

Whatever the answer, only the ill-advised underestimate political change. If the Washington Consensus proves resilient, managers must adjust operations to the growing pains of countries that champion freedom, advocate human rights, and adopt the rule of law. Prosperity may come with difficulty, but there will be prosperity for many. If the Beijing Consensus predominates, managers must rethink business in a world that uses state controls to generate economic growth at the price of freedom. Prosperity may come easily, but its price will include individual freedoms. If ideologies transform as civilizations clash, the resulting social and religious orders will reset systems. Prosperity may prove a wild card as oppositional ideologies battle for the commanding heights. ■

Political risk refers to the threat that decisions or events in a country will negatively affect the profitability and sustainability of an investment.

POLITICAL RISK

Politics is always and everywhere dynamic. At different times, different parties champion different ideologies that endorse different political systems, with unpredictability ensuing. Consequently, investing and operating internationally exposes MNEs to risks that arise from a country's political system. This class of risk, referred to as **political risk**, is the potential loss arising from a change in government policy. More precisely, it is the risk that political decisions, events, or conditions will affect a country's business environment in ways that force investors to accept lower rates of return, cost them some or all of the value of their investment, or threaten the sustainability of their operation. Figure 3.5 identifies leading causes of political risk.

Two trends increase political risk worldwide. First, many fast-growing emerging markets are rife with flashpoints. Arbitrary legal systems, fragile institutions, volatile societies, and corrupt regimes fan instability. Many firms in these countries are state-run, pursuing political goals that complicate economic situations. Aggravating matters is the fact that political risks differ from market to market. In Venezuela, managers face economic nationalism; in Brazil, a manager needs to understand Congress's multi-party alliances; in China, the task is interpreting the power and play of the CCP; in Saudi Arabia, a manager must make sense of the internal relations of the ruling family. Hence, operating in these markets is quite different from the comparatively more predictable politics in Western democracies. Analytics that work in one country often travel poorly to others.

Second, the aftermath of the financial crisis aggravates political risk in both developed and developing markets. When the Berlin Wall collapsed, globalization steadily standardized the inconsistencies of politics across markets. Certainly, countries evolved at different rates. However, as many developed in the broad context of the Washington Consensus, managers could reasonably assume that the principles of Western-style political economy, not local quirks, would shape national affairs. The global credit crisis reset the equation. Now, local politics influence the performance of global markets and the actions of MNEs on a scale not seen in decades. If the crisis continues testing people's faith in democracy, companies face growing public challenge and political constraint.

CONCEPT CHECK

Chapter 1 notes that some interest groups fear that globalization fatally weakens national sovereignty—that is, growing external control restricts a nation's right to act in its own interests. Here, we observe that this attitude often intensifies political risk. Foreign investors face higher risks when a host government becomes increasingly sensitive to threats to its sovereignty.

