**National Differences in Political, Economic, and Legal Systems**

International business is much more complicated than domestic business because countries differ in many ways. Countries have different political, economic, and legal systems.

Cultural practices can vary dramatically, as can the education and skill levels of the population. All these differences can and do have major implications for the practice of international business.

The main function of this chapter and the next two is to develop an awareness of and appreciation for the significance of country differences in political systems, economic systems, legal systems, economic development, and societal culture. Another function of the three chapters is to describe how the political, economic, legal, and cultural systems of many of the world’s nation-states are evolving and to draw out the implications of these changes for the practice of international business. This chapter focuses on how the political, economic, and legal systems of countries differ. Collectively, we refer to these systems as constituting the political economy of a country. We use the term political economy to stress that the political, economic, and legal systems of a country are interdependent; they interact with and influence each other, and in doing so, they affect the level of economic well-being.

**Political Systems**

The political system of a country shapes its economic and legal systems.1 As such, we need to understand the nature of different political systems before discussing economic and legal systems. By political system, we mean the system of government in a nation. Political systems can be assessed according to two dimensions. The first is the degree to which they emphasize collectivism as opposed to individualism. The second is the degree to which they are democratic or totalitarian. These dimensions are interrelated; systems that emphasize collectivism tend to lean toward totalitarianism, whereas those that place a high value on individualism tend to be democratic.

COLLECTIVISM AND INDIVIDUALISM

**Collectivism**

refers to a political system that stresses the primacy of collective goals over individual goals.2 When collectivism is emphasized, the needs of society as a whole are generally viewed as being more important than individual freedoms. In such circumstances, an individual’s right to do something may be restricted on the grounds that it runs counter to “the good of society” or to “the common good.” Advocacy of collectivism can be traced to the ancient Greek philosopher Plato (427–347 b.c.), who, in The Republic

**Socialism**

Modern socialists trace their intellectual roots to Karl Marx (1818–1883), although socialist thought clearly predates Marx (elements of it can be traced to Plato). Marx argued that the few benefit at the expense of the many in a capitalist society where individual freedoms are not restricted. While successful capitalists accumulate considerable wealth, Marx postulated that the wages earned by the majority of workers in a capitalist society would be forced down to subsistence levels.

In the early twentieth century, the socialist ideology split into two broad camps. The **communists** believed that socialism could be achieved only through violent revolution and totalitarian dictatorship, whereas the **social democrats** committed themselves to achieving socialism by democratic means, turning their backs on violent revolution and dictatorship. Both versions of socialism waxed and waned during the twentieth century.

**Individualism**

The opposite of collectivism, individualism refers to a philosophy that an individual should have freedom in his or her economic and political pursuits. In contrast to collectivism, individualism stresses that the interests of the individual should take precedence over the interests of the state.

Individualism was reborn as an influential political philosophy in the Protestant trading nations of England and the Netherlands during the sixteenth century.

Individualism is built on two central tenets. The first is an emphasis on the importance of guaranteeing individual freedom and self-expression. The second tenet of individualism is that the welfare of society is best served by letting people pursue their own economic self-interest, as opposed to some collective body (such as government) dictating what is in society’s best interest. Or, as Adam Smith put it in a famous passage from The Wealth of Nations, “an individual who intends his own gain is led by an invisible hand to promote an end that was no part of his intention. Nor is it always worse for the society that it was no part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it. This author has never known much good done by those who effect to trade for the public good.”4

**DEMOCRACY AND TOTALITARIANISM**

Democracy and totalitarianism are at different ends of a political dimension. **Democracy** refers to a political system in which government is by the people, exercised either directly or through elected representatives**. Totalitarianism** is a form of government in which one person or political party exercises absolute control over all spheres of human life and prohibits opposing political parties.

Democracy The pure form of democracy, as originally practiced by several city-states in ancient Greece, is based on a belief that citizens should be directly involved in decision making. In complex, advanced societies with populations in the tens or hundreds of millions, this is impractical. Most modern democratic states practice **representative democracy**.

To guarantee that elected representatives can be held accountable for their actions by the electorate, an **ideal representative democracy** has a number of **safeguards that are typically enshrined in constitutional law**. These include (1) an individual’s right to freedom of expression, opinion, and organization; (2) a free media; (3) regular elections in which all eligible citizens are allowed to vote; (4) universal adult suffrage; (5) limited terms for elected representatives; (6) a fair court system that is independent from the political system; (7) a nonpolitical state bureaucracy; (8) a nonpolitical police force and armed service; and (9) relatively free access to state information.

**Totalitarianism**

In a totalitarian country, all the constitutional guarantees on which representative democracies are built—an individual’s right to freedom of expression and organization, a free media, and regular elections—are denied to the citizens. In most totalitarian states, political repression is widespread, free and fair elections are lacking, media are heavily censored, basic civil liberties are denied, and those who question the right of the rulers to rule find themselves imprisoned or worse. **Four major forms of totalitarianism** exist in the world today. Until recently, the most widespread was **communist totalitarianism**.

A second form of totalitarianism might be labeled **theocratic totalitarianism.** Theocratic totalitarianism is found in states where political power is monopolized by a party, group, or individual that governs according to religious principles.

A third form of totalitarianism might be referred to as **tribal totalitarianism**. Tribal totalitarianism has arisen from time to time in African countries such as Zimbabwe, Tanzania, Uganda, and Kenya.

A fourth major form of totalitarianism might be described as **right-wing totalitarianism**. Right-wing totalitarianism generally permits some individual economic freedom but restricts individual political freedom, frequently on the grounds that it would lead to the rise of communism.

**Pseudo-Democracies**

Many of the world’s nations are neither pure democracies nor iron-clad totalitarian states. Rather they lie between pure democracies and complete totalitarian systems of government. They might be described as imperfect or pseudo-democracies, where authoritarian elements have captured some or much of the machinery of state and use this in an attempt to deny basic political and civil liberties.

**Economic Systems**

**MARKET ECONOMY**

In the archetypal pure market economy, all productive activities are privately owned, as opposed to being owned by the state. The goods and services that a country produces are not planned by anyone. Production is determined by the interaction of supply and demand and signaled to producers through the price system.

**COMMAND ECONOMY**

In a pure command economy, the government plans the goods and services that a country produces, the quantity in which they are produced, and the prices at which they are sold. Consistent with the collectivist ideology, the objective of a command economy is for government to allocate resources for “the good of society.

**MIXED ECONOMY**

Mixed economies can be found between market and command economies. In a mixed economy, certain sectors of the economy are left to private ownership and free market mechanisms, while other sectors have significant state ownership and government planning. Mixed economies were once common throughout much of the developed world, although they are becoming less so.

**Legal Systems**

**The legal system** of a country refers to the rules, or laws, that regulate behavior along with the processes by which the laws are enforced and through which redress for grievances is obtained.

The legal system of a country is of immense importance to international business. A country’s laws regulate business practice, define the manner in which business transactions are to be executed, and set down the rights and obligations of those involved in business transactions. The legal environments of countries differ in significant ways. As we shall see, differences in legal systems can affect the attractiveness of a country as an investment site or market.

Here, we focus on several issues that illustrate how legal systems can vary—and how such variations can affect international business.

First, we look at some basic differences in legal systems.

Next we look at contract law.

Third, we look at the laws governing property rights with particular reference to patents, copyrights, and trademarks.

Then we discuss protection of intellectual property.

Finally, we look at laws covering product safety and product liability.

**DIFFERENT LEGAL SYSTEMS**

There are three main types of legal systems—or legal traditions—in use around the world: common law, civil law, and theocratic law.

**Common Law**

The common law system evolved in England over hundreds of years. It is now found in most of Great Britain’s former colonies, including the United States. Common law is based on tradition, precedent, and custom. **Tradition** refers to a country’s legal history**, precedent** to cases that have come before the courts in the past, and **custom** to the ways in which laws are applied in specific situations.

**Civil Law**

A civil law system is based on a detailed set of laws organized into codes. When law courts interpret civil law, they do so with regard to these codes. More than 80 countries— including Germany, France, Japan, and Russia—operate with a civil law system. A civil law system tends to be less adversarial than a common law system because the judges rely on detailed legal codes rather than interpreting tradition, precedent, and custom.

**Theocratic Law**

A theocratic law system is one in which the law is based on religious teachings. Islamic law is the most widely practiced theocratic legal system in the modern world, although usage of both Hindu and Jewish law persisted into the twentieth century.

**DIFFERENCES IN CONTRACT LAW**

The difference between common law and civil law systems can be illustrated by the approach of each to contract law (remember, most theocratic legal systems also have elements of common or civil law). A contract is a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved. Some form of contract regulates many business transactions. **Contract law is the body of law that governs contract enforcement.** The parties to an agreement normally resort to contract law when one party feels the other has violated either the letter or the spirit of an agreement. Because common law tends to be relatively ill specified, contracts drafted under a common law framework tend to be very detailed with all contingencies spelled out. In civil law systems, however, contracts tend to be much shorter and less specific because many of the issues are already covered in a civil code. Thus, it is more expensive to draw up contracts in a common law jurisdiction, and resolving contract disputes can be very adversarial in common law systems. But common law systems have the advantage of greater flexibility and allow judges to interpret a contract dispute in light of the prevailing situation.

When contract disputes arise in international trade, there is always the question of which country’s laws to apply. To resolve this issue, a number of countries, including the United States, have ratified the **United Nations Convention on Contracts for the International Sale of Goods (CISG)**. The CISG establishes a uniform set of rules governing certain aspects of the making and performance of everyday commercial contracts between sellers and buyers who have their places of business in different nations.

**PROPERTY RIGHTS AND CORRUPTION**

In a legal sense, the term property refers to a resource over which an individual or business holds a legal title, that is, a resource that it owns. Resources include land, buildings, equipment, capital, mineral rights, businesses, and intellectual property (ideas, which are protected by patents, copyrights, and trademarks). Property rights refer to the legal rights over the use to which a resource is put and over the use made of any income that may be derived from that resource.12 Countries differ in the extent to which their legal systems define and protect property rights. Almost all countries now have laws on their books that protect property rights.

**Private Action**

In terms of violating property rights, private action refers to theft, piracy, blackmail, and the like by private individuals or groups. Although theft occurs in all countries, a weak legal system allows a much higher level of criminal action.

**Public Action and Corruption**

Public action to violate property rights occurs when public officials, such as politicians and government bureaucrats, extort income, resources, or the property itself from property holders.

**FIGURE 2.1** Rankings of corruption by country, 2016. Source: Constructed by the author from raw data from Transparency International, Corruption Perceptions Index 2016.

**THE PROTECTION OF INTELLECTUAL PROPERTY**

Intellectual property refers to property that is the product of intellectual activity, such as computer software, a screenplay, a music score, or the chemical formula for a new drug. Patents, copyrights, and trademarks establish ownership rights over intellectual property. A patent grants the inventor of a new product or process exclusive rights for a defined period to the manufacture, use, or sale of that invention. Copyrights are the exclusive legal rights of authors, composers, playwrights, artists, and publishers to publish and disperse their work as they see fit. Trademarks are designs and names, officially registered, by which merchants or manufacturers designate and differentiate their products (e.g., Christian Dior clothes).

The protection of intellectual property rights differs greatly from country to country. Although many countries have stringent intellectual property regulations on their books, the enforcement of these regulations has often been lax. This has been the case even among many of the 185 countries that are now members of the World Intellectual Property Organization, all of which have signed international treaties designed to protect intellectual property, including the oldest such treaty, the Paris Convention for the Protection of Industrial Property, which dates to 1883 and has been signed by more than 170 nations.

**PRODUCT SAFETY AND PRODUCT LIABILITY**

Product safety laws set certain safety standards to which a product must adhere. Product liability involves holding a firm and its officers responsible when a product causes injury, death, or damage. Product liability can be much greater if a product does not conform to required safety standards. Both civil and criminal product liability laws exist. Civil laws call for payment and monetary damages. Criminal liability laws result in fines or imprisonment. Both civil and criminal liability laws are probably more extensive in the United States than in any other country, although many other Western nations also have comprehensive liability laws.