



Research Task

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Political Economy and Economic Development

Use the globalEDGE™ site to complete the following exercises:

Exercise 1

Increased instability in the global marketplace can introduce risks in a company's daily transactions which can be unanticipated. As such, your company must evaluate these *commercial transaction* risks for its foreign operations in Argentina, China, the Czech Republic, India, Indonesia, and the United Arab Emirates. A risk analyst at your firm indicated that you could evaluate both the political and commercial risk of these countries simultaneously. Provide a commercial transaction risk overview of all six countries for top management. In your evaluation,

indicate possible corrective measures in the countries with considerably high political and/or commercial risk.

Exercise 2

Managers at your firm are very concerned about the influence of *terrorism* on its long-term strategy. To counter this issue, the CEO has indicated you must analyze the countries in which terrorism and political violence is minimal. As this will provide the basis for the development of future company facilities, a detailed analysis for these countries is required. Once completed, include recommendations which justify locating future operations to specific countries with little risk of terror activities.

CLOSING CASE

Japan's Economic Malaise

In 1989 Japan was widely viewed as an economic superpower. After three decades of robust economic growth it had risen to become the world's second-largest economy. Japanese companies seemed to be obliterating entire American industries, from automobiles and semiconductors to earthmoving equipment and consumer electronics. Japanese companies were buying assets in the United States, including movie studios (Universal Studios and Columbia Pictures), golf courses (Pebble Beach), and real estate (the Rockefeller Center in New York). The stock market was booming, the Nikkei index hitting an all-time high of 38,957 in December 1989, an increase of more than 600 percent since 1980. Property prices had risen so much that one square mile of Tokyo was said to be worth more than the entire United States. Books were written about the Japanese threat to American dominance. Management theorists praised Japanese companies for their strategic savvy and management excellence. Economists were predicting that Japan would overtake America to become the world's largest economy by 2010.

It didn't happen. In quick succession the stock market collapsed and property prices rapidly followed it down. Japanese banks, which had financed much of the boom in asset prices with easy money, now found their balance sheets loaded with bad debt, and they sharply contracted lending. As the stock market plunged and

property prices imploded, individuals saw their net worth shrink. Japanese consumers responded by sharply reducing spending, depressing domestic demand and sending the economy into a recession. And there it stayed—for most of the next two decades. Today the Japanese economy is barely larger in real terms than it was in 1989. In 2010, China passed Japan to become the world's second-largest economy. The average price of a home in Japan is the same as it was in 1983, way below the 1989 peak. The Nikkei stock market index stood at 9,600 in early 2011, 75 percent below its 1989 high. And worst of all, Japan has been gripped by deflation for the best part of two decades.

Deflation is a situation where prices are falling. When consumers and businesses expect prices to be lower tomorrow than they are today, they react by putting off spending, by hoarding cash, since that cash will buy more tomorrow than it will today. Such behavior can result in a negative cycle. Expectations that prices will fall can lead to reduced demand. Businesses respond by cutting prices further to try to get consumers to spend. Seeing this, consumers react by waiting to buy in expectation that prices will again fall in the future, and so demand continues to decline, which results in additional price cuts to try to stimulate demand, and so on. As businesses see their revenues and margins fall, they reduce employment and cut wages and salaries. This further

reduces spending power and adds to the deflationary cycle. To make matters worse, in a deflationary environment the real cost of debt goes up over time. While prices and wages fall, people still have to make fixed payments on their mortgages and car loans. Over time, this takes up an ever-greater proportion of their income, further limiting their ability to spend more on other goods and services.

All of this has happened in Japan over the past 20 years. For its part, after initially being slow to respond to falling asset prices, during the past 15 years the Japanese government has repeatedly tried to stimulate the economy and reignite consumer spending. Interest rates have been cut to zero and major investments have been made in public infrastructure. Not only has this not worked, but it has also left Japan with the highest level of government debt as a percentage of GDP in the world, amounting to some 200 percent of GDP (in contrast, the figure for the United States in 2011 was about 97 percent of GDP). The high debt load is now a limit on the ability of the Japanese government to adopt additional expansionary policies.

In seeking to explain Japan's prolonged malaise, many economists also point to demographic factors. In the 1970s and 1980s birthrates in Japan fell below replacement levels, leaving it with one of the oldest populations in the world. The working age population peaked at 87 million in 1995 and has been falling since. On

current trends, by 2030 it will be 67 million. Every year there are fewer and fewer working age people to support ever more retired people—and Japan's retired people are notorious for not spending. Japan could reverse this trend by increasing immigration or boosting the birthrate, but neither of these seems likely at the moment. Increasingly, young people are pessimistic about the future. All they have known is a world where prices for everything, including the price of labor, have fallen. They have diminished expectations.⁴¹

Case Discussion Questions

1. In the 1980s Japan was viewed as one of the world's most dynamic economies. Today it is viewed as one of its most stagnant. Why has the Japanese economy stagnated?
2. What lessons does the history of Japan over the past 20 years hold for other nations? What can countries do to avoid the kind of deflationary spiral that has gripped Japan?
3. What do you think would be required to get the Japanese economy moving again?
4. What are the implications of Japan's economic stagnation for the benefits, costs, and risks of doing business in this nation?
5. As an international business, which economy would you rather invest in, that of Japan or that of India? Explain your answer.

Notes

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2. World Bank, *World Development Indicators Online*, 2011.
3. P. Sinha and N. Singh, "The Economy's Black Hole," *The Times of India*, March 22, 2010.
4. A. Sen, *Development as Freedom* (New York: Alfred A. Knopf, 1999).
5. G. M. Grossman and E. Helpman, "Endogenous Innovation in the Theory of Growth," *Journal of Economic Perspectives* 8, no. 1 (1994), pp. 23–44; and P. M. Romer, "The Origins of Endogenous Growth," *Journal of Economic Perspectives* 8, no. 1 (1994), pp. 2–32.
6. W. W. Lewis, *The Power of Productivity* (Chicago: University of Chicago Press, 2004).
7. F. A. Hayek, *The Fatal Conceit: Errors of Socialism* (Chicago: University of Chicago Press, 1989).
8. James Gwartney, Robert Lawson, and Walter Block, *Economic Freedom of the World: 1975–1995* (London: Institute of Economic Affairs, 1996).
9. D. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1991). See also K. M. Murphy, A. Shleifer, and R. Vishney, "Why Is Rent Seeking So Costly to Growth?" *American Economic Review* 83, no. 2 (1993), pp. 409–14; and K. E. Maskus, "Intellectual Property Rights in the Global Economy," *Institute for International Economics*, 2000.
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11. "China's Next Revolution—Property Rights in China," *The Economist*, March 10, 2007, p. 11; "Caught between the Right and Left," *The Economist*, March 10, 2007, pp. 25–27; and Z. Keliang and L. Ping, "Rural Land Rights under the PRC Property Law," *China Law and Practice*, November 2007, pp. 10–15.
12. A. O. Hirschman, "The On-and-Off Again Connection between Political and Economic Progress," *American*