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# International Firms' Economic Nationalism and Trade Policies in the Globalization Era

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Harish C. Chandan and Bryan Christiansen



# International Firms' Economic Nationalism and Trade Policies in the Globalization Era

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*Maria A. Robson, Northeastern University, USA*

The purpose of this chapter is to illuminate the importance of the biases and motivating factors that have propelled economic nationalist movements across the globe. Too frequently scholars assume economic nationalism as a starting point to understand strategic choices. The authors argue that ethnic and racial biases, however, are an important antecedent to economic nationalism that transitively impact firm strategic processes such as internalization. Specifically, they suggest that ethnic and racial tensions that exist within and between governments and people add unique pressure structures to which firms respond. Through a case study of South Africa, the authors highlight the impact that these pressure structures have on firm-level strategic processes surrounding internalization.

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The chapter provides a conceptual framework for consideration for decision makers in firms from smaller developing economies during an era of increased economic nationalistic rhetoric in developed economies and shifting global trade patterns. Talking a longer term view, one might see this current level of political rhetoric as a continuation of the contest between globalization and free market ideology against viewpoints associated with mercantilism and other forms of economic nationalism. The impact of these trends on strategies of firms from developing economies within global value chains is explored. There are three basic strategic suggestions for firms from smaller developing countries which are interested in expanding internationally within the framework of operating within a global value chain.



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This chapter qualitatively examines cross-national managerial strategies employed at the Japanese automakers in the context of economic nationalism. It proposes and tests a simple yet versatile conceptual framework by developing existing models and integrating foundational concepts available in literature. Proposed as a tool for comparative analysis on management styles, the framework has two extreme ends of a continuum to capture not only variants of the social realities but also changes of businesses as it shifts between the extremes. The findings suggest that the force of economic nationalism likely affects the Japanese automakers' growth strategies, and the dynamics of managerial styles are company-specific under intensified globalization.

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Nationalism can manifest itself in different forms. It is not only closing the door to the other nations (autarchic policies). On the contrary, sometimes it exhibits as crazy expansion, combining autarchy and imperialism. Economic nationalism presents contradictions. Nowadays, in front of the experience of globalization, driven by the so-called "Washington consensus," we do witness new projects coming from the PRC. The Belt and Road Initiative (BRI), formerly known as One Belt One Road (OBOR), is the most important economic policy for China in the 21st century and represents at the same time a new idea of globalization, based on cooperation instead of a sharp competition. On the other hand, countries located in and around this area have their own views regarding this program, positive and negative. This chapter attempts to provide a deep understanding of the economic nationalism concern through the BRI program.

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International economic developments are driven by two conflicting trends: globalization and localization with rising protectionism in many global regions and nations. Russian economy seems to be well globalized and integrated into the world economy. But it is still composed mostly of mineral fuels, oils, distillation products (48%), commodities (15%) with the sign of economic nationalism and state capitalism in the growing degree of direct and indirect state participation in the economy, rising from 35% in 2005 to approximately 70% in 2015. During the last 15 years the model of state capitalism, combined with a significant level of world integration, supported economic growth, development, and even rising competitiveness of Russia. On the other hand, the Russian economy is slowing down and balances between stagnation and recession, and a significant share of state-owned economy in the long run can lead to slowing down the internal competition and innovation.

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This chapter examines the dynamic of the major actors in today's new space race. The initial space race featured nation-states as the primary actors. However, the current space race has undergone privatization and now features corporations as additional key players, along with developing nations. The result is the semi-private commoditization of a public good that crosses through different hemispheres, as well as competition between actors from both the firm and state level. Building on world systems theory and institutional theory, this chapter argues that the privatization of space exploration mandates the construction of inter-hemispheric institutional frameworks that apply globally. A descriptive case study that juxtaposes India and SpaceX offers foundational insight into how inter-hemispheric institutions are created. Given the challenging parity between state sovereignty and global consensus and its influence on firm behavior, this chapter proposes an exploratory examination of the processes and strategic choices behind inter-hemispherization to incite future scholarship.

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The failure of some African Union member-nations including Nigeria to endorse the African Continental Free Trade Agreement (AfCFTA) that would create one of the largest free trade areas in the world has provoked a lot of controversies that are yet to be resolved. While some of the relevant stakeholders in the countries that have refused to sign the treaty are urging the heads of their countries' governments to withhold assent until when all the contending issues regarding the AfCFTA are amicably settled, others desire to have the agreement signed in order to harness its benefits for the continent. As the controversies rage, it appears that the implementation of the much awaited agreement has been put on hold, thus thwarting the progress of the continent. This chapter therefore wades through the controversies and points the way ahead for the AfCFTA to be acceptable by all.

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*Jeffrey Kurebwa, Bindura University of Science Education, Zimbabwe*

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This chapter seeks to understand the EU-ACP trade relations under the economic partnership agreement (EPA) arrangement and its implications on economic nationalism of developing nations with specific reference to Zimbabwe. The research strongly leans on the view that EPAs have little or no economic benefit to the ACP. Even though the EU tagged the ensuing trade relationship with the ACP as partnership, in the real sense, it is more of paternalism. This is especially so as the EU dictates the terms and the pace of the negotiation, owns the incentives (in the form of aid and technical assistance), and either

dispenses or withdraws it at will, depending on the “behavior” of the ACP countries. In order to benefit from EPAs, ACP countries must fund their own economies. ACP states should also address internal political challenges before committing to multiple economic fronts such as the EPAs.

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The aim of this chapter is to study the impact of the selected macroeconomic indicators on unemployment rate in the region of Western Balkan countries and, more specifically, Albania, Serbia, Macedonia, Montenegro, Bosnia-Herzegovina, and Kosovo. This research is based on the time period 2000 to 2017 and includes five countries and the econometric model used in here is panel data. Data are retrieved from official and trustable sources such as World Bank and International Monetary Fund (IMF). The methodology used is the vector autoregressive model (VAR), unit root test, Hausman test, Granger causality test. All the macroeconomic variables, inflation, interest rates, GDP, and FDI are found to have a significant impact on unemployment rate of this group of countries. The novelty of this study remains the fact that this analysis is performed for the Western Balkan countries as a group. The results can serve and can be taken into consideration when applying similar econometric analysis in the future researches or implementing new policies that influences the macroeconomic factors.

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This chapter examines the effects of USA economic nationalism in the second-hand clothing (SHC) industry within Sub-Sahara Africa (SSA). The SHC industry creates an estimated 355,000 jobs in the EAC, which predictably generates incomes of US\$230 million that supports an estimated 1.4 million people. The chapter looks at attempts by Kenya, Ghana, Nigeria, Zambia, and Rwanda, among other Sub-Saharan to curtail SHC to protect their infant or struggling textile industry through subtle economic nationalism policies. It then examines the repercussions of having Rwanda implementing the ban from US market. The study inspects why the Trump-led administration feels that the SHC industry is important to the US. Undeniably, the chapter will put forward a case for banning of SHC and why it is gaining notoriety in the Sub-Saharan Africa region. The chapter finally advises what managers ought to do in the wake of economic nationalism and American only policy in Africa.

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*Yang Liu, Southern New Hampshire University, USA*

Nationalism is not closing the door to other nations. On the contrary, sometimes it exhibits as crazy expansion. For example, during the Second World War, both Adolf Hitler and Emperor of Japan claimed that they are helping their citizens. However, that is not the truth. Both German and Japanese people suffered something that they wouldn't have suffered without this war. Meanwhile, nationalism is one reason that the other countries keep fighting the war. By observing the relationship among nationalism, government policies and intervention, and FDI, this chapter attempts to offer an understanding of how FDI is impacted by the nationalism and government policies and intervention by providing two cases: the Brexit of the UK and the “American First” of the USA.

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This chapter addresses conceptual relationships between corporate social responsibility (CSR) and a set of related phenomena typically labeled as economic nationalism, economic patriotism, economic protectionism, populism, and antiglobalization. The research question addressed is whether this set of related phenomena redefines or at least affects CSR in significant ways that practitioners and scholars should include in the conception of CSR and, if so, how theoretically. Such investigation is affected by two essential circumstances. First, CSR remains a topic of continuing theoretical controversy: specific “responsibility” of any business anywhere is not a resolved matter. Second, economic nationalism and related phenomena—which appear to be rising in importance—are opposed to the economic, political, and social globalization effects following the 1995 founding of the World Trade Organization (WTO). The chapter seeks to refine CSR for varying conditions as shaped by economic nationalism, economic patriotism, economic protectionism, populism, and antiglobalization.

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## Preface

The current globalized world economy is interconnected. However, there is a political and economic trend of Economic Nationalism in U.S.A., Europe, and other countries leading to import tariffs and protectionism. The goal of the economic nationalism for a nation is to promote its economic growth and prosperity of its citizens. It represents a set of country-specific economic practices to create, strengthen and protect a nation's economy in the context of international markets. The recent trend of economic nationalism or protectionism stems from the rapid globalization, the recent economic crisis, trade deficits and the nationalist movements. The globalization is also perceived as a threat to national security by some countries as they perceive the national greatness in terms of military power (Ali, 2017; Mason, 2017; Iliescu, 2017; Warburton, 2018). Recent examples of economic nationalism include UK exiting from European Union (Brexit, 2017), the U.S. pulling out of the multilateral Trans-Pacific Partnership trade deal involving twelve countries while Japan trying to achieve a deal among the remaining eleven countries (Nikkei Asian Review, 2017). The opposition to Transatlantic Trade and Investment Partnership (TTIP) between U.S. and the European Union signals a new environment with a potential for nationalistic, protectionist and anti-globalization policies. Economic nationalism encourages economic policies aimed at promoting domestic control of consumption, labor and capital formation. It questions the benefits of unrestricted global free trade. The economic nationalism often calls for trade protectionism, limiting imports, increasing exports, currency manipulation and restricting immigration (Pryke, 2012). There is a relationship between economic nationalism and foreign direct investment (FDI) in emerging markets. The public opinion and prevailing preferences regarding FDI affect the location decisions of multinational companies (Jacobsen & Jacobsen, 2011).

Economic nationalism can be understood in terms of local government economic policies, attitudes of domestic firms towards foreign domestic investment, the attitudes of consumers towards foreign goods and firms, and the interaction of the multi-national firms and domestic firms. The expectations model of economic nationalism includes the people's expectations of their government, domestic firms, and the general public, in terms of restricting the activities of foreign firms. (Akhter, 2007; Nakano, 2004). An alternative view of economic nationalism differentiates it from protectionism and defines as leveraging of national resources to secure economic benefits from the world economy. This view holds that the countries are not only active participants in globalization but they continue to strategically express nationalism in new global settings by supporting national firms and citizens overseas. Business leaders of the multinational corporations focus not only on the benefits that they will derive from entering a country, but also the benefits they will deliver to their domestic economy by investing capital in a foreign country (D'Costa, 2009).

## **Preface**

Different countries practice economic nationalism in different ways based on their emerging priorities in the social, political and economic contexts. Both the developed economies and developing economies are exhibiting a recent surge in economic nationalism. The increasing globalization and the growth of world markets through greater exports has threatened the economic growth of developed economies that import more than export like the U.S.A. Many Asian firms have become globally competitive by using the processes of globalization and economic nationalism. Through effective firm strategy and economic nationalistic policies of China, the Chinese multi-national firm Huawei has exceeded Swedish firm Ericsson for making telecommunication equipment. Other examples include Lenovo and Haier from China and Infosys from India. Many Western nations including U.S. are beginning to warm up to the idea of using economic nationalistic policies to promote their own industries and make them more competitive globally (D'Costa, 2012). A country's economic openness affects its economic nationalism. The economic interests of a country in the domestic market relative to its interests in the foreign market influence its economic nationalism sentiment. Increasing the foreign trade reduces the economic interests in the domestic market and thus weakens its economic nationalism. Using the Chinese Political Compass data and the World Value Surveys data, this prediction holds both cross-sectionally and over time. Based on the cross-country data, this also applies to the analysis of nationalism across countries (Lan & Li, 2015).

Economic nationalism can be misinterpreted as anti-globalization and isolation, which can be self-defeating for a nation in the hyper-connected world economy. The complexity of the implementation of economic nationalism lies in preserving self-interest and promoting international economic partnerships. Economic nationalism can co-exist with globalization. Economic nationalistic policies can be used to manage the globalization processes to a country's own advantage. Globalization can be used as a means to serve the developmental needs of a country using economic nationalistic policies to have access to foreign capital, expertise and markets leading to export-oriented domestic industries. Economic Nationalism is not just a "protectionist" ideology. Economic Nationalism demonstrates the economic significance of policies that promote the industries in a nation to grow and expand beyond its national borders to become global. It is associated with context-specific economic policies including support for economic liberalization and globalization (Helleiner, 2004; Stiglitz, 2002).

The multinational firms are facing an increasingly unstable international investment climate due to the economic nationalism leading to foreign assets being taken over by domestic governments by nationalizing the strategic assets like minerals and oil (Wagner & Disparte, 2016; Green, 2008). The CEO's and managers of the multi-nationals have to explore the political-risk insurance. For domestic and multi-national firms, the negative sentiments about immigration will have an impact on global talent management, foreign domestic investment and mergers and acquisitions. The business leaders of domestic and multinational firms have to devise new strategies to deal with the governments, consumers and markets in this new environment. The multinational corporations have to overcome the protectionist sentiments among consumers and government regulators and reinvent their corporate social responsibility models. They have to think about the new strategies in dealing with the country-specific perspectives of economic nationalism.

Along with globalization, there is increasing awareness about economic nationalism. The goal of the economic nationalism for a nation is to promote its economic growth and prosperity of its citizens. It represents a set of country-specific economic practices to create, strengthen and protect a nation's economy in the context of international markets. Economic nationalism encourages economic policies aimed at promoting domestic control of consumption, labor and capital formation. There is a relationship between economic nationalism and foreign direct investment (FDI) in emerging markets. The economic

nationalism creates uncertainty for domestic and global business leaders. In this uncertain environment, the business leaders have to come up with new strategies to deal with consumers, governments, and markets. This book provides an understanding of the recent rise of the economic nationalism in the context of the hyper connected global economy. Strategies for the managers of the domestic and international firms are discussed to make their firms successful. Country-specific perspectives of economic nationalism are presented.

This book begins with a look at economic nationalism and international business (Chapter 1). A conceptual framework for the impact of economic nationalism on MNE's from smaller developing economies is presented (Chapter 2). A managerial analysis under economic nationalism and globalization is presented as a case study for Japanese automakers in USA (Chapter 3). The belt and road initiative in China is presented in terms of economic nationalism and globalization (Chapter 4). A case study of Russia is presented to explore whether economic nationalism can be a useful tool for economic growth and development (Chapter 5). The implications of the privatization of the new space programs on the international business are discussed (Chapter 6). The impact of the African Continental Free Trade Agreement (AFCFTA) on the economic growth of developing African countries is discussed (Chapter 7). A case study of Zimbabwe is presented that explores the effects of the European Union (EU)-African, Caribbean and Pacific Partnership Agreements on Economic Nationalism (Chapter 8). For Western Balkan countries, the impact of macroeconomic indicators on unemployment rate is discussed in Chapter 9. The influence of the current climate of economic nationalism in USA on the second hand clothes industry in sub Saharan Africa is discussed (Chapter 10). The last two chapters discuss economic nationalism and foreign domestic investment (Chapter 11) and corporate social responsibility (Chapter 12). This publication covers the implications of the current climate of economic nationalism and trade policies on the international firms using case studies in USA, Europe, Africa, Japan and China. Conceptual frameworks are presented on the impact of economic nationalism on international business, foreign domestic investment and corporate social responsibility. Managerial analysis is presented under globalization and economic nationalism.

The target audience of this book includes the business leaders, government policy makers, managers of domestic and multinational firms and researchers working in the field of economic nationalism, economic growth, foreign domestic investment, and global talent management. The CEO's and Managers of domestic and multi-national firms will benefit from the discussion of strategies in today's volatile, unpredictable and uncertain economic environment with the increasing sentiment of economic nationalism. A balanced perspective is necessary where economic nationalism and globalization can co-exist. We trust that this work will stimulate further research on this very timely topic of economic nationalism, international firms and globalization.

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# Chapter 1

## Economic Nationalism and International Business

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### ABSTRACT

*The purpose of this chapter is to illuminate the importance of the biases and motivating factors that have propelled economic nationalist movements across the globe. Too frequently scholars assume economic nationalism as a starting point to understand strategic choices. The authors argue that ethnic and racial biases, however, are an important antecedent to economic nationalism that transitively impact firm strategic processes such as internalization. Specifically, they suggest that ethnic and racial tensions that exist within and between governments and people add unique pressure structures to which firms respond. Through a case study of South Africa, the authors highlight the impact that these pressure structures have on firm-level strategic processes surrounding internalization.*

### INTRODUCTION

As the economic and political distances across the world continue to constrict, individuals, firms, and governments are experiencing both the positive and the negative externalities of globalization (Dau, Moore, & Soto, 2016; Mahatney, 2013). On the positive side, the world has experienced increased trade relations, cross-cultural exchange, and an unprecedented flow of knowledge across borders - all impacting firm behavior (Churie, Sjostedt, & Corell, 2005; Dau & Wesley, 2016). On the negative side, however, there have been increased natural disasters and health epidemics, man-made calamities in the form of

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terrorism and global financial collapses, resulting in a recent backlash towards globalization and a shift towards economic nationalism rooted in ethnic and racial biases (Abrahms, 2008; Economist, 2015; Dau, Moore, & Abrahms, 2018; Hopkins, 2017).

Despite the relevance and resurgence of nationalist economic policies and stratification for firm strategy and behavior (Dau, et. al., 2017; Helleiner, 2002), this phenomenon remains understudied in international business. Moreover, existing research fails to address the antecedents of economic nationalism, and how these different antecedents put different pressures on firms. Thus, in order to have a holistic understanding of firm behavior and strategy during the current rise of economic nationalism (Held, 2004), it is critical for scholars to look at the underlying forces that propagate the use of economic nationalism as a policy tactic. We fill this gap in the literature by first illustrating the motivating factors of economic nationalism and then discussing how these motivating factors inform the internalization processes of firms as they continue to navigate changing economic policy structures. What factors drive internalization by firms in emerging markets? In addition to market-based country-specific advantages, we demonstrate that economic nationalism influences firms' internalization decisions.

Contemporary studies of globalization's impact on economic nationalism center on the motivations of governments, policymakers, and entrepreneurs (Helleiner, 2002; Helleiner & Pickel, 2005). Infrequently do they examine non-elite promotion of economic nationalism (Hopkin, 2017). This omission is rather startling given that their popular support is what fuels this phenomenon. Moreover, this populist support from the bottom adds a unique pressures through which firms must navigate. There is a tendency among those who study economic nationalism to gravitate towards economic determinism (Akhter, 2007; Arnason, 1990). Under these circumstances the primary assumption behind the current wave is that this is a movement driven by those on the losing end of globalization.

If this were the case, do the left-behinds intentionally forego alliances with other domestic left-behinds who happen to belong to a different ethnic, racial, or confessional community? On the contrary, economic nationalists in the U.S., in their demands to overturn globalization, have eschewed forming alliances with different ethnic groups within the working class, instead joining hands with nativists (Mishra, 2017: 76). If we want to fully understand ordinary rank-and-file economic nationalists, and the groundswell supporting this movement, we must take into account critical non-economic factors. In their eyes, globalization is not limited to jobs on the move. It is also associated with mass immigration, both legal and illegal, the elevated birthrates of ethnic and racial minorities vis-à-vis the country's ethnic and racial majority, and an overall fear that their socially privileged position in their country is declining. In parsing out these motivating factors, we are better positioned to understand the underlying mechanisms that promote economic nationalism and can thus better identify how this impacts firms.

Amidst the current spike of economic nationalism (as seen in the United States, the United Kingdom, and other countries), firm internalization is an important consideration. Stemming from the management and international business literature, internalization theory discusses the strategic decisions firms must make to either internalize or externalize their processes across borders (Rugman, 1981). Key focal points of the literature include how firms internalize knowledge, operations, and product flows to offset the costs associated with market imperfections (Rugman & Verbeke, 2004). The literature has placed a heavy emphasis on the internalization of knowledge flows, given the propensity of firms to maintain secrecy (Mudambi & Navarra, 2004). To protect critical information and knowledge systems, firms internalize their operations across borders, rather than externalizing them (Casson, 2015).

Although firms are already keen on protecting their information and knowledge, in the current global political climate and spike in economic nationalism, the internalization processes of firms are critical for

both scholars and academics to examine (Rugman 1981; Rugman & Verbeke, 2004). Thus, the purpose of this chapter is two-fold. The first objective is to identify and describe the underlying forces driving economic nationalism, which has surprisingly received limited attention. Only with this foundation, will it be possible to understand how economic nationalism subsequently impacts firm behavior. The second objective of the chapter is to offer a theoretical discussion of how the internalization process of firms is impacted by economic nationalism, with an emphasis on the underlying causes of economic nationalism. By focusing on the antecedents to economic nationalism, we extend extant scholarship by showing how racial and ethnic biases create divergent pressure structures for firms. We will supplement this discussion with a case study of the subsequent impacts of economic nationalism on the internalization process of firms in South Africa. The findings of this chapter will offer critical insights for policymakers and practitioners as economic nationalism continues to proliferate across the globe.

## **NATIONALISM AND THE LOGIC OF MATERIAL AND SOCIAL GAIN: OUTLINING THE UNDERLYING FORCES DRIVING ECONOMIC NATIONALISM**

The most impactful economics-based analysis of nationalism in the late twentieth century was Hechter's (1975) *Internal Colonialism* thesis. Post-World War II scholarship in the social science linked nationalism with decolonization. Therefore, nationalism was presumed a growing pain associated with modernization and industrialization (Deutsch, 1966: 190-191). These academics expected nationalist sentiments to dissipate over time in the developing world and they dismissed the possibility that they could exist, let alone flourish, in the industrialized west. Contrary to those expectations, the late 1960s and 1970s witnessed a flurry of nationalist movements in industrialized countries. Flemish and Walloon were tugging at Belgium's seams, Québécois nationalists challenged the endurance of the Canadian Confederation, Scottish and Welsh nationalists dreamed of splitting off from the United Kingdom, while Basque and Catalan nationalists threatened to carve up the Spanish state. Analogizing ethnic groups to socio-economic classes, Hechter argued that capitalism's uneven development in culturally heterogeneous countries generated a *cultural division of labor* pitting the country's core against an ethnically distinct and economically marginalized periphery. In a manner of speaking, the conditions promoting decolonization movements in the developing world were present within the metropole. Economic exploitation, presumably, was nationalism's root cause.

In short order, various scholars pointed to major problems with the internal colonialism model. In the third quarter of the twentieth century, nationalism was on the rise in underdeveloped regions of industrialized countries. It was also fomenting in integral parts of the industrialize core such as Canada's Quebec (Connor, 1994: 149; McRoberts, 1979: 296) and Spain's Catalonia (Woolard 1989). Even Hechter's study was problematic. An internal colonialist study of Britain's Celtic fringe would situate Ireland in the underdeveloped category. However, that was not the case with Scotland – an integral part of the UK's industrialized core.

Would a microeconomic approach to nationalism shed additional light on the phenomenon? Many of these studies have centered on the cost-benefit calculations of nationalist elites (e.g., Marquardt, 2018; Mitra, 1995; Laitin, 1992). Elites, particularly the intelligentsia, are critical actors in any nationalist campaign. They are the primary artistes involved in articulating and disseminating nationalist narratives (Herzfeld, 1997: 67). While elites claim they champion the masses, those on the upper rungs of the socio-economic ladder are always out to benefit themselves (Pareto, 1991: 36). Indeed, one of their

most important tasks is selecting the tangible cultural markers delineating the *us-them* boundary. Nationalist elites objectify group parameters in such a way that inter-group divisions preserve intra-group hierarchies and privileges (Barreto, 2001; Barreto & Lozano, 2017). Elites' motivations are clear. Like venture capitalists, they take risks in the pursuit of high rewards. For elites those are prime and excludable private goods (Olson, 1965).

While elite incentives in a nationalist campaign are clear, those inducements do not apply to the group's rank and file. This conceptual problem is also present in *internal colonialism* – the erroneous assumption that elites and the masses share the same economic interests. The best elites could do in a nationalist struggle is dole out non-excludable public goods – a conceptual problem leading to the *free-rider paradox* (Olson, 1965). As Popkin (1979: 251) commented: “Whether a self-interested peasant will or will not contribute to a collective action depends on individual – not group – benefits.” Indeed, Breton (1964: 379) assumed that the working class should be less inclined towards nationalism than their more affluent co-ethnics. Elites are critical to the articulation of nationalist narratives and spearheading their cause, but no nationalist campaign can prosper without the support of laborers (Connor, 1994: 161). Explaining nationalism is a major challenge precisely because of the collective action problem (Hardin, 1995: 14).

Both macro- and micro-economic approaches to the study of nationalism stumble on account of a common conceptual problem. While nationalists frequently claim their commitment to resolving economic crises as the *cause célèbre*, this phenomenon's essence is noneconomic. Economic conditions may exacerbate ethno-national tensions but they do not generate them (Connor, 1994: 47, 161). One of the most noteworthy texts in the study of nationalism is Benedict Anderson's (1991) *Imagined Communities*. Herrera (2005: 12) combined Anderson and Connor when she contended that popular notions of economic advantage and disadvantage were just as *imagined* as national identities: “...the meaning of the economy is socially constructed by actors and their social and institutional contexts” (Ibid., 94).

Western intellectual tradition separated our capacity for logical thinking from our feelings (Descartes, 1989: 44; LeDoux, 1996: 24). That partition was critical to the development of our modern understanding of utility. Such an assumption, splitting our ability to reason from our capacity to emote, favored the standard assumption of *homo economicus* – the classic maximizer of tangible goods. This tradition ignored other classic thinkers such as Bentham (1988: 2), Rousseau (1984: 89), and Spinoza (in Descartes, Spinoza & Leibniz, 1974: 281) who understood that we all aspire to maximize material, social, and spiritual payoffs. Indeed, Veblen's (1973: 29-44) classic *The Theory of the Leisure Class* understood that strategically-oriented actors' pursuits were driven by more than the drive to maximize wealth. And Rousseau (1984: 89) contended, our emotions are not divorced from, but an integral part of, our ability to reason. Our modern understanding of utility, which dismisses social and psychological notions of pleasure and pain, masks its intellectual underpinnings (McDermott, 2004: 699). As Barker (2001: 114) noted, “...the real problem was not with the supposed irrationality of those who engaged in collective activities, but with an “inadequate conception of rationality, which takes identities and interests as given, rather than as dynamic, and which fails to take account of identity cultivation, maintenance, and expression, as a major part of public life.”

A full account of any individual's motivations must weight our dual nature. It is not a matter of binary choices: *homo economicus* versus *homo sociologicus*. Rather, the rational nationalist has both material and socio-emotional payoffs they aspire to maximize (Barreto 2009). Excludable material resources can be doled out, but only to a select few – group elites. The primary motivator for the average nationalist is socio-emotional. “Utility maximization should not only take into account the utility of what *we have*

(and the activities we carry out) but also the utility we get from what (we think) *we are*” (Pagano 1995: 190; emphasis in the original text). This system protects itself from the classic free rider paradox by recruiting a vast array of self-appointed norm enforcers eager to prove their metal, and their loyalty, by lauding compliant nationalists and condemning defectors (Barreto 2009). To the degree someone feels a strong group attachment, such an individual equates their individual payoff with the best interest of the collective (Akerlof & Kranton 2010: 18; Mill 1993: 33; Wintrobe 1995: 44).

An individual’s choice to favor, say, economic payoffs over the social counterparts, is a matter of a person’s attachment to the group in question. A social club may elicit some degree of emotional attachment, but it pales in comparison to one’s family. Indeed, promoters of the *imagined community* market the nation – a prime example of a *Gesellschaft*, or artificial community – as a *Gemeinschaft*, or natural community (Tönnies, 2001). Hence, nationalist rhetoric is dripping with references to the nation as the embodiment of the great and paramount extended family (Connor, 1994: 77-78; Smith, 1992: 438).

If emotions are where we should begin looking for answers, the question remains as to which ones are primarily responsible for the latest wave of economic nationalism circumnavigating the globe. The answer, says Petersen (2002: 40) is resentment. An individual’s esteem is intimately linked with their group, and their group’s status may have shifted, perhaps dramatically, relative to others. Sidanius and Pratto (1999: 38) insist that most manifestations of oppression and group conflict, including nationalism, “can be regarded as different manifestations of the same basic human predisposition to form group-based social hierarchies.” Regarding nationalism in particular, Mishra (2017: 274; emphasis in the original text) contended: “Its political resurgence shows that *ressentiment* – in this case, of people who feel left behind by the globalized economy or contemptuously ignored by its slick overlords and cheerleaders in politics, business and the media – remains the default metaphysics of the modern world since Rousseau first defined it.”

And what is fueling this resentment? The post-Cold War era has dramatically accelerated the pace of globalization. A major part of globalization, no doubt, is a changing economic landscape, translating into the relative deprivation of some regions vis-à-vis boom times for others. But alongside these changes, has been an unprecedented global wave of economic, environmental, and war refugees resulting in demographics shifts that are perceived as threats to the dominance of entrenched, dominant ethnic groups (Strand, Urdal, & Côté, 2019: 69). Add to immigration a series of anxieties associated with the relative birthrates of immigrants and particular ethnic and racial minorities. As Loizides (2015: 54) noted: “The degree to which the presence of ‘ethnic others’ is acknowledged, opposed, or misrepresented in the national narrative of a dominant group defines, to a large extent, majority nationalism.” Hence, the so-called *demographic threat* has both an internal and external component. In the case of India, Hansen (1999: 5) argued: “it was the desire for recognition within an increasingly global horizon, and the simultaneous anxieties of being encroached upon by the Muslims, the plebeians, and the poor that over the last decade have prompted millions of Hindus to respond to the call for Hindutva at the polls and in the streets, and to embrace Hindu nationalist promises of order, discipline, and collective strength.” Racial resentment is a key factor to the ascent of the Tea Party and Trumpian right-wing populism in the United States (Jouet, 2017; Tope, Pickett & Chiricos, 2015; Vance, 2016; Zeskind, 2012).

Dramatic economic changes in the global economy are coinciding with dramatic demographic change. These shifts in the population foretell a shift not only in economics but, more importantly for our purposes, the cultural, ethnic, and racial balance of power within countries. Thus, in order to understand how shifts towards economic nationalism are impacting firms and firm strategy, it is imperative to understand the forces driving economic nationalism.

## **THE INTERSECTION OF ECONOMIC NATIONALISM AND FIRM INTERNALIZATION**

### **Firm Internalization**

Firm internalization reflects firms' decisions to internalize their processes across international borders rather than relying on external supply chains. The theory focuses on both knowledge and product flows in response to market imperfections. Internalization theory builds on Ronald Coase's theory of the firm, which explains why and when firms will form, rather than separate processes taking place in the external market; firms exist when internalization reduces transaction costs (Coase, 1937). Internalization theory illuminates the behavior of multinational enterprises (MNEs), emphasizing efficiency. Internalization theory focuses on organizational design as a response to transaction costs and market imperfections; firms consider these factors when making decisions as to whether to internalize processes across borders rather than externalizing them in international markets (Hymer, 1960). This is particularly important with regard to the internalization of knowledge, rather than research and development taking place in open market transactions. Entry into foreign markets can take many forms: direct investment by the firm leads to the retention of knowledge-based advantages for the firms making the investment, whereas alternatives such as joint ventures can lead to the MNE relinquishing some of its knowledge-based advantage (Rugman, 2010: 4).

Internalization theory has since developed to examine the multitude of strategic and organizational decisions regarding foreign direct investment and internalization decisions within regions (Verbeke and Kano, 2012: 136). Contemporary internalization theory incorporates transaction costs – firms internalize the externality of knowledge, which is otherwise a public good – and resource-based decision making, which is country-specific (Rugman, 2010: 3). In contrast to Coase's theory of the firm, in which transaction costs are the unit of analysis, internalization theory treats the firm as the unit of analysis, focusing on firm-specific advantages (FSAs) and country-specific advantages (CSAs) that lead MNEs to internalize international processes. Different FSAs lead to "heterogeneity of firm-level behavior within any industry"; MNEs within an industry will make different FDI decisions (Rugman, 2010: 4). MNEs make decisions about which locations in which to do business, and how to structure their activities in these countries; according to Rugman's classic internalization theory, these decisions are determined by firm-specific advantages and country-specific advantages (Narula and Verbeke, 2015: 613). Analysis of MNEs based in emerging markets, such as China and India, has generally supported the theory of FSAs, which for newer MNEs can originate in country-specific advantages implemented by local government policy, including privileged information as to where or how to access resources (Narula and Verbeke, 2015: 619). With regard to knowledge flows, however, recent scholarship indicates that MNEs from countries with advanced economies engage in knowledge-based internalization and financial gains, whereas MNEs from countries with emerging economies are more likely to have financial gains from monopolistic activity (Buckley and Tian, 2017: 976).

What explains regionalization – namely, the tendency for MNEs to concentrate their international sales in their "home region", rather than a relatively even international distribution? (Verbeke and Kano, 2012: 135). Modern internalization theory acknowledges that the answer lies not only in an examination of transaction costs, which would be provided by the international version of Coase's theory of the firm. Scholars instead focus on specific additional, primarily economic factors. For example, Dunning's eclectic paradigm, deemed the OLI paradigm, focuses on three factors that determine FDI: ownership (O),

location (L), and internalization (I). MNEs leverage their competitive ownership advantages within their home country when they expand their activities internationally, internalizing their ownership advantages within specific countries (Rugman, 2010). This is intended to reveal situations in which internalization is preferable to cooperation with other firms through mechanisms such as joint ventures. Regional free trade or investment agreements will further increase the competitive position of local firms with FSAs, enhancing the likelihood that they will expand and internalize their operations across borders within that particular region (Narula and Verbeke, 2015: 613). Neither the eclectic paradigm nor traditional approaches to internalization theory, however, take sufficient account of noneconomic factors, particularly how ethnic factors can influence investment decisions.

## **The Case of South Africa**

In many countries, economic nationalism is a political and policy tactic to encourage economic development, stimulate job creation, and foster *in-country* entrepreneurship. This nationalism is rooted in racial and ethnic bias. Previous literature has paid limited attention to the role that these biases play. South Africa exemplifies the stated and promoted objectives of economic nationalism, however this nationalism is rooted in racial or ethnic biases. As our case subsequent case study will elucidate, the federal government, responding to populist pressures and long-standing racial and ethnic biases, pressures firms to act in the interests of national economic development through the use of rhetoric based in patriotism and national pride (Helleiner, 2002). Despite glaring race-based economic inequalities the post-Apartheid state continues to embrace the rhetoric of colorblindness in a bid to promote said pride (Milazzo, 2015). We contend that South African firms experience this pressure from the populist biases as well as from the government policies, and thus make strategic decisions in response to these pressure structures. Thus, South Africa, given its history of racial tensions and ongoing racial relationship rebuilding and current surge of economic nationalism, serves as a valuable case study for understanding how firms internalize operations in response to federal economic strategy and mass populist racial and ethnic biases.

Following the collapse of the apartheid system of laws in the early 1990s and the establishment of the democratic government in 1994 (US Dept of State Archive, 2009), companies in South Africa were struggling to find place in the rapidly changing economy. The country had previously dealt with the poverty of a nearly-bankrupt national treasury until the end of apartheid and a swift economic boom. In the decade between 1998 and 2008, the South African economy grew by 3.5% per year (Goodman, 2017). Today, South Africa is the largest economy in Africa and a hub of innovation, entrepreneurship, and technological advances (Nattrass, 2010). One of the forces that caused this rapid economic development was economic nationalism supported and promoted by the government.

The South African state encourages economic nationalism through cultivating consumer pride in South African products and pressuring businesses to adapt to this growing culture. The Proudly South African Campaign was established in 2001 by the National Economic Development and Labor Council and is a membership-based organization that seeks to educate South African consumers about local goods and encourage South African businesses to internalize their supply chains and maintain South Africa ownership, even when internationalizing across borders (Proudly South African, 2018). The campaign uses rhetoric based in nationalist economic thought to encourage consumers to support job creation, economic cultivation, and national pride with their purchasing power.

Proudly South African contains representation in leadership by state, corporate, union, and community actors. The stated mission is to address education, health, job creation, anti-corruption, and

rural development through local procurement and local economic consumer investment (Proudly South African, 2018). This mission is enacted through influencing procurement in the private sector to increase local production and ownership within corporations. Proudly South African follows the federal government's economic alleviation and economic stimulation plan, the New Growth Path Plan, which is part of the broader national development agenda (Proudly South Africa, 2018). The organization lobbied to have the Local Procurement Accord passed and signed in 2011, which created national incentives for businesses to internalize (Van Wyngaardt, 2016). This pressured firms to change and adapt their local decision-making, prioritization, and subsequent behavior to be more regionally-aligned.

The rhetoric used throughout the campaign's branding and marketing reflect the economic nationalism of the state. The center of the Proudly South African vision and mission is an acronym: "PRIDE" where even the P stands for Patriotism, the R for Reindustrialization, I for Innovation, D for Domestic Consumption, and E for Entrepreneurship, Economic Development and Export Development (Proudly South African, 2018). This blatantly exemplifies the nationalist and economic development agenda of the state as promoted through this campaign.

The campaign influences businesses through a mandate and an incentive. Proudly South African authorizes the usage of its logo and stamp of approval in product packaging and marketing if a company completes its assessment and falls in line with its three core mandatory standards. These standards include: at least 50% of the cost of production must be incurred in South Africa, product or service must be at high-quality as proven by accreditation, company must comply with fair labor standards of state, and company must comply with environmental regulation (Proudly South African, 2018). If a business meets these requirements, it is eligible for membership and companies then use the Proudly South African stamp on their products to encourage consumers to buy local-made products. Due to the success of this campaign, more businesses are incentivized to internalize their production streams and supply chains. Regionalism dictates that even when these companies internationalize, they maintain South African ownership and local procurement.

Yivani Cosmetics is an example of a firm that has created, adapted, and changed their firm strategy to reflect the agenda of economic nationalism as promoted by the state. Yivani was founded by a South African entrepreneur in 2011 to market natural-based cosmetic products to South African women; it became a member of Proudly South African seven years later (Yivani, 2018). Yivani has expanded to export into the US and the UK, and in 2015 signed contracts to expand distribution into India, Ghana, Liberia, Nigeria, and Zimbabwe (BBQ Online, 2015). The company sought to automate and internationalize its manufacturing process, however, was incentivized to retain this production in house, in order to maintain its status as a Proudly South African business and keep the rhetoric of economic nationalism in its mission and marketing.

Businesses such as Yivani Cosmetics have intentionally kept product manufacturing to match regional identity and in the process of internationalizing, have internalized their supply chains, contributing to the economic growth that has been a hallmark of post-apartheid South Africa. However, despite this economic recovery, racial and ethnic disparities continue to exist exhibited through economic inequality (Goodman, 2017). As of last year, 10% of the country, majority white, owned upwards of 90% of the country's wealth, and 80% of the population, majority black, owned next to nothing at all (Orthofer, 2016). As economic nationalism can be rooted in cultural prejudices about race and ethnicity, economic nationalist attitudes of the state solidify, rather than alleviate, continued racial economic inequality that falls along racial divides in South Africa.



## **DISCUSSION AND CONCLUSION**

The purpose of this chapter has been to elucidate the impact that racial and ethnic biases have on economic nationalism, and thus their transitive impacts on the firm internalization processes. These biases create unique pressure structures through which firms must navigate and alter their strategic choices accordingly. Recently, the world has seen a dramatic spike in economic nationalism across the globe. While scholars have long studied the consequences of economic nationalism, less attention has been paid to the antecedents of economic nationalism. We assert that non-economic antecedents, such as ethnic biases, drive economic nationalism and this includes perceptions – whether empirically accurate or not – that one community has disproportionately benefitted vis-à-vis another, particularly the dominant group (Anderson, 2016; Cornell, 2018; Wimmer, 2017). From this assertion, we contend that companies experience different pressures that change their strategic choices as a result of these biases. Through the use of South Africa as a case study, and the recent government-led push towards “PRIDE” in nationalism, we contribute to the extant literature on internalization theory by outlining how these noneconomic factors can influence investment decisions. As governments and populations continue to promote economic nationalism, companies must figure out how to navigate these tensions driven by ethnic biases.

The existing literature on firms’ decisions to internalize processes across borders has focused predominantly on economic factors, including firm-specific advantages. The fact that there is variation in foreign direct investment decisions made by firms within the same industry is acknowledged, but generally attributed to firm-specific advantages, or country-specific advantages. The case study explored in this chapter demonstrates that local government policies do provide different country-specific conditions that influence firms’ decisions to internalize processes across borders; however, the factors influencing government policy and firm response are not solely economic. Instead, ethnic motivations play a role in laying the country-specific conditions on which firms operate, and economic nationalism therefore influences firm internalization decisions. Furthermore, this analysis makes a contribution to the limited literature on regionalization, which caveats the internalization theory findings to add a focus on internalizing within the firm’s local region. Internationalization by firms based in emerging markets appears to be less driven by firm-specific advantages than by country-specific advantages (Narula and Verbeke, 2015: 619); however, to this finding, we must add that economic nationalism within the home country influences these country-specific advantages and thereby induces firms to internalize across borders within their home region.

Despite the contributions and importance of the arguments put forth in this chapter, there are several limitations that serve as opportunities for future scholarship. First, although this chapter highlights the driving factors behind economic nationalism and their transitive impact on firm internalization processes, the chapter only focuses on South Africa as a single case study. The use of a single case study was purposeful to elucidate descriptive and narrative findings. Further, the details were collected objectively with due diligence. However, the use of a single case study represents a limitation that future scholarship can build upon. Future research could expand on this research program by examining other country contexts to see if firms in other countries that host high levels of economic nationalism experience the same pressure sets. Further, future research could examine countries of divergent levels of development, such as advanced market or frontier market contexts. Second, this research program could be built upon by the use of statistical analyses. Our research focuses on the antecedent forces of economic nationalism. This research could be supplemented by quantifying these forces in order to create a metric for the strength of economic nationalism in a country. By doing so, scholarship could yield generalizable findings.

As the world continues to experience heightened tensions between borders and economic nationalism continues to rise, all actors, including firms, are going to experience different pressure sets. Thus, both practitioners and scholars ought to be concerned with understanding the antecedent impacts driving economic nationalism to be able to fully understand the reactive and proactive strategic choices firms make. In the current world climate, MNEs are set in a challenging position. On the one hand, they transcend state boundaries. However, as state boundaries get more exclusive and economic nationalism heightens, these firms experience added pressure and norms to navigate. As these pressure sets proliferate and exacerbate, it is essential that scholars understand how MNEs behave.

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## Chapter 2

# The Impact of Economic Nationalism on MNEs From Smaller Developing Economies: A Conceptual Framework

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### **ABSTRACT**

*The chapter provides a conceptual framework for consideration for decision makers in firms from smaller developing economies during an era of increased economic nationalistic rhetoric in developed economies and shifting global trade patterns. Talking a longer term view, one might see this current level of political rhetoric as a continuation of the contest between globalization and free market ideology against viewpoints associated with mercantilism and other forms of economic nationalism. The impact of these trends on strategies of firms from developing economies within global value chains is explored. There are three basic strategic suggestions for firms from smaller developing countries which are interested in expanding internationally within the framework of operating within a global value chain.*

### **INTRODUCTION TO STRATEGY IN DEVELOPING ECONOMIES**

Crafting a strategic approach for a firm will always be difficult and complex as strategy involves long-term planning. Without using a crystal ball, predicting the future is fraught with uncertainty. Designing a strategic approach requires matching the internal capabilities of the firm with the expected future external needs and conditions of the market (Ensign, 2008), therefore, a good understanding of both the internal and external environments in which a firm operates would be expected to improve the outcomes of strategic planning. But even with good information, decisions are often influenced by the human brain's limitations of processing large amounts of information and unconscious biases which often produce less than optimal decisions (e.g., Kahneman, 2011; MacLean & Dror, 2016; Montibeller & Winterfeldt, 2015). Filtering through information and giving the proper weight to different and often conflicting pieces of

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information is often a critical factor in making good strategic decisions. Therefore, in crafting strategy, separating emerging trends from temporary fads and political rhetoric could be considered crucial to success, but this is much easier to do in hindsight than in foresight.

One of the biases which can be harmful when evaluating information is called the availability bias, where decision makers give more weight to easily available information and tend to downplay less obvious or less easily accessible information (e.g., Rönnlund & Rosling, 2018; Schwarz et al., 1991; Tversky & Kahneman, 1973). Although social media has changed the way people access information to some extent, the media coverage of major events and trends tend to frame how individuals perceive much of the external world. When making decisions, people tend to overreact by giving more weight to information coming from news stories and current headlines and often ignore less obvious sources of information. For example, it has been shown investors tend to overreact to stories of companies in the news and undervalue the more fundamental aspects of a company's strategy and operations when making investment decisions (e.g., Das & Krishnakumar, 2015; Heston & Sinha, 2016; Piccoli, Chaudhury, Souza, & da Silva, 2017); and we also see government leaders often overreacting in response to recent news stories when making public policy (Maor, 2016).

At the time of writing there is a lot of attention in the media being paid to possible trade wars, which due to the availability bias tends to make many people perceive the level of economic nationalism as increasing rapidly, yet a closer look at the trade statistics does not necessarily support this view. In fact in 2017, despite all the rhetoric of economic nationalism, global trade growth rates were the highest they have been in six years in terms of both volume and value (WTO, 2018, p. 30).

Perceived changes in the global environment are likely to affect strategic decision making for most firms, but creating strategy in a large company in a developed economy, where access to financial and human resources are assumed, can be quite different than developing strategy in a company from a smaller developing economy which has access to a different set of resources. Changes in global environmental conditions are likely to influence strategic decisions differently in firms originating from developed as opposed to smaller developing countries.

This article will first look at the often reported phenomenon of the rise of economic nationalistic attitudes, then move on to look at more fundamental changes affecting international trade and finally explore the impact both of these situations might have on strategic decision making in firms originating and primarily operating in smaller developing markets.

## **GLOBAL TRADE PATTERNS AND ECONOMIC NATIONALISM**

In both the academic literature and popular press there has been a lot of attention paid to the recent apparent growing scepticism over international trade and globalization, especially in Western countries (Ghemawat, 2016a). For example, Petriglieri (2016) wrote, "These are dark times for cosmopolitans. Discontent with globalization and resentment towards minorities, immigrants, and intellectuals have fueled the rise of nationalism in Europe and the United States" (p. 9). The economic nationalism found in anti-globalization rhetoric is often intertwined with other issues such as patriotism, stronger focus on racial identity, and social concerns over immigration. The populations in Western countries appear to have become increasingly divided over the value of "globalization." While reports of anti-immigration and economic nationalism have been on the rise in Europe, there remains significant national differences

in average attitudes in different countries (Marozzi, 2016); indicating these attitudes do not necessarily dominate throughout the continent but instead might often be in response to specific local issues and concerns.

It appears there are generational and social class divisions in attitudes towards globalization, with the generally younger, better-educated, and wealthier segments of Western societies being more likely to be in favour of policies and practices associated with increased globalization. While the generally older, less-educated, and less wealthy segments are more likely to support policies which are more isolationist and mercantilist (e.g., Bonikowski & DiMaggio, 2016; Ghemawat, 2016b; Hoffman, 2009). Furthermore, it appears the anti-trade, anti-immigration, and economic nationalistic movements currently seen in Western societies have been primarily driven by socio-political and cultural factors, and are not fundamentally concerned with economic issues or even increased levels of trade (Collinson, 2017).

There are a number of explanations for this apparent rise in anti-globalization attitudes in Western nations (Boddeyn, Jean, & Rittig, 2017; Von Glinow, 2017). Piketty (2014) associates the growing discontent with increased income inequality and the rise of a small number of the super-rich who appear to have gained more from globalization than the average citizen of Western countries. Political rhetoric also seems to contribute, as it has been shown expressing support for anti-trade, anti-immigration, and anti-globalization policies can be effective in gaining political support; as seen in the election of Donald Trump in the USA and the vote to leave the EU in the UK. This concept is supported by the results of Helbling, Reeskens, and Wright (2016), who found when politicians and leaders used more exclusive rhetoric which appeals to the racial or national identity of the population they were able to influence public opinion to a significant extent. While the use of more inclusive rhetoric about the benefits of diversity and openness had less effect. This human tendency of the majority to be influenced by more exclusive rather than inclusive arguments might have its origins in human biological evolution (Tuschman, 2013); which might help explain some of the success of the promotion of isolationism and protectionism as effective political platforms despite the lack of economic success of previous implementation of these types of policies. After all, "...isolation is a recurring factor in poverty and backwardness around the world, whether that is physical isolation or cultural isolation" (Sowell 2015, p. 4).

Cox (2017) pointed out anti-globalization/economic nationalism is a form of populism, and is not usually based on any identifiable ideology or even specific practices; but instead its primary purpose is to provide scapegoats and enemies for politicians to attack in order to gain and retain political power. The rhetoric can change to meet changing circumstances and the expression of the feelings is often believed to be more important than the implementing of any actual practices or policies. There is overwhelming evidence of the positive correlation between economic growth and poverty reduction with levels of international trade (e.g., Berggren & Jordahl 2005; Lehnert, Benmamoun, & Zhao, 2013; Moore & Griffith 2015; Srinivasan, 2009). As voters are normally influenced to a significant extent by economic conditions, it is unlikely most of the proposals heard in the economic nationalistic rhetoric used in many political debates in developed western economies will turn into actual policy and be fully implemented. For example, since the Trump Administration came into power in the USA, imports, exports, and trade deficits have all risen (U.S. Census Bureau, 2018); which might indicate the economic nationalistic bark of the new administration is much stronger than its bite. In aggregate, internationally, the growth in levels of international trade has slowed in recent years, although the longer-term trends still show increases (WTO, 2018). "Predictions that the era of globalization will soon end are too pessimistic" (Hu & Spence, 2017, p. 63).

## **The Impact of Economic Nationalism on MNEs From Smaller Developing Economies**

*Table 1. US imports, export, and trade deficit in goods and services. Monthly averages in millions of dollars*

	<b>Imports</b>	<b>Exports</b>	<b>Trade Deficit</b>
2016	225,746	184,293	-41,625
2017	240,139	194,536	-45,512
2018 (Through June)	257,710	208,234	-49,476

Source: Data from U.S. Census Bureau (2018)

An argument can be made economic nationalism has been around almost as long as has recorded history. A few examples: The Ming Dynasty in China has often been considered to have been the most advanced economy in the world before turning towards anti-trade and isolationist policies at the same time Western countries started exploring the world (e.g., Fairbanks & Goldman, 1992; Ferguson, 2011; Pomeranz, 2000); mercantilism was the dominate economic philosophy for centuries in Europe where imports were discouraged and exports were promoted (e.g., Bernstein, 2012; Irwin, 1991; Schaeper, 1983); restricting trade to prevent exploitation of workers has always been a key feature of Marist thought (e.g., Marx & Engels, 2004/1848; Powell, 1994; Sowell, 1985); and an economic nationalistic movement was quite active in protesting against exploitation of workers in both developed and developing countries in the early 2000s (e.g., Dobbs, 2004; Weis, 2005; Weisman, 2003).

The debates between wanting to live in free societies where individuals choose for themselves where to live and who to trade and engage with versus living in societies where the government restricts trade, engagement with outsiders, and movements of people have been ongoing for centuries and are unlikely to be resolved anytime soon. Despite the lack of empirical support and failure of previous policies of exclusion, political and economic discussions continue to remain “stubbornly protectionist, mercantilist and xenophobic” (Cochrane, 2016, pp. 110-111).

### **Global Attitudes**

It should be kept in mind, the Western world is not the only part of the global economy. On the surface, it appears the popularity of international trade, although not necessarily increased levels of immigration, is strong throughout Asia. For example, the Chinese government has put a heavy emphasis on its *One Belt, One Road* initiative to increase interconnectedness in the region and increase levels of international trade within the Asian region (e.g., Chheang, 2017; Liu & Dunford, 2016; Swaine, 2015); The Association of Southeast Asian Nations (ASEAN) has been working to implement agreements to facilitate more intra-regional trade (Das, 2016; Das, 2017; Zhao, 2016). Also a shift in the economic, political, and cultural connectivity and focus of Southeast Asian nations, slightly away from trade with Western countries, towards more engagement with firms and customers from China and other developing Asian nations is being seen (Chong, 2017; Narine, 2017; Pang, 2017a, 2017b; Story & Cook, 2016).

Sub-Saharan Africa has been one of the least globally connected regions of the world as far as trade goes, and has seen its share of global trade decline while poverty reduction and economic growth have not kept pace with what has been seen in some other regions of the world, particularly in Asia (Kigabo, 2010). Ayittey (1994) argued in the newly independent countries of Africa, “capitalism” and openness to international trade were associated with colonial exploitation. This economic nationalistic attitude,

which appears to have hampered growth and poverty reduction, apparently has continued up until the present, which has led to the dominance of anti-market/anti-globalization attitudes in both government circles and the general population. However in more recent times, we have seen a limited, but substantial, overall improvement in performance in many Sub-Saharan African economies (Arndt, McKay, & Tarp, 2016). This improved performance is correlated with an increase in both amounts of international trade and acceptance of trading relationships with other countries, specifically with China (Dollar, 2016; Jones & Liu, 2017; Stevens & Newenham-Kahini, 2017; MacPherson, 2016).

Latin America has a long tradition of anti-trade attitudes, high levels of inequality, and slow economic growth (e.g., Giroletti, 2003; Marichal & Topik, 2003; Menezes-Filho & Vasconcellos, 2007). The South American region has continued to experience a decline in levels of trade in recent years (WTO, 2018) which has been correlated with poor economic performances. While there are always limitations and inaccuracies when generalizing about a large and diverse region, it would appear the economic nationalism currently driving the policies of the governments in Venezuela and Bolivia are part of a long regional tradition fuelled by strong anti-US attitudes and the popularity of socialist political ideology. The popularity of socialism in Latin America probably can be partially attributed to the high levels of income inequality historically seen throughout the region.

In Russia, there has also been a decline in the value of products traded internationally; but this decline would appear to be mostly attributed to lower oil prices and not specifically to economic nationalistic policies and sentiment in the country (WTO, 2018). Russia has in recent times had relatively fairly low levels of international trade and economic growth. Current political tensions between Russia and Western nations will likely result in preventing Russia from further integrating into the global economy.

These long-term trends in attitudes towards globalization, as well as GDP growth statistics, would appear to indicate the growing importance of the Asian region as a center of international trade and should be taken into consideration when formulating strategic business decisions. Thus there may be more opportunities for firms from developing economies to start to shift away from patterns found in existing global value chains (GVCs).

The rise in economic nationalism and anti-trade attitudes in Western and Latin American countries is a concern for companies and individuals engaging in business activities across borders, but it is probably best to look at this rise as part of a centuries' old contest between inclusive and exclusive ideologies and not something radically new. Also as evidenced by trade patterns and political pronouncements, much of the world, in particular throughout Asia and parts of Africa, the popularity of globalization and freer trade would seem to be on the upward part of a cycle. Therefore these populist movements which promote more of a mercantilist and isolationist approach do not appear to be global in nature. And even in the USA and UK, actually policies have for the most part not followed very closely the economic nationalism rhetoric as advocated by some politicians.

### **Long-Term Trends: Moving Away From a Western-Centric System of International Trade.**

While the impact of economic nationalism and anti-globalization rhetoric and attitudes may not have had the impact sometimes predicted, these attitudes could be an indication of discontent in the Western world of a move away from a Western-centric international system of trade to a system where the region of the world where the majority of the planet's population lives, Asia, is beginning to share a leading role. It is doubtful we will be seeing a new "globalization with Chinese Characteristics" (Hu & Spense, 2017, p.

59) in the near future, as demographics and other factors might make future Chinese growth more in line with growth seen in other developing economies (Bai & Zhang, 2017). But we are seeing a shift in trade patterns showing significant increases in trade between developing economies, particularly within the Asian region. Therefore indicating there is a long-term trend away from the dominance of international trade involving developed economies. Trade with or between the least developed economies remains very low throughout the world (WTO, 2018); indicating there is a lot of room for growth in levels of international trade. It is likely incorporating the least developed economies and their companies increasingly into international trading networks will be led mostly by developing economy firms, with many of this coming from the Asian region. A shift away from Western-centric trade and Western dominated GVCs to one where trading activities in Asia become increasing important globally will likely present both challenges and opportunities for companies in both developed and developing nations.

## **Global Value Chains**

International trade has increasingly been affected by more fragmented levels of production within GVCs; while many of our theories and available statistical information are based on the concept of a product being produced by a single company in a single location (e.g., Low, 2017; Taglioni, Winkler, & Engel, 2017; Wignaraja, 2017; Xu, 2017). Thus statistics and existing frameworks on the nature of global trade can be somewhat misleading. Also, much of the literature on GVCs makes the assumption firms in developing economies primarily supply raw materials or intermediate goods to lead firm in developed countries who will finish, market, and sell the final products (e.g., Barnes, 2017; Campling, 2017; Keane, 2017a; Razzaque & Keane, 2017). Due to the great success of many East Asian companies and economies it has often been advocated firms from developing economies follow these examples and try to move up GVCs and become lead firms in GVCs themselves (Aoki, Esteban-Pretel, Okazaki, & Sawada, 2010; Park, 2007; Pirie, 2016). However, companies outside of East Asia have often found it difficult to move up and become lead firms within a GVC structure (Staritz, Morris, & Plank, 2017; Sturgeon, Farole, Moncada, & Pietrobelli, 2017; Wignaraja, 2017).

As it is generally believed reliance on low labor costs for a competitive advantage is not sustainable over the long term (Asian Development Bank (ADB), 2017, pp. 225-229; Hoang & Pham, 2016; Sturgeon, et al., 2017); there may be other options for firms from smaller developing nations to use to increase the amount of value added in their operations besides attempting to move up to become a lead firm in a GVC. These options include become more involved in regional value chains which include companies from less developed economies and increasing competitiveness within specific levels of existing GVCs.

The composition and roles of specific firms within a GVC are not static. Keane and Baimbill-Johnson (2017) found some firms operating in developing economies have been able to increase their value-added contributions to global value chains, but these increases have not been evenly spread throughout all industries or regions. Xu (2017) argued countries and firms from developing economies should use the New Structural Economics (NSE) framework to leverage existing or potential advantages as opposed to looking at what is lacking in their internal and external environments, in comparison to what is found in other economies, and they should not try to acquire the identified resources which are lacking. For example, instead of focusing on joining into manufacturing GVCs as has been the norm in East Asia, companies in many smaller countries have taken advantage of their countries' natural beauty, good weather, and cultural heritage to engage in GVCs in the tourism industry (e.g., Hipsher, 2017; Nurse, Stephenson, & Mendez, 2017; Ong & Smith, 2014); while other firms in developing economies with

small populations and markets have focused on expanding into various service sectors where they found a competitive advantage (Low, 2017; Rutherford, 2017).

In order to succeed in low cost manufacturing in a GVC, in most cases a firm would expect to operate in an external market where there is a large and skilled work force available at low cost, access to low cost transportation networks and sometimes a large local demand for the product. These conditions are not found in many smaller developing economies and the feasibility of overcoming these limitations in order to focus on large scale manufacturing is questionable.

It is likely trade and cooperation between firms within GVCs will continue to be a major force in economic development for developing economies. But we can probably expect to see a continuation of change and evolution within the GVC model which will likely include increased specialization, the rise of regional value chains within a larger global framework, the decrease in dominance of lead firms from Western countries, and a slight decrease in focus on manufacturing physical products with services becoming an increasingly important component of GVCs. While firms from developing economies are becoming increasingly important players in GVCs, firms from the least or lesser developed nations have been mostly left out. Therefore there is substantial potential to expand international trade to areas which currently are mostly ignored by the forces of globalization and firms from developing economies might be in the best position to take advantages of these opportunities. Obviously choice of specific strategy needs to take into account all of the nuances of a particular industry, region of operations, competition, and characteristics of the owners or managers of firms, but there appear to be many opportunities for firms from small developing countries to expand their role in the international trading system through increased connectivity with firms from less developed regions. One possible strategy is to develop the capacity to become lead firms in regional value chains which are either stand-alone lead firms or are part of wider global value chains.

## **Regional Lead Firms**

Obviously, it is easier to propose basic strategic approaches than to implement them successfully, and a discussion of strategies of multiple firms in different locations and industries will have to remain on a high step on the ladder of abstraction, as described by Hayakawa (1952). It should probably also be kept in mind, strategy cannot be effectively developed without consideration of the context and the external environment a firm originated from and operates in (Mol, Stadler, & Arino, 2017)

It is generally believed firms from developing economies are at a competitive disadvantage compared to firms in developed economies, especially in industries that reward high levels of economies of scale or innovation (Manning, Kannothra, & Wissman-Weber, 2017; Shenkar, 2009; Wang & Cuervo-Cazurra, 2017); and when examining lists of national competitiveness using existing criteria one sees a domination of advanced economies (Ju & Sohn, 2014). However, firms in developing economies seem to have some competitive advantages as well as some disadvantages. In addition to having access to lower cost labor, firms in developing economies sometimes have more flexibility and adaptable ownership structures as well as experience working in unstable environments where the informal economy has a more central role in business activities. These experiences gained in one developing economy can often be helpful when expanding regionally or to other less economically developed markets (Cuervo-Cazurra & Genc, 2008; Hipsher, 2007; Seshanna, 2009). Also firms originating from developing economies are often not as restrained by domestic legal frameworks as firms from more developed economies and are much less likely to face scrutiny or have their operations and conditions compared to benchmarks

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found in developed economies by the international media or NGOs (Globerman, 2014; Shenkar, 2009). Thus making it somewhat easier for firms from developing economies to operate in a location where the economic, legal, and culture environments are significantly different from what is found in more economically developed countries.

There are no global best practices in formulating a business strategy, as one can find examples of success using very different approaches and each choice of a business strategy requires making trade-offs and a decision on what to do also includes a decision on what not to do (Peng, 2002; Porter, 1980, 1996). Choosing a strategy includes trying to link a company's internal capabilities with needs of the market and a firm's capabilities, structure, and approaches are heavily influenced by the external environment in which a firm operates and from where it originated (e.g., Klein, Waxin, & Radnell, 2009; Li & Harrison, 2008; Prasnikar, Pahor, & Svetlik, 2008; Walsh, 2004). Therefore, firms in developing economies often choose different strategies than firms in more developed economies (e.g., Bach & Allen, 2010; Hagan & Amin, 1995). For example, firms selling to consumers in more developed economies generally have access to target markets with more disposable income than generally found in developing economies and therefore are more likely to focus on high end differentiation strategies where style and brand image are highly important; while firms coming from developing economies are more likely to focus on costs, prices, and value (Shah, 2012; Shenkar, 2009).

MNEs originating from developing markets tend to focus on the top of the pyramid markets (London & Hart, 2004; Ricart, Enright, Ghemaway, Hart, & Khanna 2004) and in market segments where technological innovation or brand image are of primary importance. Consumers from both developed and developing economies often demonstrate a preference for brands in some product categories associated with coming from relatively wealthy and technologically advanced countries (e.g., Contractor, 2013; Herstein, Berger, & Jaffe, 2014; Kan, Cliquet, & Gallo, 2014); making it difficult for firms from developing economies to compete directly in some segments of many consumer product categories. Hipsher (2016) advised firms originating from developing economies to avoid direct competition in market segments where global MNEs have competitive advantages and instead place more focus on the market segments where the developing economy firms have a competitive advantage. One way to implement this type of strategic approach is to become a lead firm in a regional value chain that incorporates firms from lesser developed markets as well.

This strategic approach of moving up the value chain to become a lead firm in a regional value chain in relatively low-tech or mature industries would be expected to be a somewhat different approach than the one frequently used by firms found in Japan, South Korea, and Taiwan which were involved in industries with more advanced technologies and became global lead firms in the electronics, computer, and other higher tech industries. Examples of companies successfully using the strategy of being a lead firm in a regional market while creating and selling under their own brand names successfully include the Thai energy drink manufacturers Carabao Tawandang Co. Ltd., maker of Carabao Dang, and Osotspa Co. Ltd., maker of M-150, as well as the very successful Thai-based MNE Charoen Pokphand Group (CP) which has developed into a regional leader in Asia in agricultural related products and other industries. In a global market, having a brand image associated with a developing economy can often be a major obstacle to achieve consumer acceptance, but being associated with being from a relatively wealthy part of a region appears to a strength when selling in some market segments in less economically developed regional neighbours.

It has been shown firms from developing economies generally benefit from being part of GVCs, but it can also be difficult for these firms to break free from their role as providers of low value-added ac-

tivities (e.g., Taglioni, et al, 2017; Utama, 2015; Wignaraja, 2017). Moving up the ladder to become a lead firm in a GVC may not be practical for many firms originating in small developing countries which are currently involved in a GVC, especially when operating in a fairly mature, highly technical or very competitive industry. But moving up the value chain, but within a more limited geographical area could be more feasible. This strategic option might be feasible for a wide number of developing economy firms and allow firms to gain more profits through gaining control of higher value-added activities.

Another option is not to break free of an existing GVC, but to become a regional lead firm within a larger GVC structure. For example, Dihel, Goswami, Hollweg, Shahid, & Slany (2017), Kaplinsky (2017), and Keane (2017b) each made the point much of the international trade in agricultural products in Africa is conducted through regional value chains with some African firms having increased their role and thus have created a form of regional lead firm within a larger global structure which incorporates producers from even less economically developed countries. Another example has been seen with some ethnic minority Akha and Tai Lue farmers in the rubber industry in China supplying GVCs who have outsourced some of the production to other members of the same ethnic groups in Laos PDR (Sturgeon, 2011). This strategy would appear to be a win-win situation as it helps bring some benefits to less developed regions by incorporating them into the global trading system while at the same time increasing the level of value-added activities controlled by firms within developing countries.

### **Increasing the Value-Added in Existing Segments of a GVC**

There has been an increase in the use of specialization in GVCs and in the production of complex products and services resulting in increased fragmentation of production (Staritz, Morris, & Plank, 2017; Sturgeon, et al., 2017; Taglioni, et al., 2017). This increase in specialization and fragmentation could create opportunities for firms to deepen their hold on a particular place within the value chain, which might allow for capturing more of the value created within the overall GVC. For example, the demand for automobiles is expected to continue to increase in Africa and developing countries in Asia, but not in Europe or North America. While this does not imply we will necessarily see a large number of firms in Africa and developing countries in Asia moving up to become lead firms within automotive GVCs, we might see the assembly function in developing regions increase in importance within existing GVCs and grow. Therefore the changing nature of an industry can produce, “the development of local, national and regional value chains within a globalised organisational structure” (Barnes, 2017, p. 139).

Kaplinsky (2017) argued manufacturing or producing final products or services are not automatically the part of the value chain where most profits are created and gave the examples of the agricultural and mining businesses in New Zealand and Australia which create or extract raw materials. Yet the profitability of producing these raw materials is often higher than the profitability of the manufacturing of final consumer products as there can be more competition in producing finalized products as opposed to producing raw materials or components. Creating more profits and adding more value in the intermediate or raw material stages of a GVC would often be dependent on achieving economies of scale and the use of more efficient technologies and not just access to low priced labor.

It is expected the advantage of having access to low priced labor will continue to diminish in the future in most industries (Taglioni, et al., 2017). In addition to use of technology, it is highly possible changing demographic patterns will also play a role in the changing nature of GVCs. With an aging population in much of East Asia and Europe, and a fairly young and growing population in India as well as many



Arab and African nations, it would seem probable some of the labor intensive activities of GVCs could be moving away from China or other parts of Asia to other areas of the world in the near future.

## **CONCLUSION AND RECOMMENDATIONS**

It is expected the impact of the current economic nationalism movements will be limited and temporary and are unlikely to create situations where major strategic changes as a response will be required in the short term for most firms engaging in international trade. However, the longer-term impact of changing economic and trade patterns can create both opportunities and challenges which will most likely lead to the need to make major, but possibly incremental, strategic changes by leaders of firms in developed, developing, and less developed economies.

Strategies for firms from smaller developing countries in an era of slowing growth in international trade and increased levels of anti-globalization rhetoric would expect to be different to some extent than it would be for firms from more economically developed regions and where economic nationalistic movements have the most strength. MNEs centered in more developed economies may have to show a response to public opinion and government attempts to restrict international trade to a greater extent than will firms in smaller developing nations. Due to the changing nature of trade patterns, MNEs in developing economies should not think they are totally dependent on trade with Western or developed countries in the long-term and should take advantage of changing trade patterns, economic opportunities, and demographics.

While often debated, the economically developed nations of the world seem to have also greatly benefitted from the era of globalization, despite the claims of some people making zero-sum game assumptions that workers in the developing world have taken jobs away from the more economically developed countries. But with more openness also come more competition which creates increased opportunities and challenges which, even if it creates more wealth overall, will result in a shift of wealth and power from some segments of an economy to others. The shift from an economy primarily based on manufacturing to an economy based on more intangible value created in services has been causing some short-term pain for some workers in Western economies, although in reality in a competitive free market economy there will always be some adjustment problems and pain as there is a constant rise and fall of the wealth of specific industries, individuals, and firms.

It is never surprising when individuals and other special interest groups who feel they are not sharing in the benefits of globalization react negatively to increased openness in an attempt to increase their personal benefits even if it is at the expense of increasing benefits for the overall economy and individuals working in other segments of the economy. This is to be expected as democracies are as much a contest for power between competing special interest groups as they are based on contests of competing ideas. All Western democracies have tried to balance the protectionist pressures from various special interest groups with the desire to grow the economy through openness and trade for decades and seem to have always found some sort of compromise. It is not apparent our current environment is creating a need for significantly different decisions or approaches than in the past.

But the longer term trend indicating Asian economies and firms are increasing in importance in the global trading system will gradually create a very different world economic system. While claims Asia will dominate global trade are probably not very realistic in the foreseeable future, developed and developing countries in Asia are increasing their levels of trade while growing their economies, thus offering

new international trading opportunities for firms from other developing or least developed countries. There are great opportunities for increased trade by East and Southeast Asian firms with firms in South Asia, Africa, and Latin America, but public opinion and government policies influenced by ideas of economic nationalism need to be overcome in order for firms to be able to increase international trade and investment in these regions.

In crafting strategies in the constant evolving world, it might be a good idea for decision makers in firms in developing economies to pay more attention to the incrementally changing long-term trends as opposed to putting too much weight on current political rhetoric and news headlines.

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# Chapter 3

## A Conceptual Framework for Managerial Analysis Under Economic Nationalism and Globalization: A Study of Japanese Automakers in the USA

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### **ABSTRACT**

*This chapter qualitatively examines cross-national managerial strategies employed at the Japanese automakers in the context of economic nationalism. It proposes and tests a simple yet versatile conceptual framework by developing existing models and integrating foundational concepts available in literature. Proposed as a tool for comparative analysis on management styles, the framework has two extreme ends of a continuum to capture not only variants of the social realities but also changes of businesses as it shifts between the extremes. The findings suggest that the force of economic nationalism likely affects the Japanese automakers' growth strategies, and the dynamics of managerial styles are company-specific under intensified globalization.*

### **INTRODUCTION**

The automobile industry, which constitutes a part of the manufacturing sector, has large multinationals, such as Toyota Motor Corporation (“Toyota”), Honda Motor Co., Ltd. (“Honda”), and Nissan Motor Co, Ltd. (“Nissan”). The major industry players have an extensive global network with localized subsidiaries worldwide. Toyota places a public release, dated January 16, 2018, on their website regarding their annual output in North America: With 46.5 thousand employees, Toyota manufactured 2.0 million

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vehicles in 2017. Despite their large-scale operations in the US, the Japanese automakers may need to expand further their establishments. Dated November 6, 2017, CNN online news features President Trump's trip to Japan and communication with Japan, Inc., including executives from the automakers. With the mission of reducing the nation's trade deficit with Japan by \$57 billion, the President asked them to increase the production of cars in the US instead of exporting from Japan. The mission appears to exemplify the current issue of economic nationalism, which tends to promote trade protectionism that can limit imports (Pryke, 2012).

Cross-national management has been an interest of researchers and practitioners. Takeo Fujisawa, cofounder of Honda, once explained his professional journey:

*Japanese and American management is 95 percent the same and differs in all important respects. – T. Fujisawa, Cofounder, Honda Motor Corporation (Adler, 2000, xiii)*

What differs between Japanese and American management, if not extinct, may not exactly be five percent today. However, it can be hasty to say that the two styles of management have converged with no material differences between them. This line of discussion seems to pose the question of how the Japanese multinationals manage their US operations and reconcile the “five percent” portion in the context of economic nationalism currently being intensified in the USA. Under such circumstances, the Japanese automakers may make more foreign direct investments in the USA for further growth and/or survival in the fierce competition. If the significance of the “five percent” portion is great, the two management styles will likely have more negotiations in cross-national settings. The difference of management styles seems to have direct relevance to the issue of economic nationalism, especially in the case of the country combination of Japan and the USA. This chapter will discuss the following three research questions: what elements constitute the “five percent” portion, why the two styles of management are different, and how the portion will possibly change in the context of economic nationalism, focusing on “all important respects”. This research has turned into the proposition of a new framework by developing existing models available in literature. The framework may be used to analyze management styles and their changes in the context of economic nationalism.

The existing body of literature offers rich discussions over the cross-national differences. Notably, Sako (1992) provides a useful framework entitled Arm's-Length Contractual Relation (“ACR”) and Obligational Business Relation (“OCR”), based on important evidence discovered in the electronics industry in the UK, where the local and the Japanese businesses were compared for Sako's study. ACR-OCR has two extreme ends of a continuum to capture any variants of the social realities sitting between the extremes. Also pertinent is the conceptual framework of liberal market economies (“LME”s) and coordinated economies (“CME”s) in the field of political economies (Hall and Soskice, 2001). Integrating these two frameworks, this chapter will propose a three-level framework named Arm's-Length Business Relation (“ABR”) and Obligational Business Relation (“OBR”), and test its theoretical validity. It is partially named after ACR-OCR because it is partly built on ACR-OCR. It differs from ACR-OCR in that it assumes general applicability to any trading relations between Japan and other countries, while ACR-OCR has its theoretical coverage of the electronics industry in Japan and the UK. The ABR-OBR framework is structured to be as all-embracing as possible. This chapter will begin with a review on ACR-OCR and LME-CME, establish the framework, and tests it against the qualitative findings obtained from the automobile industry.

## The ACR-OCR Model

Sako (1992) conducted a comparative study between British and Japanese business practices in the electronics industry, focusing on British trading relationships (defined as ACR between British manufacturers and their suppliers in Britain) and Japanese trading relationships (defined as OCR between British subsidiaries of major Japanese manufacturers and their suppliers in Britain). Table 1 is a summary of the descriptive definitions.

Table 1 summarizes the grounded elements of eleven features of the ACR and OCR patterns that are labelled (A)-(K), quoted from Sako (1992, 11-12), as listed in Appendix A. As presented, the OCR transaction patterns are contradictory from the ACR standpoint in the extreme sense, and vice versa. If a manufacturer and their suppliers agree on and strictly follow the ACR pattern for instance, the OCR pattern is no longer an option. In other words, the other practice is not transferrable as-is, though it may not always be the case. Sako (1992) begins her book with an important clarification: “It cannot be presumed that there is one single characteristic pattern of buyer-supplier relations in Japan and another in Britain” (1992, 2). ACR is not intended to assert that all British buyers and suppliers, without exception, equally exhibit all the ACR characteristics. By the same token, OCR never represents all Japanese buyer-supplier relations. ACR and OCR are “constructed to capture complex variations in buyer-supplier relations” and “best thought of as lying at the ends of a continuum” (Ibid.). Both Britain and Japan have “a range of actual trading patterns which lie on the ACR-OCR continuum” and in practice “the modal Japanese inter-company relationship is more OCR than the modal British one” (1992, 15). ACR and OCR are the extreme ends to capture complex corporate variations sitting somewhere between the ACR/OCR ends in the real business world. Figure 1 is an attempt<sup>1</sup> to illustrate the discussion:

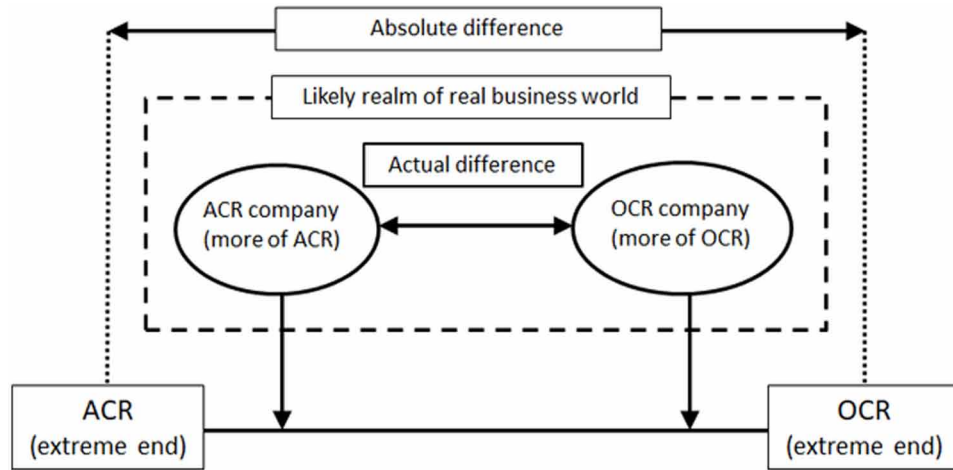
Sako (1992, 10) writes “There are two dimensions which capture the essence of ACR and OCR relationships, namely the degree of interdependence and the time span for reciprocity”. As described in Table 1, the ACR-OCR differences are attributable to the two dimensions. This chapter focuses on the degree of interdependence for the sake of brevity<sup>2</sup>. Labelled (A) in Appendix, transactional dependence (Sako, 1992, 11) describes the extreme patterns of interdependence between the manufacturers and the component suppliers. Because the high degree of interdependence is non-existent in the extreme sense of the ACR pattern, it may be difficult to understand for those who are not familiar with the OCR pattern. This chapter refers to the unfamiliarity as the lack of mutual knowledge. Cited from Sako (1992, 10), the following explanation on goodwill trust mitigates the difficulty:

*Table 1. A summary of the ACR and OCR patterns*

ACR	OCR
<ul style="list-style-type: none"> <li>● Involving a specific, discrete economic transaction with an explicit contract, which spells out before trading commences each party’s tasks and duties in every conceivable eventuality, as far as human capacity for anticipation allows.</li> <li>● Unforeseen contingencies to be settled by resort to some universalistic legal or normative rules.</li> <li>● All dealings to be conducted at arm’s and length, to avoid undue unfamiliarity, with neither party controlled by the other.</li> <li>● An easily available option of seeking an alternative trading partner when a contract comes to an end.</li> </ul>	<ul style="list-style-type: none"> <li>● Involving an economic contract covering the production and trading of goods and services.</li> <li>● Embedded in more particularistic social relations between trading partners who entertain a sense of mutual trust.</li> <li>● Transactions taking place without prior agreement on all the terms and conditions of trade because of the above underpinning.</li> <li>● An incentive to deviate from the tasks and duties spelt out in a contract and do more than is expected by the trading partner: Such an incentive results from expectations that the act of goodwill will lead to a similar response from the trading partner.</li> </ul>

(Adopted from Sako, 1992, 9-10).

Figure 1. ACR-OCR illustrated.



What underpins heavy mutual dependence as an acceptable, even preferred, state of affairs is the existence of ‘goodwill trust’. ‘Goodwill trust’ is a sure feeling that trading partners possess a moral commitment to maintaining a trading relationship. It may manifest itself in not taking unfair advantage of one’s circumstances (for which shared principles of fairness exist) and in offering preferential treatment or help whenever the need arises.

Goodwill trust is a “sure feeling” because it is a shared way of thinking beyond the corporate boundaries among the Japanese (OCR individuals) that Sako interviewed during her research. This interpretation suggests the necessity of examining the individual level, in addition to the organization level, for meaningful research. Firms have preferred styles, such as ACR and OCR, but professionals (or individuals) make the decisions that become the corporate decisions. Perhaps more precisely, firms are the reflections of individuals’ business decisions (Ketkar et al., 2012), some of which are driven by their individual beliefs that possibly pertain to Sako’s most grounded findings, which are the two dimensions as aforementioned. This chapter will establish a multi-layered model to include the individual level.

There is a later study that not only helps mitigate the lack of mutual knowledge but also tests the ACR-OCR framework. Toyoda (2003, available only in Japanese) conducted comparative research on the supplier contracts between the ACR and OCR patterns in the automobile industry. Table 2 summarizes his findings: the difference of the actual trade agreements made between the manufacturers and their suppliers in the automobile industry between *oubei* (the West in English) and Japan.

Table 2. Different trade agreements

J-System	W-System
Master trade agreement and separate or individual agreement(s).	Purchase order (PO) and accompanying documents.

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The “West” can be further categorized in many ways, but Toyoda’s comparative approach is theoretically acceptable. Toyoda reports the shared elements in his findings obtained in North America and Europe through interview research. Due to the various differences of management styles between Japan and the West, many researchers adopt the distinction to focus on the critical points, not the relatively minor differences. Aoki (1994, 33) for example uses “the J-system” and “the W-system” to refer to “the Japanese corporate system” and “the corporate system found in the West” respectively. This chapter borrows Aoki’s terminologies for discussion purposes, as the W-system and the J-system are generally equivalent to the ACR and OCR patterns, respectively.

Toyoda (2003, 29-30) writes that, in the J-system, the master trade agreement is used for general terms and conditions, and the separate or individual agreement determines specifics such as pricing. The Japanese assume a continued business relationship based on the high degree of interdependence (Sako, 1992). The master agreement is typically automatically renewed unless both parties terminate it. In the W-system, the PO is usually valid for one year, and both parties negotiate for renewal every year (Toyoda, 2003, 30). The PO is a legally binding document: *The American Heritage Dictionary of Business Terms* defines it as “A buyer’s written order to a supplier indicating all of the terms of a proposed transaction. A purchase order obligates the buyer if accepted by the supplier” (Scott, 2009, 421). Regarding the practice differences between the systems, Toyoda (2003, 33-34) writes of the following two major points: i) supplier selection and ii) supplier involvement in new product development. Adopted from Toyoda (2003, 34), Table 3 describes the processes of supplier selection.

Toyoda (2003, 34) points out the critical difference in the supplier selection process: In the W-system, the PO is sent out in each selection stage, meaning that a real screening process takes place in each stage. In the J-system by contrast, a request for a trial piece usually means that commercial production is awarded unless there is a critical problem with the supplier. This J-system approach perhaps appears rather senseless to ACR business professionals.

Toyoda’s research makes three contributions: First, it supports the concept of ACR-OCR. Its findings reveal the supplier selection process that drives Sako’s two dimensions. Second, it has tested the theoretical applicability of ACR-OCR to the automobile industry beyond the electronics sector, where Sako carried out her research. Finally, it suggests that the ACR pattern generally represents the “West”, including the English-speaking countries, as Toyoda investigated the shared elements in those countries.

*Table 3. Supplier selection processes*

	<b>J-System</b>	<b>W-System</b>
Initial state	Master trade agreement made.	Pool of suppliers to be selected.
Vehicle development stage	Collaborative work between manufacturer’s engineers and suppliers’ engineers.	Product development request and PO sent to suppliers.
Early selection stage	Suppliers selected that manufacturer sends RFQ, based on supplier’s technology and past transaction history.	Suppliers selected that manufacturer sends RFQ, after comparing suppliers’ products.
Middle selection stage	RFQ and accompanying documents evaluated. Price negotiation between manufacturer and suppliers.	RFQ and accompanying documents evaluated. Manufacturer’s target price presented.
Final selection stage	LOI sent to selected supplier to make a trial piece: Commercial production promising.	PO sent to selected supplier to make a trial piece.

Note: “RFQ” and “LOI” stand for a request for quote, and a letter of intent, respectively.  
(adopted from Toyoda, 2003, 34)

This section has examined the ACR-OCR framework in cross-national settings. The literature suggests that ACR-OCR has a potential to be used for a general comparison of managerial styles, as long as the two extreme ends are reasonably defined with the current specificities. The following section will examine the distinction of liberal market economies (“LME”s) and coordinated economies (“CME”s) in the field of political economies (Hall and Soskice, 2001). The LME-CME framework is structured at a broader level and encompasses the manufacturing sector.

## **The LME-CME Model**

Hall and Soskice (2001) discusses the typology of capitalism, proposing two types of political economies: liberal market economies (“LMEs”) and coordinated market economies (“CMEs”). In LMEs, “firms coordinate their activities primarily via hierarchies and competitive market arrangements”, and “market relationships are characterized by the arm’s-length exchange of goods or services in a context of competition and formal contracting” (2001, 8). As for CME, they (Ibid.) write “In contrast to LMEs, where the equilibrium outcomes of firm behavior are usually given by demand and supply conditions in competitive markets, the equilibria on which firms coordinate in CMEs are more often the result of strategic interaction among firms and other actors”. Hall and Soskice make a positive contribution, but unfortunately it is often criticized for their oversimplified typologies. Campbell (2010, 102) writes:

*Many critics of the varieties of capitalism approach have argued that it oversimplifies institutional reality. Real-world national political economies are in varying degrees complex institutional hybrids. They consist of a variety of interrelated institutions, some typical of liberal market economies and some typical of coordinated market economies.*

Nevertheless, the LME-CME typology is frequently cited in academia, as many scholars perceive it as relevant and useful. In discussing institutional change in financial systems, Deeg (2010, 313-314) explains why:

*There is... no simple correspondence between typologies of financial systems and typologies of capitalism. Comparative institutional theories of capitalism postulate anywhere from two to six types of capitalism, whereas institutional theories of finance typically postulate two or three types.... Thus for the purpose of simplifying discussion, we use the parsimonious Varieties of Capitalism typology to illustrate some of the key linkages between the financial system and firm behavior (financing patterns and market strategies) that are posited in the literature.*

The discussions suggest that the LME-CME typology is still prevalent though has its weakness of being oversimplified. This weakness can be mitigated by treating each of the LME and CME typologies as the two extremes to capture a multi-dimensional spectrum of possible types of institutional theories. The LME-CME extremes may not capture all types of political economies around the world, but the mitigating treatment remedies their weakness. This chapter will make constructive use of the prevalent idea of LME-CME, rather than calling it a parsimonious type.



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According to Hall and Soskice (2001, 20), the LMEs include Canada, the UK and the USA, all of which generally exhibit the ACR pattern (Sako, 1992; Toyota, 2003). The CMEs include Japan, which is typically OCR. The correlation seems to suggest that the models have a possible level of theoretical relevance. Figure 2 is an attempt to integrate the two frameworks:

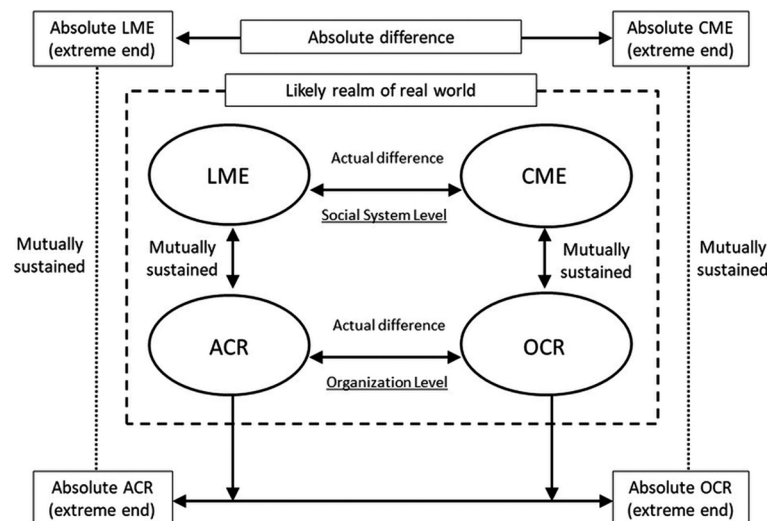
Each of the LME and CME definitions contains a key word to characterize the pattern: “Arm’s-length” (“ALP”) for LME and “strategic interaction” for CME. This CME feature of strategic interaction is, in Sako’s words, “embedded in more particularistic social relations between trading partners who entertain a sense of mutual trust” (Sako, 1992, 9) in OCR examined earlier. Sako (1992, 10) refers to this mutual trust as goodwill trust, which is the shared way of thinking under the unique dimension.

The shared notion of goodwill trust appears to explain the existence of keiretsu in Japan. The word *keiretsu* often means a series of subcontractors organized under a principal manufacturer (vertical keiretsu), and at other times, refers to a group of large firms in diverse industries (horizontal keiretsu)” (Hoshi, 1994, 287). “Most of Japanese industry was a collection of big industrial groups like Toyota” (Miyashita & Russell, 1994, 1) can be an appropriate remark made by Boone Co., cited in their book. Goodwill trust, or the high level of interdependency, denotes the OCR relationships within the OCR company groups. On the other side, LME and ACR are connected through the ALP, which is the shared cardinal rule for the paradigms. This classification corresponds with the fact that no keiretsu exists in LME (Miyashita & Russell, 1994).

One way of describing the LME-CME framework can be the typology of wealth creation (Hampden-Turner & Trompenaars, 2000). This chapter presupposes that LME and CME represent the patterns of wealth creation in the respective societies. Such patterns can be placed at a higher level than ACR-OCR, which captures trading relations at the organization level.

This section has examined LME-CME and its theoretical correlation with ACR-OCR. The following section will examine the pertinent literature concepts, which support this study’s multi-level approach. It will then create a combined model entitled ABR-OBR to be tested.

Figure 2. Integration of LME-CME and ACR-OCR.



## The ABR-OBR Model

Arie de Geus (2002, 77-128) writes of the concept of an entity's persona, originally coined by a renowned German psychologist, William Stern, who developed the intelligence quotient (IQ) formula. "To Stern, each living being has an undifferentiated wholeness, with its own character, which he called the *persona*" (2002, 84). To explain the concept, de Geus introduces a vertical ladder that William Stern drew in 1919. The ladder has five levels, namely *Deity/Divinity/Godhead* being on the top row, followed in descending order by *Nation, Tribe, Family* and *Individual* placed on the lowest row, each of which is "a persona in its own right" (2002, 87). As de Geus refers to the concept as "persona (identity)" in his book, the closest colloquial expression of *persona* can be *identity*, though they may not be semantically identical. Borrowing Stern's ladder, de Geus illustrates a company (for example Royal Dutch/Shell discussed in his book) using a ladder with seven levels, namely *Society* being on the top, followed in descending order by *Corporation, Company, Division, Work Group, Team* and *Individual*. The regionally unique pattern, such as LME and CME examined earlier, can be the persona of the society. The structure of this chapter corresponds with their idea to describe the whole. Across the levels, each entity (an OBR firm for example) has its unique characteristics, constructing its persona of the OBR pattern. The concept of persona supports the theoretical structure in this chapter.

Williams and Zumbansen (2011, 12) write about the concept of embeddedness, which is helpful in conceptualizing the connections between the levels mentioned previously. To explain *embeddedness*, Williams and Zumbansen (2011, 8) first borrow the following quote with respect to "a sociological and institutional perspective to bear on a fundamental observation" (Granovetter 1985, 481-510):

*Markets are embedded within the social and political systems in which they arise. Thus, the markets cannot be considered free-standing institutions outside of a society, as the 'free market' often had been, and still is in some contexts. Rather 'the market' must be understood as an embedded institution that manifests the social and political values of the society in which it is embedded, including the professional and transnational networks that affect the market, even as it develops its own logic and values.*

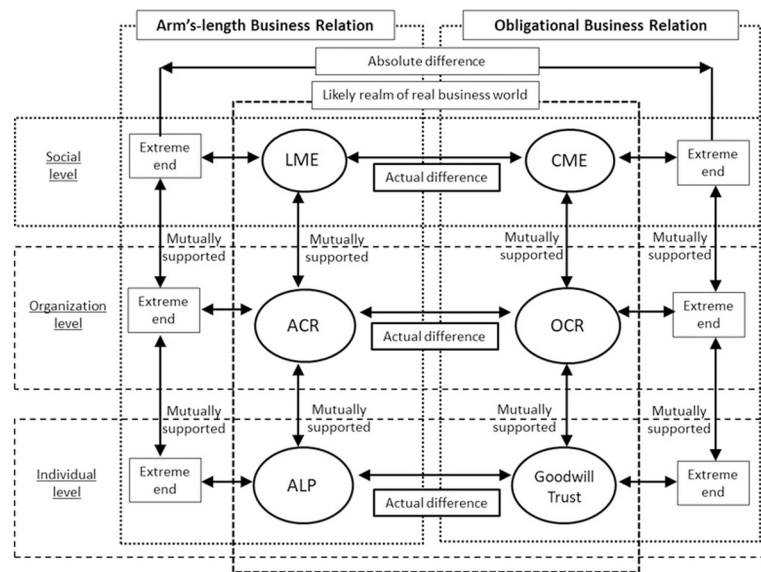
This 30-year old quote still attracts many academic interests perhaps because it provides something critical today. Following the quote, Williams and Zumbansen (2011, 8) offer their observation:

*One implication of this view is that corporate governance reforms cannot be considered in isolation from a thorough understanding of the social and cultural context in which companies arise, and in conjunction with a thorough understanding of the complementarities between companies, corporate governance systems, and the political and institutional frameworks in which companies operate.*

They appear to have borrowed Granovetter's work in order specifically to discuss corporate governance, but Granovetter's implication appears broader than that. The shared part of their arguments can be that institutions and markets are embedded in a society and manifest social values, and that is why those cannot be discussed in isolation from social values. An example of a social value can be goodwill trust (Sako, 1992, 10) as examined earlier. Combining the concepts reviewed herein, Figure 3 illustrates the proposed ABR-OBR model to be tested:

This diagram is entitled the ABR-OBR model to distinguish its differences from Sako's ACR-OCR. ABR-OBR assumes the widest theoretical applicability to any trading relations in any industry between

Figure 3. ABR-OBR model.



Japan and other countries, though this chapter focuses on the differences between Japan and the English-speaking countries in the manufacturing context. The model has the social system, organization and individual levels. This structure is set based on the assumption that the three levels are vital for discussion and not too much for a single research project. At the individual level, ABR has the ALP, which represents the individuals' trust in the arm's-length principle and the shared preference of it over goodwill trust in the extreme sense. In relation to the ALP, there is a relevant specificity, which is *freedom*, to elaborate ABR. In his well-known book *Capitalism and Freedom*, Friedman (1962, 195) explains it as "a belief in the dignity of the individual, in his freedom to make the most of his capacities and opportunities according to his own lights [*sic*], subject only to the proviso that he not [*sic*] interfere with the freedom of other individuals to do the same". The ALP is cardinal, perhaps because it best regulates the ABR entities with the freedom of choice. On the other hand, goodwill trust is an unspoken code of conduct in the OBR extreme. It governs the OBR entities including the keiretsu groups.

Miyashita and Russell (1994, 7) write "The word *keiretsu* does not translate neatly into English, and that is the beginning of the problem". It is problematic in a cross-national setting because their purposes of existence are not exactly the same. de Geus (2002, 100) argues "There are in fact two different types of commercial companies in existence today, distinguished by their primary reason for being in business". Below is a summary of the two types cited from de Geus (2002, 100-103):

*The first type is run for a purely "economic" purpose: to produce maximum results with minimum resources. This sort of "economic company" is managed primarily for profit.... The economic company is not a work community. It is a corporate machine. Its sole purpose is the production of wealth for a small inner group of managers and investors. It feels no responsibility to the membership as a whole.... The second type of company, by contrast, is organized around the purpose of perpetuating itself as an ongoing community.... Return on investment remains important. But managers regard the optimization of capital as a complement to the optimization of people. The company itself is primarily a community.*

His discussion explicates the different purpose of existence for the two forms of alliances. The first type (of economic company, “E-type”) and second type (“C-type”) represent the W-form and the J-form, respectively. Perhaps the notion of a “work community” or a “community” may require an additional explanation because individuals, who are only familiar with the E-type, are naturally unfamiliar with the C-type. The preceding quote reads that any C-type company can be a community “with the purpose of perpetuating itself as an ongoing community” (“C-type purpose”). This C-type purpose, however, applies to various industrial groups besides a company. A keiretsu group can also be a diffused level of “community”. The Japanese have goodwill trust beyond the corporate boundaries following the C-type purpose. The keiretsu groups are organized around the C-type purpose, while Western strategic alliances are not. This chapter presupposes that the proposed three levels have a mutually nurturing relationship in the respective societies.

To reiterate, the model is set up not to propose the rigid dichotomy but to capture the social realities, in which the profit-making firms operate following the ALP and goodwill trust to varying degrees. Similarly, the model is not to judge which pattern is better than the other. This study focuses on the pattern differences for analysis and considers that neither pattern is superior to the other. In the model, the concept of embeddedness (Williams & Zumbansen, 2011) is expressed as the connection, which supports the mutual existence of the three levels. This chapter tests the ABR-OBR model against the findings and evaluates its theoretical validity. ABR-OBR can be used as a tool for analyzing cross-national business strategies in the context of economic nationalism, which may change the environment of cross-national businesses.

## **METHODOLOGY AND DATA COLLECTION**

This research employed methodological triangulation, as well as data triangulation for maximizing research confidence. Triangulation refers to the process of “using more than one method or sources of data in the study of social phenomena” in order for greater confidence in findings (Bryman & Bell, 2007, 413). This chapter triangulated document analysis and case studies. There seems to be an academic debate as to whether case study research is a methodology or a choice of what is to be studied, but literature generally suggests that case study research can be “a strategy of inquiry, a methodology, or a comprehensive research strategy” (Creswell, 2013, 97). Perhaps the bottom line is that a methodology is “a way of thinking about and studying social reality”, and methods are “a set of procedures and techniques for gathering and analyzing data” (Strauss & Corbin, 1998, 3). In terms of document analysis, literature generally suggests the four criteria for choosing documentary sources: authenticity, credibility, representativeness, and meaning, all of which are vital for the sources to be genuine, accurate, free from error or distortion, typical of its type, comprehensive, and unambiguous (Denscombe, 2003, 220; Bryman, 2004, 381). This research’s focus on the automobile industry has helped have appropriate data sources. Evidential data, for example interview results posted in the news media dedicated to the automobile industry, are readily available for research on everyday cross-national interactions and pertinent topics, such as the Japanese keiretsu. The choice of industry has come with a high level of data availability, data suitability and research effectiveness. Methodologically speaking, this research adopted the case-study driven grounded theory approach (Strauss & Corbin, 1998) with document analysis on secondary data.

Stewart (1984, 14) warns of the disadvantages of secondary data available in literature: “Category definitions, particular measures, or treatment effects may not be the most appropriate for the purpose

at hand.” As a result, “Not all information obtained from secondary sources is equally reliable or valid” (1984, 23). The grounded theory approach, which involved the act of making constant comparisons, helped mitigate the disadvantages. This research is structured in such a way that its arguments are based on its original findings supported by the literature findings. In other words, the original findings and the literature data mutually supported each other.

## **FINDINGS**

### **The High Level of Interdependence**

This section will report on the shared value of goodwill trust embedded in the following qualitative data regarding the Toyota<sup>3</sup> group’s major supplier, which is chosen for analysis as it is a part of the Toyota keiretsu. In the interview with Automotive News conducted on June 30, 2014 (Greimel, 2014), Tadashi Arashima, President of Toyoda Gosei Co., Ltd. (“Gosei”)<sup>4</sup>, spoke of his vision for the future:

*I want to change this company into a true, real global supplier. That is the goal. In Japan, we can rely on Toyota very much. But if it is outside of Japan, except for maybe Indonesia or Thailand, Toyota’s market share is still quite low and not so stable. We have to have a broader customer base.*

This short yet quality interview data contains many implications. For analysis, it is disaggregated into two: i) in Japan, Gosei relies on Toyota and ii) outside Japan, Gosei needs to be on its own and expand its business by finding new customers. The first unit is straightforward evidence that supports the continued existence of goodwill trust shared within the Toyota group. As discussed previously, goodwill trust is the representative Japanese societal value subsumed under the dimension of the high level of interdependence. Goodwill trust is unique to OCR, which is the extreme pattern of the Japanese manufacturer-supplier relation.

The second unit of analysis concerning Gosei’s non-Japanese operation may appear remote from goodwill trust at first. The expansion of non-Toyota businesses can be a growth strategy common for all major automotive suppliers in any countries in order to survive in the increasingly globalizing automobile industry. Nevertheless, the second unit is evidence to support the OBR pattern observable in the Toyota group. The following is another interview data for further analysis regarding Toyota’s recent development. In the interview with Automotive News conducted on July 7, 2015 (Greimel, 2015), Yasunori Ihara, President of Aisin Seiki Co., Ltd. (“Aisin”, another major Toyota supplier), explained Aisin’s growth strategy:

*Before, Toyota’s purchasing policy was ‘Don’t sell to non-Toyota,’ ‘Please insist on Toyota.’ But now they are promoting it, that we should sell to non-Toyota. They have changed their policy.*

Why has Toyota changed their policy? Akin to Gosei, Aisin is selling parts to non-Toyota. Greimel (2015, 52) offers a good explanation on Toyota’s global strategy:

*It may seem counterintuitive, but Toyota installed former board member Yasunori Ihara as the new president of one of its most important suppliers with the mission to selling more parts to Toyota’s rival*

*automakers. But Toyota's strategy is hardly altruistic. Indeed, its thinking goes: If Aisin, the Toyota Group parts maker Ihara now runs, sells more to Toyota's competitors, Aisin's own products will improve in price and performance. Call it the virtuous cycle of Toyota Group suppliers stepping up business with outside automakers.*

If successful, this strategy will yield an obvious benefit: "The higher sales volume brings down parts prices for all carmakers, benefiting new partners as well as long-established customer No. 1, Toyota" (Greimel, 2015, 52). The strategy pertains primarily to economies of scale, the concept of which may be seemingly remote from goodwill trust. The critical point here is Aishin's ultimate goal, which is to be a good Toyota supplier based on their goodwill trust with the suitable business strategy for the on-going industry-wide globalization. It is wrong to judge, based on the superficial part of the strategy change, that the Toyota group has ended making keiretsu transactions. If a researcher only examines Aishin's new relationships with non-Toyota companies, overlooks Aishin's shared goal within the Toyota group, and claims "Toyota no longer employs the keiretsu system", this wrong conclusion exhibits "the ecological fallacy that arises from a mismatch of unit of analysis" (Neuman, 2006, 168). The unit of analysis here is the continued existence of the Toyota keiretsu based on their goodwill trust, not their strategic adjustments necessary for survival.

It is important to reiterate that Yasunori Ihara, Aishin's president, is dispatched from Toyota for the shared goal: Aishin to be a better, stronger Toyota supplier in order to provide more affordable parts for Toyota. Tadashi Arashima, Gosei's president, is also sent from Toyota. According to his biography available in Bloomberg<sup>5</sup>, he first joined Toyota in 1973 and then served Toyoda Gosei Co. Ltd, Toyoda Gosei Meteor GmbH, Toyota Motor Europe NV/SA, Toyota Motor Sales USA, and Toyota Motor Marketing Europe during this career with the Toyota Group. All of his job changes are solely based on Japan's mandatory job rotation system under lifetime employment (Ono, 2010), which is a pillar of Japanese management (Abegglen, 2006). The pieces of evidence together indicate that Toyota has coordinated Gosei and Aishin's growth strategies. This coordination stems from the primacy of interdependence in the OBR context.

## **The Low Level of Interdependence**

The previous section has identified the high level of interdependence observable in today's Japanese automobile industry. Moving onto the other side, this section first examines the belief in the arm's-length principle ("ALP"), which is the very essence of ABR. Scott (2009, 23) defines an arm's-length transaction as "a transfer of property between a willing buyer and a willing seller with no coercion or advantage being taken by either party. An arm's length transaction is most likely to result in a fair price to both the buyer and the seller". "A fair price" usually refers to a market price in the regional sense, which is generally taken for granted in the LMEs, including the English-speaking countries. This chapter perceives the belief in the arm's-length concept as a shared way of thinking within the regions. As noted earlier, this view does not mean to assert that all transactions are purely based on the ALP in the ABR societies, nor that no transaction conforms to the arm's-length rule in the OBR societies. The belief in the ALP is a dominant constituent of the ABR pattern, which is in theory one extreme end. On the other end, the OBR pattern hinges on goodwill trust. All businesses, including ABR and OBR entities in the real world, stand somewhere between the extremes.

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Edward Lapham, the executive editor of Automotive News, writes of his opinions in his article with the headline “Comment: Times change, but supplier talk doesn’t” (Lapham, 2008) in Automotive News. It talks about the ACR suppliers’ relationships with General Motors Company (“GM”), Ford Motor Company (“Ford”) and the US operation of Fiat Chrysler Automobiles (“Chrysler”), all of which are multinational automakers headquartered in the US. Because his comment is short yet high in quality and cohesive in conveying his message on the ABR pattern, the entire comment is quoted as evidence:

*I ran across an upbeat headline the other day: “A brand new way... to do business: GM and suppliers to be partners.” No, the story wasn’t about the happy talk of the need for collaboration, heard at the Management Briefing Seminars this month. The headline was from the February 25, 1985, issue of Automotive News. It quoted Donald Pais, who was then director of materials management for General Motors’ Chevrolet-Pontiac-Canada group. The rhetoric never seems to change. One executive who was in Traverse City, Michigan for this year’s seminars told me that the presentation by Ford purchasing boss Tony Brown about the company’s preferred suppliers sounded a lot like the spiel that former Ford purchasing boss Carlos Mazzorin used to deliver nearly a decade ago. In the same session, John Campi, Chrysler’s executive vice president of procurement, used a PowerPoint slide that showed his view of healthy supplier relations. It had three main elements: lowest total cost, highest quality and fastest time to market. Though worded differently, Lopez’ three benchmarks that suppliers had to meet were the same: quality, service and price. But in 1992, most suppliers were certain that Lopez really only cared about lowering GM’s cost and would use any excuse to tear up supply contracts and renegotiate prices. Times and circumstances change. You can call companies that sell stuff to automakers’ vendors, suppliers, partners or collaborators. But by any name, suppliers still depend on their customers. And like shoppers everywhere, automakers want the best price they can get. The rhetoric never changes, because the basic relationships don’t change. (Lapham 2008)*

This comment candidly talks of the ACR social reality from the suppliers’ viewpoint, without being deceived by the sales patters made from the large automakers’ viewpoint. It offers many insights: GM and its suppliers are, in reality, not collaborative partners in the true sense of the word. GM’s US operations and its Canadian operations are by and large managed in the same manner with respect to purchasing. The three benchmarks “quality, service and price” are paramount for the Detroit Three, which refers to GM, Ford and Chrysler. Among those three benchmarks, “price” in the ABR sense represents the arm’s-length principle. Lapham points out that the culturally-driven practice of the ABR pattern (“rhetoric” in his words) never changes, suggesting that the stability of the ABR pattern is high through economic ups and downs over the past 30-plus years.

### **Change in the Degree of Difference**

The preceding two sections have presented evidence that substantiates the two extreme ends of the proposed framework. To explore the dynamics of trading patterns in the real business world, this section will examine Nissan’s North American operation (“Nissan NA”), which appears to have become more of ABR. This study differentiates Nissan NA from Nissan because it may not be operationally identical to Japan’s Nissan. In her Automotive News article *Nissan Aims to Improve Its Supplier Relationships*, Chappell (2016) makes the following comments on Nissan NA: “Nissan is vowing to mend its ways with North American parts suppliers, following a year of criticism that it is pushing too hard for price

reductions” (2016, 20). Her article contains Nissan’s explanations, delivered by Mr. Chris Reed, a Nissan North America executive as follows:

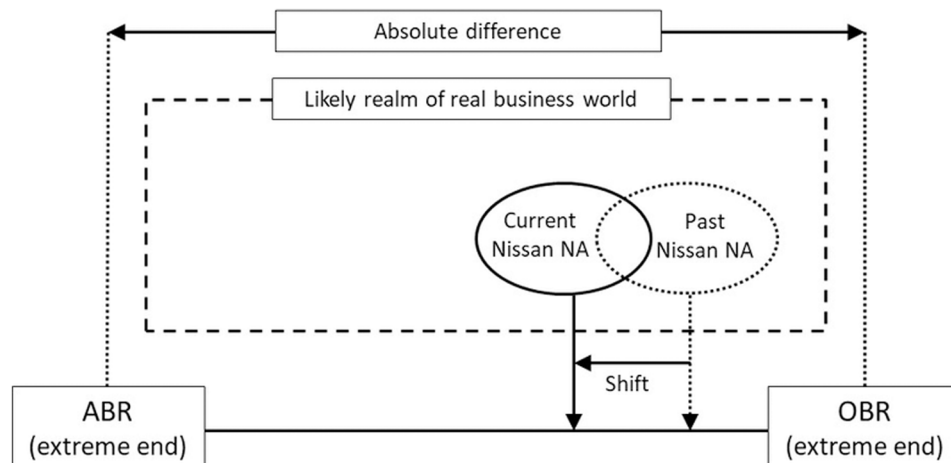
*By bringing suppliers into the planning too late, the automaker has often already locked into hard cost targets, and that suppliers looking at such cost targets might be limited in what they can give the company.*

Portrayed in his explanation, Nissan NA’s approach to its suppliers seems to have departed from the typical OBR practice, which features a high level of interdependency for the planning based on goodwill trust between an OBR automaker and their suppliers. The interview data suggests that Nissan NA’s management has possibly become more remote from the OBR end, or alternatively said, Nissan NA’s practice (of Nissan-supplier relationship) has been localized in the USA more than it used to be. The following section will present additional evidence for the OBR characteristic and the change of Nissan NA’s managerial style. Figure 4 attempts to illustrate the pattern change of Nissan NA in terms of manufacturer-supplier relation at the organization level.

To reiterate, this change took place not in Nissan’s Japanese operation but in their North American operation. The shift distance represents how much Nissan NA has moved towards the ACR side on the linear scale between the ABR and OBR extremes. One possible reason for Nissan NA’s shift from the OBR pattern may be that, as widely known, Nissan’s top management has become highly international since 2000 or around. The CEO change at Nissan’s Japanese headquarters might have allowed Nissan NA to change under the influence of the local ABR pattern, becoming more remote from the OBR end. The CEO change probably have lessened the restriction of the prevailing Japanese OBR pattern, on which Nissan NA’s expatriate Japanese managers based their business decisions in the past. All these scenarios can be theoretically illustrated in the ABR-OBR framework.

This section has examined the evidential comments made by the high-level managers that support the proposed framework. The next section will summarize the findings and envisage the consequences of a greater level of globalization under the economic nationalism from the standpoint of the Japanese multinationals.

Figure 4. Change of Nissan NA





## DISCUSSIONS

The findings have supported each of the patterns in the proposed ABR-OBR model. Table 4 summarizes the categories of findings elicited in this research and borrowed from the literature, presented in the form of two extremes to capture the social realities.

This research has developed the categories through the grounded theory approach (Strauss & Corbin, 1998) by constantly making theoretical comparisons of the findings. This interplay helped satisfy the need to condense all the findings into the grounded element: Each society has the nexus of categories across the levels. The actual state of each of the categories is not as binary as the extremes presented, but the findings indicate that the extremes generally represent the modal patterns in the respective societies. Table 4 answers the research questions: It signifies the “5% portion” (Adler, 2000, xiii), and the extremes give shape to the differences of managerial styles. ABR-OBR can capture a change of a management strategy.

As mentioned earlier, no pattern is superior to the other. A normative practice in one society may not always so once it goes beyond the national boundary. The following subsections will look at the positive and negative sides of global expansion.

### Positive Consequences

This section will discuss the positive scenarios of globalization by analyzing publicly available research, “Tier 1 Supplier Working Relations Index” or “WRI” (Hedge, 2015) in the OBR context in the ABR-OBR framework. Planning Perspectives, Inc. (“PPI”), a Michigan-based research firm, annually conducts a useful study on automobile manufacturer-supplier relationship. Developed by Dr Henke, president of PPI, as well as a Professor of Marketing at an American university, WRI is “a quantification of suppliers’ working experiences with a company to whom they are supplying products and/or services” according to their website<sup>6</sup>. Appendix B shows their study’s 16 variables (adopted from Figure 1 in their webpage<sup>7</sup>), and Figure 5 illustrates the quantified results transformed to a linear scale of 0 to 500 (adopted from Figure 2 on the same webpage). Figure 6 illustrates their results over the last decade. According to their

*Table 4. Summary of findings.*

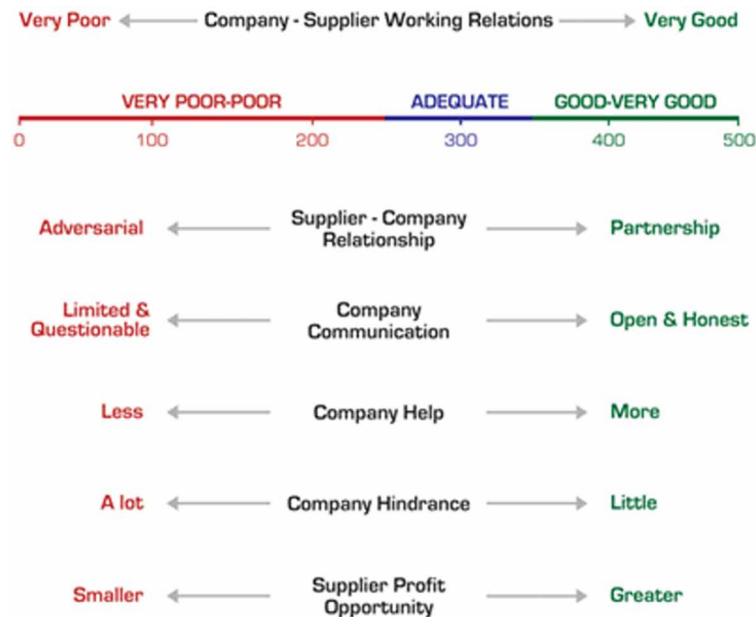
Grounded finding	Arm's-Length Business Relation (ABR)	Obligational Business Relation (OBR)
LME-CME patterns of wealth creation at the social system level		
Business relationships	Market relationships	Non-market relationships accepted
Transaction	Formal contracting	Non-formal contracting accepted
Unique corporate form	Strategic alliance	Keiretsu
ACR-OCR trading patterns in the manufacturing sector at the organization level		
Degree of interdependence	Low	High
Time span for reciprocity	Short	Long
Supplier selection process	Conducted every vehicle life	Conducted every relationship
Underlying beliefs at the individual level		
Principal rule	Arm's-length principle	Goodwill trust
Social orientation	Freedom	Interdependency
Shared purpose	Economic purpose	Community purpose

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press release (Hedge, 2015), their study has been carried out for the last 15 years, and in the recent 2015 study “541 sales persons from 435 Tier 1 suppliers - representing 1,595 buying situations (e.g. supplying brake systems to FCA, tires to Toyota, seats to GM) and 59% of the six OEMs’ annual buy - responded to the survey. Demographically, the supplier-respondents represent 44 of the Top 50 NA suppliers and 67 of the Top 100 NA suppliers.” These descriptions indicate that the WRI is generated from a massive research project.

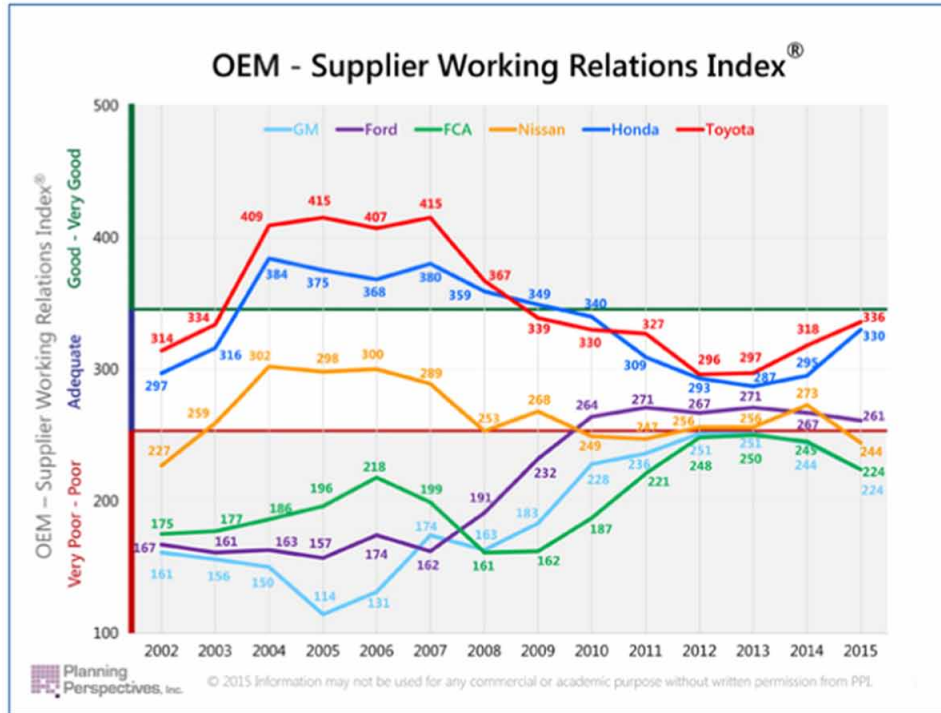
PPI does not release their survey questionnaires nor the formula to compute the WRI index values, so their results may only be used to have general ideas on their 16 variables classified into the five components, with regard to the automakers’ North American operations. However, this chapter borrows the WRI as evidence because it is easy to interpret and is based on a large number of survey data. One feature of their study is supplier-driven: It is the sum of the suppliers’ judgment results on the OEMs such as GM and Ford. The WRI components and variables read that, other than Supplier Profit Opportunity, their components correlate to the ACR-OCR patterns in a way that the more OCR (more of the J-system), the higher the scores are on the linear scale. Their study results cannot be taken as definitive evidence but considered a general consensus that the highly rated manufacturers respect collective collaboration with the suppliers for quality improvement. The WRI results indicate that the Japanese 3 (Toyota, Honda and Nissan) have scored higher than the Detroit 3 (GM, Ford and FCA), though Nissan has not been rated high in the last seven years. In their study report, Hedge (2015, 3) explains “One word can explain the difference in supplier relations between Toyota and Honda and the other four automakers, said Henke: Commitment.” His key word signifies goodwill trust in the OBR pattern, rather than the freedom of choice given to the ABR suppliers. One possible interpretation of the study can be that the respondents (suppliers) rate Toyota and Honda well, because Toyota and Honda are more collaborative about the

*Figure 5. Working relations index (WRI)  
(adopted from Planning Perspectives, 2013, Figure 2)*



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Figure 6. OEM supplier working relations index  
(adopted from Hedge, 2015, 1)



parts quality than the others, even in North America. Toyota and Honda’s North American operations can be generally influenced by a typically J-system way of management developed in Japan (Liker & Hoseus, 2008), though the level of cross-national influence may differ company by company. However, the OCR entities tend to believe that continued, often quasi-eternal, manufacturer-supplier relationship is vital for new product development and secures financial sustainability for the OCR group in the long run. This belief is nothing but goodwill trust (Sako 1992, 10) - “a sure feeling that trading partners possess a moral commitment to maintaining a trading relationship” - the core component of OCR. In the extreme OCR pattern, having an evergreen relationship outweighs following the arm’s-length criteria, which is used to choose the cheapest deal and as a result breaks the existing trading relationship.

The WRI findings indicate that Nissan NA has not been rated high since 2010. The change of Nissan NA indicates that, while Toyota and Honda are more OCR even in North America than the Detroit 3, the Nissan suppliers see Nissan NA as ABR as the Detroit 3. The results show that in the recent years Nissan NA has possibly become more ABR than it was before.

Obtained from the standpoint of automobile suppliers, their findings suggest that the OBR pattern can generate positive results in the globalized context. The OBR trading relationships tend to be longer than the ABR extreme, where the buyer-supplier relationships practically have no end date because of goodwill trust (Sako, 1992). However, the favorable topics discussed in this section may be the tip of the iceberg. The following section of a short case study will examine the negative consequences of global expansion with the case theme of price-fixed automobile parts.

## **Negative Consequences**

According to Automotive News (Greimel 2016, 3), “US auto dealers and consumers are suing parts makers, saying they paid more for their vehicles because of price-fixing by the suppliers. The civil suits follow numerous criminal cases filed by the federal government over price-fixing.” Indeed, the Antitrust Division of the US Department of Justice (“DOJ”) has been investigating into price-fixing since 2011 in collaboration with the FBI, according to the Department of Justice’s webpage<sup>8</sup>. Dated May 31, 2018, the DOJ places the latest news on their webpage about a Japanese auto parts company, which is to pay a \$12 million criminal fine. The news reads “The Antitrust Division’s prosecution of widespread collusion in the auto parts industry has yielded more than \$2.9 billion in fines and convictions of 46 corporations and 32 executives”. Morgan Lewis offers a useful report *Automotive Parts Investigation Summary*<sup>9</sup> that lists the 65 criminal cases, most of which are Japanese businesses, as of February 1, 2017. Greimel (2016, 32) reports on the background behind the lawsuits:

*The plaintiffs cite what they call the Japanese business practice of shoken, meaning “respecting commercial rights” or “respecting incumbency.” The understanding was if one supplier had an existing relationship with an automaker, the others wouldn’t muscle in on that territory. They would “pretend” to compete but ensure their bids were too high, the suits claim. Suppliers also allocated business among themselves geographically, the suits say.*

The definition of shoken appears to mirror goodwill trust, which promotes the C-type purpose between an automaker and its suppliers based on their long-term business relationships for collaboration to produce quality vehicles at their best in their OBR approach.

As discussed earlier, Toyoda Gosei Co., Ltd. (“Gosei”) and Aisin Seiki Co., Ltd. (“Aisin”) are Toyota’s important suppliers. In 2014, both agreed to plead guilty for fixing prices and rigging bids on automobile parts. Gosei and Aishin were to pay \$26 million<sup>10</sup> and \$35.8 million<sup>11</sup> in fines, respectively.

One important implication of this case study is that Japanese multinationals should be aware that some of the OBR aspects cannot be transplanted or translated as-is to the ABR society. As examined earlier, the concept of embeddedness may be expressed as the nexus of tight connections between regional practices and societal specificities, including laws. When a foreign practice of OBR is imported to the USA and turns out incompatible in the destination society, the imported OBR practice may result in serious consequences.

## **CONCLUDING REMARKS**

This study’s findings suggest that each society has its character, which can be expressed for example as LME or CME. Within the proposed framework, the social specificities have mutually nurturing relationships across the levels in the respective societies. No pattern can be superior to the other, as the compatibility between the specificities can weigh heavily in one society. Under the intensified globalization in the context of economic nationalism, the major Japanese automakers may need to be more knowledgeable when expanding their US operations. The expansion may entail a greater level of localization that probably calls for sensible cross-national management. No automakers can build cars without supplier support, yet their managerial strategies appear to vary by management and location. The framework

may be used as a supporting tool to analyze what is effective and preferable in the respective societies by comparing the different attributes, which affect supplier relation.

Huntington (1996/2011, 21) argues “In the Post-Cold War world, the most important distinctions among peoples are not ideological, political, or economic... They are cultural” in his famous book *The Clash of Civilizations and the Remaking of World Order*. His definition of *culture* appears to overlap the OBR belief in goodwill trust being referred in this chapter. The findings support the existence of various dichotomies with two extreme ends and consequently the idea that the world is not homogeneous. In the respective societies, educators and researchers conduct research on regional business practices and introduce them as correct practices at educational institutions. The graduates then become the business decision-makers, following the contents of their education and the institutional rules laid out at the workplace. The chain of whole social activities is carried over by generations. Regionally shared patterns at each level, which together support the development of the social chain, deserve attention in today’s globalizing world.

Lastly, the best way of applying the proposed ABR-OBR framework is not to argue that the sets of patterns are inevitably uncompromising and unmanageable but to consider how to reconcile them between societies. There is a saying: Opposites attract. Two best friends are often likened to the opposite poles of a magnet. Their friendship is the result of good communication and reconciliation. ABR-OBR is intended as a theoretical tool for positive and constructive use to help identify cross-national differences and overcome the lack of mutual knowledge.

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## ENDNOTES

- <sup>1</sup> All figures are created by the author unless otherwise specified.
- <sup>2</sup> Refer to Jacobs (1991) for the time span for reciprocity.
- <sup>3</sup> Toyota and its subsidiaries sold over nine million cars, trucks and buses worldwide under the Toyota, Lexus, Daihatsu and Hino brands in the fiscal year ended March 31, 2014. Toyota manufactures vehicles and parts in 27 countries and regions around the world and sells them in more than 170 countries and regions. Fact sheet available at <http://www.toyota.com/usa/investors/> (accessed 24 January 2016).
- <sup>4</sup> Gosei is one of the major Toyota-affiliated (“keiretsu”) component suppliers. Toyota has a 42.65% ownership interest in Gosei. Sales to Toyota account for more than 60% of Gosei’s consolidated sales on a global basis. Gosei has 65 group companies in 18 countries and was founded in 1949 as a spin-off of Toyota’s rubber product division. Fact sheet available at <http://www.toyoda-gosei.co.jp/kigyuu/library/> (accessed 24 January 2016).
- <sup>5</sup> <http://www.bloomberg.com/research/stocks/people/person.asp?personId=22865682&privcapId=319676> (accessed 13 August 2017).
- <sup>6</sup> <http://www.ppi1.com/> (accessed 20 March 2016).
- <sup>7</sup> <http://www.ppi1.com/working-relations-index/> (accessed 20 March 2016).
- <sup>8</sup> <https://www.justice.gov/atr/division-update/2015/auto-parts-investigation-2015> (accessed 13 March 2016).
- <sup>9</sup> <https://www.morganlewis.com/news/morgan-lewis-report-aggressive-global-cartel-enforcement-to-continue-in-2017> (accessed 1 September 2018).
- <sup>10</sup> <https://www.justice.gov/opa/pr/toyoda-gosei-co-ltd-agrees-plead-guilty-fixing-prices-and-rigging-bids-automobile-parts> (accessed 13 March 2016).
- <sup>11</sup> <https://www.justice.gov/opa/pr/aisin-seiki-co-ltd-agrees-plead-guilty-customer-allocation-automobile-parts-installed-us-cars> (accessed 13 March 2016).



**APPENDIX A**

*Table 5.*

ACR	OCR
<ul style="list-style-type: none"> <li>• (A) Transactional dependence: Buyer seeks to maintain low dependence by trading with a large number of competing suppliers within the limits permitted by need to keep down transaction costs. Supplier seeks to maintain low dependence by trading with a large number of customers within limits set by scale economies and transaction costs.</li> <li>• (B) Ordering procedure: Bidding takes place; buyer does not know which supplier will win the contract before bidding. Prices negotiated and agreed before an order is commissioned.</li> <li>• (C) Projected length of trading: For the duration of the current contract. Short-term commitment by both buyer and supplier.</li> <li>• (D) Documents for exchange: Terms and conditions of contract are written, detailed and substantive.</li> <li>• (E) Contractualism: Contingences are written out and followed strictly.</li> <li>• (F) Contractual trust: Supplier never starts production until written orders are received.</li> <li>• (G) Goodwill trust: Multiple sourcing by buyer, combined with supplier's low transactional dependence.</li> <li>• (H) Competence trust: Thorough inspection on delivery; the principle of caveat emptor predominates.</li> <li>• (I) Technology transfer and training: Only the transfer, training or consultancy which can be costed and claimed for in the short run occurs.</li> <li>• (J) Communication channels and intensity: A narrow channel between the buyer's purchasing department and the supplier's sales department, with frequently kept to minimum necessary to conduct business.</li> <li>• (K) Risk sharing: Little sharing of risk; how risk, resulting from price and demand fluctuations, is to be borne by each party is spelt out in explicit prior agreement.</li> </ul>	<ul style="list-style-type: none"> <li>• For a buyer, avoidance of dependence is not a high priority; it prefers to give security to few suppliers, though may still dual or triple source (some from a fringe group of suppliers with whom it has ACR relation) for flexibility. For a supplier, avoidance of dependence is not a high priority, but it may well have several OCR customers (plus, perhaps, a fringe group of ACR customers).</li> <li>• Bidding may or may not take place. With bidding, buyer has a good idea of which supplier gets which contract before bidding. Without bidding, there is a straight commission to supplier. Prices are settled after decision about who gets the contract.</li> <li>• Continued beyond the duration of the current contract. Mutual long-term commitment.</li> <li>• Contracts contain procedural rules, but substantive issues are decided case by case. Contracts may be oral rather than written.</li> <li>• Case-by-case resolution with much appeal to the diffuse obligation of long-term relationships.</li> <li>• Supplier often starts production on the basis of oral communication, before written orders are received.</li> <li>• Sole sourcing by buyer, combined with supplier's transactional dependence.</li> <li>• Little or no inspection on delivery for most parts. (Customer may be involved in establishing supplier's quality-control systems.)</li> <li>• Not always fully costed, as benefits are seen as partly intangible and/or reaped in the distant future.</li> <li>• Extensive multiple channels, between engineers, quality assurance personnel, top managers, as well as between purchasing and sales managers. Frequent contact, often extending beyond the immediate business into socializing.</li> <li>• Much sharing of risk, in the sense that the relative share of unforeseen loss or gain is decided case by case, by applying some principle of fairness.</li> </ul>

## APPENDIX B

*Table 6.*

<b>Components</b>	<b>Variables</b>
Supplier-Company Relationship	1. Supplier trust of Company 2. Supplier-Company overall working relationship
Company Communication	3. Company open and honest communication with suppliers 4. Company communicates timely information 5. Company communicates adequate amounts of information
Company Help	6. Help Company gives to suppliers to reduce costs/hourly rates 7. Help Company gives to suppliers to improve product/services quality
Company Hindrance	8. Company late/excessive product/services design/specification changes (reverse measure) 9. Conflicting objectives across Company functional areas (reverse measure) 10. Supplier given flexibility to meet established cost/quality objectives 11. Supplier involvement in Company product/services development
Supplier Profit Opportunity	12. Company shares savings from suppliers' cost reduction proposals 13. Company rewards high performing suppliers with new/continued business 14. Company covers sunk costs on cancelled or delayed programs 15. Company concern for supplier profit margins when asking for price reductions 16. Suppliers' opportunity to make acceptable return over long term

# Chapter 4

## Economic Nationalism and Globalization, Evidence From China (Belt and Road Initiative)

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### **ABSTRACT**

*Nationalism can manifest itself in different forms. It is not only closing the door to the other nations (autarchic policies). On the contrary, sometimes it exhibits as crazy expansion, combining autarchy and imperialism. Economic nationalism presents contradictions. Nowadays, in front of the experience of globalization, driven by the so-called “Washington consensus,” we do witness new projects coming from the PRC. The Belt and Road Initiative (BRI), formerly known as One Belt One Road (OBOR), is the most important economic policy for China in the 21st century and represents at the same time a new idea of globalization, based on cooperation instead of a sharp competition. On the other hand, countries located in and around this area have their own views regarding this program, positive and negative. This chapter attempts to provide a deep understanding of the economic nationalism concern through the BRI program.*

### **GLOBALIZATION**

Globalization is a term that every person is using but the meaning is multiple, depending on the perspective adopted. According to Meydan Larousse, the origin of “global” means “undertaken entirely”; it also means “homogeneity” in French. Therefore, in sum, the word “global” means “entirety” and “homogeneity” in western languages. The word “globalization” may ground to the term “global village”, named by Marshall McLuhan in his book “Explorations in Communication” in 1960. In the book “Global Modernities” published in 1995, Mike Featherstone, Scott Lash, and Roland Robertson explained the theoretical definition of the term “globalization”. It is also defined as “fast and continuous inter-border

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flow of goods, services, capital (or money), technology, ideas, information, cultures and nations” by the American Defense Institute. In addition, the American Defense Institute infers that economies will be integrated through the globalization processes, accompanied by the internationalization of corporations, organizations, markets, and governments (Dulupçu & Demirel, 2013).

Thereby, we can see globalization as a process of interaction of national policies and economies. On the other hand, the debate on globalization has brought to light two main standpoints with a broad heterogeneity of temporal references.

There are those who believe that globalization is a phenomenon which already existed between the nineteenth and twentieth centuries (Hirst & Thompson, 1999; Frieden, 2006), or that it even evolved in harmony with imperialism and European colonialism since 1492 (Swyngedouw, 2003; Harvey, 2000; Shiva, 1997). Conversely, other authors, sociologists, and political scientists believe it is a completely new phenomenon (Held-McGrew, 2000; Scholte, 2005), a product of the radical reorganization of trans-planetary and supra-territorial human activities. This latter standpoint could be partly included in the so-called ‘geo-economics of neo-liberal common sense’ (considering the success of the theses by Thomas Friedman), that notwithstanding the diversity of analysis, offers an a-geographical, fluid and flat view of the world, marked by the processes of deterritorialization and extra-territoriality (Sparke, 2004; Smith, 2005). However, the geographical concept of globalization can be restricted to the last thirty years during which capitalism has been radically reconfigured and reorganized (Harvey, 2006, 2001, 1990; Brenner, 1999; Brenner & Theodore, 2002). This is not to deny deep historical continuities of globalization in colonial and imperial eras (nothing comes from nothing), but rather to affirm the importance of analyzing the most recent space-time *discontinuity*.

From our point of view, the concept of globalization exists as a purely geographical concept referring to complex territorial forms/spaces taken on by capitalism in the post-bipolar period. Some radical geographers have made significant contributions to unraveling the complexity and originality of the social, political and economic geography of globalization. The analyses of the capitalism spatial evolution by Brenner (1999, 2002), Swyngedouw (2003), Harvey (2006, 2001) and Arrighi (1994, 2007) provide an understanding of the historical reasons responsible for the present reconfiguration of the nation-state and the globalization processes.

## **Political Analysis of Globalization: Globalization and the World Order Reconfiguration**

Politically, we can start to say that the widely applicable concept of globalization has favored ideologically transmitted debates related to the expansion of US military and financial neo-liberalism. There are links for example between the liberal theses of Wilson and Roosevelt and the neo-liberal ones of Thatcher, Reagan, and Blair (Smith, 2005). Far from seeing globalization as a finishing line in a more just world without historical roots, we think it is worth to assert that the novelties of the last decades, which inform globalization, require a more advanced theoretical systemization of its geographical articulation (Parenti, 2010). More specifically, the current world (dis)order is a combination of multi-polar geopolitical and geo-economic dynamics which, downsizing the USA’s role in the world, would explain the following macro-processes: the US ‘military neo-liberalism’ as set out in the *New American Century Project*, the new pervasiveness of the *Beijing Consensus* in Africa and Asia (Ramo, 2004; Arrighi, 2007), and finally the regionalization of the world (Geopolitics, 2007). We are living in a hierarchical and globalizing world indeed!

We are convinced that the image of a flat world must be questioned at the root and that the expansion of capitalism and its territorial forms requires a renewed effort of analysis to understand its complexity. Think about the redefinition of the monetary system and energy market in a multilateral sense, due to Beijing's influence in the world and its new strategic axes being consolidated in Central and Southern Asia, Middle East and Africa. The direction of change in the geopolitical world order can be traced by analyzing, for example, the development of energy infrastructures at a regional level (sub/trans-national). The latter is altering the geography of energy (fracturing the relationship between OPEC and OECD). Same discourse could be done for transformation occurring in the geography of finance. For instance, we refer to the relationship between the increasing reserves in foreign currencies in Asia, the appreciating/depreciating dollar, as well as the euro-dollar competition and the new crude oil future contract denominated in yuan recently launched in Shanghai (Parenti 2009; Parenti 2018). Not to mention the increasing will from many emerging countries to trade with their own currency, euro and yuan.

The last decades' detailed study of an inter-scalar reorganization, induced by economic-political dynamics, allows us to rationalize fundamental questions relating to the metamorphosis of power relations at global and regional scales.

## **Economic Analysis of Globalization: Reasons Stimulated Firms Go Global**

Dunning (1993) identifies four main reasons stimulated firms to go global, which are market seeking, resource seeking, strategic asset seeking and efficiency seeking. Literally, seeking cannot bring outcome, while operating can. In the past decade, there has been an acceleration of R&D internationalization, accompanying with the globalization of innovation. Companies with innovative advantage go beyond home country to foreign locations, building cross-cultural networks (Turpin & Krishna, 2007).

Many scholars focus research on the value of innovation in firms and networks' internationalization (Coviello & McAuley, 1999; McDougall & Oviatt, 2000; Dana, 2004). Some of them consider the application of innovation as a trigger in the globalization process, which makes quick returns on huge investments (Sharma & Blomstermo, 2003; Knight & Cavusgil, 2004; Rialp et al., 2005; Johanson & Vahlne, 2009). Innovation offers insights into the driving forces of globalization, while globalization itself plays a key role in innovation, especially in marketing, knowledge transfer and production (Williams & Shaw, 2011), thanks to multilateral trade agreements and technological advancement.

Hence, it is widely confirmed that innovation can improve corporate performance. For example, introducing new products and production processes, increasing investment in innovation, developing and licensing new technologies, and adopting more efficient production techniques, firms can become more competitive and gain higher economic returns (Hall & Mairesse, 1995; Adams & Jaffe, 1996). However, according to Freeman et al., (1982), the "radical innovation" has always been supported by a well-organized synergy between private forces and government plans (Mazzucato, 2011).

On the other hand, with the development of international business in a globalized world, feelings of economic insecurity generate among people. Especially, economic growth downward, after the 1990s and 2008 financial crises stimulates economic and political nationalism, which are believed helping defend the magnificent interests of certain countries (Ali, 2017; Iliescu, 2017).

## **NATIONALISM**

According to the dictionary by Merriam-Webster, nationalism is “loyalty and devotion to a nation”. It is a definition that recalls the idea of “imagined communities” proposed by Anderson (1983). However, while we talk about economics, especially international economics, “a nation” is also an economic system - territorially defined, which interacts with other national economies, for trade, investments, technological transfer, etc. Therefore, essentially, in a globalized world economy, economic nationalism is often self-contradictory. However, it does exist, and cannot be ignored.

Nationalism can manifest itself in different forms. It not only closes the door to the other nations (autarchic policies) but also exhibits as crazy expansion, sometimes, combining autarchy and imperialism. For example, during the Second World War, both Adolf Hitler, Benito Mussolini and Emperor of Japan claimed that they were helping their citizens. However, all German, Italian and Japanese people suffered something that they would not have suffered without this war. These people could have lived in a peaceful environment, so as the victims. We may infer from this disaster that a rigid nationalism could not help any society, even though it seems like can at the very beginning, eventually it will bring more damage than benefit.

Economic nationalism presents similar contradictions as political nationalism. Economic nationalism never disappears. While the economic development decreases, the economic nationalism increases. When economy depressing, citizens who are instigated by politicians, start blaming the foreign countries, for example accusing immigrants of stealing jobs. (Ali, 2017; Iliescu, 2017).

## **Governments’ Trade Promotions of International Business and Globalization**

Governments play an important role in international business and globalization. Especially, international trading and globalization were pushed up by governments’ trade promotions, such as the subsidies, export financing, FTZ (Foreign Trade Zones), special government agencies, and free trade intergovernmental agreements. Governments provide financial support in form of low or none interest loans, tax breaks, or cash payments. They increase export by helping corporations with loans or loan guarantees, which are the export financing. Also establishing FTZs (Foreign Trade Zone), which are specific geographic regions, where customs duties and taxes are lower than the other areas in the same nation. Special government agencies serve corporations by assigning business trip to other countries for the CEOs and open trade offices in other countries to helping corporations operating there. In addition, governments join WTO, negotiate, and sign trade agreements with other countries to help international business and globalization (Wild & Wild, 2014).

The Belt and Road Initiative (BRI) is one of the most important economic strategy of China, which aims to enhance globalization, but it triggers also fears and nationalistic concern of the countries involved in it and even countries not involved in it.

## **The Belt and Road Initiative (BRI)**

During his trips to the Central and Southeast Asia, the Chinese President Xi Jinping proposed the Belt and Road Initiative (BRI) as a “Silk Road Economic Belt” and 21<sup>st</sup> Century Maritime Silk Road in 2013. The Belt and Road Initiative (BRI), formerly known as One Belt One Road (OBOR), is the most important economic policy for China in the 21<sup>st</sup> century and represents at the same time a new idea of

globalization, based on cooperation instead of a sharp competition. The foundational strategy of it is to rebuild the Silk Road, which was the oldest international trade space between China and Europe since B.C. 114. The first Silk Road started from Xian, China, ended at Rome, Italy. The Maritime Silk Road (MSR) expanded the international business through the South China Sea.

EU has been the biggest trader with China since 2004. The international trade volume between them exceeded 600 billion USD in 2014 (Zhao, 2016). EU imports equipment and machinery, industrial and consumer goods, and clothing, while exports of equipment and machinery, chemicals, and aircraft and vehicles. From 2003 to 2017, the total export value from the EU28 countries to China increased from about €49 billion to €198 billion, while the total import value from China to the EU28 countries increased from €107 to €375 billion (See Figure 1).

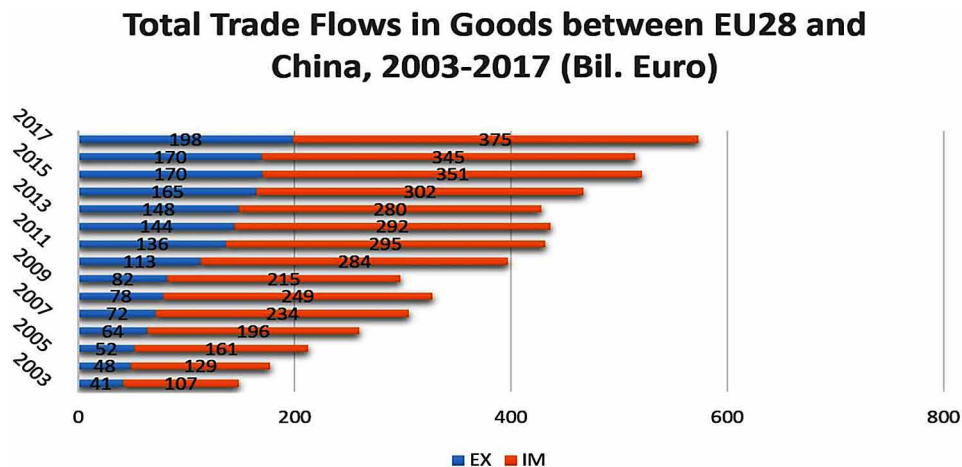
Although Europe is in a position of trade deficit with China, it is also true that it has recorded significant surpluses in both services and high-value products. Looking at many years, it can also be noted that overall European exports are constantly increasing and there is a tendency to rebalance their respective balance of payments. According to the EU commission, “In fact the EU’s overall trade balance is positive” (European Commission, 2018). With the BRI, this benefit will keep increasing.

Nowadays, the Chinese government is trying to rebuild and expand the ancient trade space by launching the BRI. Europe is the destination of the ancient Silk Road as well as the BRI. Looking at the infrastructures built, in construction and proposed, it is clear that each European region has different roles, interests, and potentialities in the BRI framework. For example, whilst central Europe can benefit more directly and consistently from railways connection, Italy, and in general, the Mediterranean region, can benefit more from an increase in trade volume by sea (Fardella and Prodi, 2017).

Considering the distance, transportation and logistics could be a major problem. On the contrary, to deal with this problem, China provides the solutions on infrastructure construction as the support of BRI includes the China Railway Express to Europe, as well as maritime and air transportation, such as Luxemburg-Zhengzhou and Xian-Amsterdam. By these constructions, China could promote further economic cooperation not only with the terminal, which is Europe but also with countries along the belt and road through the Eurasian Continent Economic Corridor (Liu & Chen, 2017). This road literally

*Figure 1. Total trade flows in goods between EU28 and China, 2003-2017*

*Source: Data downloaded from the EU commission, <http://ec.europa.eu>*



is under construction. Railway and highway will finally connect the Europe and China as Eurasia, in an innovative and advanced way. For example, the New Eurasia Land Bridge (also named the Northern Eurasian Corridor) is already operational (Georgiev, 2015).

If we focus on the implementation of the BRI, it is clear that there is still enormous potential for Chinese investments in Europe - and vice versa - which have become geographically and sectorally differentiated (infrastructure, tourism, football, telecommunication, etc.). We find various typologies: specialized (for example, Huawei and Lenovo) and diversified (such as Fosun or Wanda), in research and development activities and in the organization of academic, scientific and cultural forums. There is also complementarity between the Chinese and European national plans for connectivity and transport, as shown for example by the BRI-TENT comparison. It is also worth to note that in 2016 China and the European Commission signed a MoU for a Connectivity Platform (Wang et al. 2017).

In addition, on May 19, 2015, Premier Li Keqiang announced: “made in China 2025”, which is the Chinese version of the European Initiative “Industry 4.0”. It targets to reform the entire industry of China from the low-end manufacturing to the high intelligent-supported and innovation-driven production during two five-year plans, the 13<sup>th</sup> (2016-2020) and the 14<sup>th</sup> (2021-2025) (STPI, 2015).

The MIC 2025 will grow along with the BRI, expanding international trading and establishing deeper bilateral, multilateral and regional cooperation with countries located in this area than before (STPI, 2015). On the other hand, the BRI and the MIC 2025 together show the significant ambition of China, which triggers fearsome concerns about them from the countries that located around the BRI region and even countries that not located in this region.

One main concern of several developed countries is they will be surpassed by China entirely someday. China is already the world second largest economy following the USA only, measured by the nominal GDP, even though it is still a developing country. When China transforms into an industrialized country by implementing the MIC 2025, what will happen to the industrialized countries that were surpassed by it?

Another concern is from the emerging and developing countries that are located along the BRI: they face a dilemma that joining the BRI means to be involved more with China, while not joining the BRI means being left behind of a huge economic development opportunity.

## **The BRI Is Changing the Balance of the World**

With the end of the Cold War, not only a new era of greater international security and peace began, under the thrust of a capitalist globalization considered relentless and beneficial. Simultaneously, the US strategists’ ambitions for dominion also increased. We are referring to the new American assertiveness, today resumed in the site of “Foreign Initiative”, which emphasizes the use of the military tool in a logic of interstate rivalry and spheres of influence, with the objective of conserving and strengthening a world supremacy position. However, in the light of the US-NATO interventions aimed at the regime changes of entire nations and the correlated re-engagement, in the sense of the counter-balancing and integration in Eurasia, among China, Russia and Iran, it can be affirmed that the representation of a post-bipolar world, more fluid and indefinite, seems to be rather partial. According to some political geography scholars, many of the most popular stories on the world order (for example those on globalization and free trade) were functional to serve projects of domination, or the more or less imperial nature (Dalby, 2008).

The West, with the North-Atlantic Alliance (NATO) as its main military expression, has contributed in recent years to the increase of international insecurity. The USA’s need to conserve a preeminent



role at a military level has been accompanied, starting from the 1980s, with a growth of the financial globalization, speculative in nature and fruit of a political-cultural process of progressive deregulation (Parenti, 2018). The prescriptions of the Washington Consensus, based on a top-down and one-size-fits-all approach which ignores the specific macroeconomic features of the single state actors, contributed to the generation of various crises in different Latin-American, African and Asian countries, favoring the unsustainable indebteding processes (foreign debt crisis of the 1980s) and operating speculations on the smaller currencies (currency and banking crises of the 1990s). The example of the Argentinean crisis of 2001-2002 is enlightening in this sense: the default of December 2001 was “the last drop” of a situation, wherein the fixed parity between the Argentinean peso and the US dollar had been for some time unsustainable and artificially prolonged through the continuous issuance of loans by the International Monetary Fund. The default on foreign debt translated into a political and social crisis, with 50% of the population plunged below the poverty line. From the periphery of the system, these problems then transferred directly to the core, hitting since 2007 the heart of the world-system, across the USA and Europe. The financial-economic crisis demonstrated all its severity, placing under discussion entire political, institutional and social systems of the European Union and threatening at the roots not only the survival of the Euro (also a political symbol) but also the multi-decade project of community integration.

On the other hand, today the US political system appears to be rather subordinated to the power of financial capitalism, while it expresses an unrelenting activism at the military level. The crisis which the West is undergoing is economic, but also related to international legitimacy, and has manifested itself contemporaneously with the rise of other global powers. As long as China has become the engine of the global economy and an increasingly authoritative and influential geopolitical actor, the USA does not seem to have sufficiently understood the need to develop a more cooperative dynamics with Beijing, while Europe does not seem to have succeeded in finding a clear global position.

In addition, Europe faces a dual situation: competition and cooperation with both the USA and China. For example, a space program is a technological cooperation field that stimulates economic development for all countries. Benefits gain from advanced technology accompanying with both economic and military expansion, which replaced the dynamic of political alliances that widespread during the Cold War. With China’s political transformation, the relationship between the EU and the USA is shifting as well. For example, The Pew Global Attitudes Project collected data in June 2005 and found that China received a higher ratio of favor than the USA in six out of nine European citizens. This attitude of Europeans generates from the economic competition with both Japan and the USA and the aspiration of balancing against the dominant American authority (Johnson-Freese & Erickson, 2006).

In the current international context, the public and private actors of various state powers are before fundamental strategic choices, at least to the extent that they assume the actual unfolding of a transition from a unipolar to a multi-polar world. Here we examine an emblematic case: the meaning and the influence of the Belt and Road Initiative (BRI) in the redefinition of the relations between Europe and Asia, and their impact on the international order. Europe and the Mediterranean basin may decide to preserve their geopolitical position, remaining under US-NATO prevalent influence, or look and act in favor of a new Eurasian integration with a focus on China.

Moreover, EU is questioning the market economy status of China. Although many countries have already recognized the status - over 80 countries (WTO members) - EU disagrees. Even though we cannot neglect that direct and indirect forms of subsidizes persist also in the US and in the EU - from military sectors to agriculture. This is to say that state intervention is not an exclusive prerogative of China.

On December 2017 the EU puts in place new trade defense legislation: after one year from the initial proposal, the EU eliminated the distinction of the type of economy. However, it kept in place the possibility to use the non-standard method in price determination, in case of “significant market distortions”. The difference with respect to the past is the responsibility of the proof that is now in the hand of the European Commission (EC 2017).

On the investments side, the new EU proposal to regulate investments from third countries aimed to target two types of investments: the acquisition of technological asset in certain sectors (energy, transport, etc.) by state companies for strategic reasons and the acquisition from foreign firms that do not guarantee reciprocity in opening up to investments in their own countries. According to this perspective, European politicians would be more relaxed about selling companies, if there was some assurance that the new owner is committed to bringing new capital. A win-win strategy, according to some good practices in Europe, relates to the implementation of city-by-city and sector-by-sector cooperative projects. A successful case relates to the investments in the Central European Trade and Logistics Cooperation Zone, in Budapest.

On the other hand, Chinese investments in Europe – and abroad in general - are a very recent phenomenon. The peak was in 2016, but now they consistently reduced. Moreover, European investments in China are older and still higher, respect with those of China in Europe. The capital account imbalance of China towards Europe is reducing, as a reflex of the structural transformation of China’s economy. These facts explain also the EU’s players desire to gain higher access to China’s markets.

It is important to remember the deep roots of China’s new influence, culturally and politically, in the current changes of the international order (Parenti, 2018). The BRI has both geopolitical and geoeconomic perspectives. It is aimed to change the relationship between China and other major powers, such as the USA, Russia, and Europe. Therefore, eventually, it will impact the economic development and cooperation among many regions: Central Asia, South Asia, Middle East, North Africa, and Europe (Zhao, 2016).

The influence of Chinese thought and words on the international arena has been growing dramatically in recent years, in step with economic and diplomatic successes. In fact, China in the new era is also represented by a stronger international soft power - that is the power of ideas and strategies alternative to the status quo - exerted in the most authoritative seats of the established world order. This is occurring in economic and political forums such as Group of 20 nations, World Economic Forum, International Monetary Fund, World Bank, World Trade Organization and in other forums shaped by Chinese initiatives such as Asian Infrastructure Investment Bank, the New Development Bank and the Belt and Road initiative (Parenti, 2017).

The current economic debate on China in Europe could be criticized as an expansion of the recent explosion of China’s national power. However, the willingness of acquiring a more important role in global trade and value chains could be traced back to around 20 years ago. “Going global” strategy, devoted to SOEs and private firm’s internationalization since the end of 1990s and, more recently, the “13th Five Year Plan” (2016-2020) are intertwined strategies (confirmed in the CCP last Congress documents) aimed at improving living conditions and promoting a balanced development with the rest of the world (Parenti, 2017). The new Chinese cultural power on the world scale is supported, legitimized and deeply rooted in the material manifestations of the BRI, which includes more than 100 organizations. The initiative is already a reality, in the process of being updated, and it is inclusive, cooperative and open to adaptation, being free from ideological and political discriminants. This reality is the opposite of the old and smaller Marshall Plan.

The Chinese strategies of the last 20 years have created the conditions for the BRI to be a realistic and attractive project. The “go west” was deployed from the late nineties to today, favoring the development of internal China and boosting national interconnection and with neighboring countries; while the “go abroad strategy”, from 2000 to today, has guaranteed support for Chinese investments abroad, operated by private and state champions. The BRI is, therefore, a consequence of the successes obtained in the past years at domestic level and many investments, which we could define today related to the BRI, actually took place before its official launch in 2013 (e.g., think about the Chongqing-Duisburg railway or Piraeus port). With the BRI, President Xi Jinping continues therefore what other leader generations have prepared for, promoting continuity within a constant process of reforms and innovation (Xi, 2017). Significantly, the Chinese media and scholars are using the term of Belt and Road Initiatives instead of Belt and Road strategy on all occasions. It reflects the problem that China is facing strong suspicion from related countries. A strategy has certain goals to be achieved and clear plans and approaches towards the goals; while an initiative, in this case, could be a direction of development for groups of countries. Flexible and open to adaptation to different needs. China could act as the major contributor of rules and mechanisms and would be less likely to take the burdens of the BRI. China avoids mentioning any detailed and ultimate goals of BRI. The lack of information could be interpreted as a lack of transparency of China and leads to stronger doubts about China’s intentions in Europe.

The BRI is not only important to the EU, but also to the countries located between these two regions. For example, one of the Silk Road routes connects China and Europe through the Black Sea region, which stretches from Romania and Bulgaria, through northern Turkey and on to Georgia. It is described as “Eurasian Balkans” by Zbigniew Brzezinski in 1997. According to him, the Black Sea region joins this China – Central Asia – Europe chain to prevent against the USA alliance of the Eurasian powers exploitation of natural resources. The Organization of the Black Sea Economic Cooperation (BSEC) pursues the diversion from both Western Europe and Eastern Black Sea countries. On the other hand, through the Maritime Silk Road, the economy of this region is essential to be enhanced with both Europe and China (Georgiev, 2015).

In essence, the BRI provides an opportunity for some countries to increase their economic performance by open a huge Asian market and to improve their positions within Europe (Zhao, 2016). On the other hand, European countries have their internal debate regarding the geopolitical issues. For some other European countries, cooperating with China means betraying the US. For example, the UK joined the AIIB was seeing a significant betrayal to the US. Thereby, numbers of European politicians believe that the US’ reaction to the BRI also needs to be monitored seriously (Zhao, 2016).

In other words, China’s BRI offers a powerful and acceptable economic alternative to some Central and Eastern European (CEE) countries, which are eager to get rid of the domain of certain western European countries. And this is the main concern of the Western European countries. They are afraid of this issue comes, which means they could lose controls over the CEE countries.

For example, according to Jacoby and Korkut (2016), moving towards China means moving away from the EU for such countries as Hungary and Slovenia, who locate in between Europe and Asia. According to the Prime Minister of Hungary, Viktor Orban, the “Western European dogmas such as “liberalism” is something that Hungary tries to tear itself away from, while the economic performance of different political and economic systems, such as China, Russia, India, etc., is the attraction. By joining the BRI, Hungary can decrease the overreliance on western European countries. On the other hand, Johnson and Barnes (2015) claim that this is the economic nationalism because the policy of Viktor Orban and his center-right Fidesz party pursues a nationalist-populist platform of economic self-rule. In other words,

by joining the economic chain of BRI, Viktor Orban leads Turkey leaving away from the EU. It may not be towards China, but to self-independent; however, the location of Turkey, in the middle of Europe and Asia, makes BRI important to both sides. Therefore, holding the peace and balance in this country is a crucial deal. Without the BRI, the EU has more power over Turkey; while with the BRI, Turkey has an alternative choice besides the EU.

One main point of the BRI, from a Chinese perspective, is related to the use of investments in Europe in order to find know-how and learning new management experiences. China moves through macro-areas and individual countries, as demonstrated by the Central Eastern Europe 16 + 1 regional cooperation plan, launched by the Chinese government since 2012, or the growing strategic focus on the Mediterranean. In the first case, greenfield investments prevail, (new production activities such as branches, new plants, etc.), while in the second case one of the main objectives is to acquire strategic assets, taking advantages of the privatization policies carried out in recent years as consequence of the credit crisis. Through these operations, China tries to exert even greater political influence on a number of issues that it does consider crucial (e.g. Tibet or the MES).

The Chinese authorities have thought to develop firstly the instruments to support the new investment plans, giving life to a multilateral institutional architecture that is structured and consolidated over time. For example, some state-owned banks, funds and investment institutions work synergistically. Think about the Silk Road Fund (SRF) linked to the PBoC, the Export-Import Bank of China (EBC) and the China Development Bank (CDB), which have developed subsidized credit schemes for the BRI. In addition, they work together with the European Investment Bank (EIB). These are some of the financial institutions behind the Asian Infrastructure Investment Bank (AIIB), joined by almost all European countries. These banks will interact with other financial institutions, such as the BRICS New Development Bank, but also the World Bank. Finally, it is important to remember the signature in 2015 of the EU-China memorandum on the BRI, to develop synergies between different investment plans, such as those between SRF and EFSI (European Fund for Strategic Investments) (Wang et al. 2017). Obviously the more the BRI develops and the greater the need for security, that is, of control systems that protect the new interconnections (in this regard we already see developments in Algeria - Cherchel - Djibouti, Srilanka, and Pakistan).

From an alternative angle, EU needs China as a supplementary resource for economic development. EU launched the 2020 strategy in 2010 to enhance a win-win cooperation. If we look at the establishment of the European “Partnership Instruments” to promote international cooperation, we can clearly see many areas of mutual interest which correspond to common priorities in both the EU and China (research, academy, innovation, etc. -European Commission, 2017). In fact, in 2013, the EU and China signed the EU-China 2020 Strategic Agenda for Cooperation and Comprehensive Investment Agreements. However, if these strategies cover many fields, from global challenges to business, from diplomacy to academic development and cooperation, and the relations with China have strongly improved – as a matter of figures – there are still many criticalities to be addressed. The EU has been facing financial, migration, terrorist crises, showing many limits in terms of poor internal governance and subordination to the US strategies. Consequently, Chinese public opinion and authorities are strongly questioning the reliability of the EU and their general confidence in the hypothetical alternative role played by Europe (Chang & Pieke, 2017). Here we can find a reason for the main Chinese method to approach Europe, which is focused prevalently on bilateral agreements with single countries and city-to-city relations.

Along with the BRI, China will involve deeply in Eurasia, facing amount of problems. First of all, the trust deficit between Europe and China. Some European politicians see the BRI as the Chinese Marshall Plan, by which China will transfer its economic power into geopolitical influence to move its own globalization policy forward. Second, some European countries are very cautious about the FDI from China. For example, Chinese SOEs (State-owned enterprises) helped Greece through the Greek Debt Crisis. However, some EU headquarters considered this as a disturbance within the EU, because they concern that the Chinese government is behind the Chinese SOEs (State Owned Enterprises). Therefore, Chinese SOEs' business may have some political purposes. They are concerning that China enhances its political power by investing in the EU (Zhao, 2016). EU ambassadors also stated that "China's plans to create three huge trade corridors between Asia and Europe will likely hurt the European Union's trade interests" (Martin, 2018).

Thereby, nationalism is raising in the countries with these concerns. More and more European countries are limiting, restricting, and prohibiting Chinese companies' M&A. For example, Germany is preparing a legislation to check the drain of technology and know-how which being replaced by Chinese items. It has been adding more regulations stopping China from gobbling up its companies since 2017 (Gilchrist, 2017; Bryan & Heller, 2018). France has also said that BRI shall not benefit China alone. It has tightened its controls on Chinese investment to protect domestic high-tech since the beginning of 2018 (Fouquet, Deen, & Beaupuy (2018).

These countries see Chinese FDI and even the BRI as a potential threat to their domestic business and technology. Same proposals have been issued at EU level, with the Juncker plan, that is about foreign investment scrutiny. If passed, the legislation will help EU members to stop China from the unbridled investment. This will also make it necessary for China to share investment-related information with each EU member country and European Commission (Financial Express, 2018).

On the other hand, these policies trigger opposite from some domestic companies, who rely on the FDI from China and operating in China. For them, limited Chinese FDI weakens their capabilities of absorbing capitals, since with or without Chinese FDI, high-tech is a high eliminating business. New technology is generating every day. The main competitors of European companies are the American companies, even Japanese companies rather than Chinese companies. For instance, the main competitors of the BMW, Mercedes-Benz, Citroen, and Peugeot are Jeep, Lincoln, Ford, Honda, and Toyota. For these European car manufacturers, they need Chinese FDI to support competition with American car manufacturers.

Europe and China have shown to be interested in boosting economic development and working at the same time on cultural cooperation (schools, universities, think tanks etc.). However, both positive and negative feelings and standpoints overlap in this new geopolitical and economic dynamics. The US National Endowment for Democracy coined for example a term – "sharp power" – to define and discredit China and other competitors. This term has become very popular in the West. Moreover, if we look at European public opinion and authorities, we find that there are multiple and divergent voices on the new Chinese influence in relation to the Belt and Road. It is ironic to hear from the West criticisms of media manipulation and political interference addressed to China and other countries. Turning this accusation to China (and Russia) seems curious about the Western long-term history of media domination and interference in the internal affairs of other countries. The history of the National Endowment for Democracy is proof alone of this irony. The responsibilities attributed to these countries could be easily attributed to the accuser.

The Mercator Institute for China's Studies, based in Berlin, has offered rising skepticism and criticism in a February 2018 report, maintaining that China is exploiting, in an opaque way, the European Union's weaknesses to interfere in the internal affairs of member states. On the contrary, other authoritative voices see the new Chinese proactive role in Europe as beneficial and constructively alternative to the current state of affairs, characterized by slow economic recovery, political instability, and belligerence under the US-NATO alliance system.

In Italy, for example, Manlio di Stefano, a Member of Parliament of the five Stars Movement, has expressed this thought several times. In 2016, he talked about the BRI like this: "It is fascinating the attention of China on developing the project in a different way. The intrinsic principles of the BRI (Belt and Road initiative) adhere to those of the UN Charter. The project is open to new nations and will follow market rules, working actively to satisfy mutual advantages for all the participants." Our studies and arguments are closer to this constructive interpretation of China's new soft power, but, as written, in Europe the political and cultural perspectives on this subject are still varying and often divergent.

In addition, fears of the Belt and Road Initiative (BRI) are triggering anti-China moves from some influential countries, such as Australia. The Australian Financial Review (AFR) has reported that Australia is mulling to set up a "joint regional infrastructure scheme" to come up with an "alternative" to China's BRI, which is set to further spread Beijing's influence (Financial Express, 2018). One reason behind this issue is even though the Australia Act 1986 makes Australia an independent country by removing the relationship between the Australia and British Parliament, it still considers itself as a part of the western world because of a natural relationship with the United Kingdom. However, this relationship is fading. The BRI ties the EU and Asia as a Eurasia, which means the West and East have a tighter relationship. But Australia, because of its geographic location, is far away from this continent. Therefore, in the future, it will have less and less opportunity for economic development and political alliance.

In addition, the USA also has a serious concern regarding the BRI.

On March 9, 2018, the President of the USA, Donald Trump, started imposing tariffs on steel imports, and later, other goods imported from China. Simultaneously, China hits back as the same value of American goods. Trump claimed he is doing the best for his country, while China tried to discourage these movements by increasing the tariffs on agricultural products. However, a lot of companies will suffer a huge loss, employees will lose their jobs and customers will eventually pay for everything. Moreover, this action impacts not only these two countries but the whole world. European, Mexican and Canadian companies have already complained that they will be hurt because of the new steel tariff. On May 30, 2018, Wilbur Ross, US Secretary of Commerce announced that, according to a trade law which protects national security, the US imposes new tariffs on steel (25%) and aluminum (10%) imported from Canada, EU, and Mexico since June 1, 2018. Meanwhile, the EU also imposes tariffs on imported US goods, which contain agriculture, clothing, steel, motor vehicle, and so on.

Additionally, more and more countries will be impacted since they are also in the supply chain of these giant countries. Therefore, eventually, many countries will be involved in these economic nationalism tensions. Recently, Treasury Secretary Mnuchin paid a visit to China for discussing trade disputes, because of the huge implications a "trade war" would have, if not properly managed and solved. It seems that both big powers are reaching new positive compromises.

On June 1, 2018, the EU, following the US, started official complaints against China, who was claimed to undermine the intellectual property rights of European companies, in the WTO. Cecilia Malmström, European Commissioner for Trade, stated that technological advance is the foundation of European high technological economy, which provides jobs in EU and supports competition in the worldwide market.

With the economic development of China and its commercial influence, nationalism, not cooperation, has been increasing. Even more, countries are claiming that they are protecting their companies and economies. Is it true? With the globalization processes of the last decades, no nation can be economically independent. Companies expanded from SMEs (small and medium-sized enterprises) to MNEs (multinational enterprises). They are earning profit from the global market. Once governments raise the trade barriers, their own companies and workers suffer as well.

At the end of the day, it is important to notice that either the Belt and Road Initiative and the Made in China 2025 are both still in the infancy and they will take time to show all their potentialities. It will necessitate protection and trust between many polities and stakeholders in a world that is severely fractured.

Nationalism hits both domestic business, which is doing business with foreign economies, and international business, which brings FDI into the domestic market. On the contrary, globalization provides an opportunity for knowledge and innovation exchange. Thereby, new innovations rise and economic development enhances. However, it is necessary to find new forms of cooperation in the current economic geography changes. Globalization processes can gain new supports, in a period of rising nationalism, within shared responsibilities between countries. Respecting different paths of development should become a pillar of the current reorganization of the global economic governance, balancing national priorities and the mutual benefits of interdependence.

Aiming to enhance the international business, but also a fair international cooperation, the BRI could represent a benchmark model of new forms of cooperation, starting from the need to build material infrastructure and real economy interconnectedness. All countries participate in the BRI could benefit from it.

Reshaping international relations according to a cooperative and win-win approach will require further engagement from the international community and, each country that adheres to the Chinese initiative should play its own part with a high sense of responsibility. World peace is at stake.

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# Chapter 5

## Russia:

### Traveling Scylla and Charybdis of Economic Nationalism – Could Economic Nationalism Be a Useful Tool to Boost Economic Growth and Development?

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#### **ABSTRACT**

*International economic developments are driven by two conflicting trends: globalization and localization with rising protectionism in many global regions and nations. Russian economy seems to be well globalized and integrated into the world economy. But it is still composed mostly of mineral fuels, oils, distillation products (48%), commodities (15%) with the sign of economic nationalism and state capitalism in the growing degree of direct and indirect state participation in the economy, rising from 35% in 2005 to approximately 70% in 2015. During the last 15 years the model of state capitalism, combined with a significant level of world integration, supported economic growth, development, and even rising competitiveness of Russia. On the other hand, the Russian economy is slowing down and balances between stagnation and recession, and a significant share of state-owned economy in the long run can lead to slowing down the internal competition and innovation.*

#### **INTRODUCTION**

Nations rely on a system of production, resource allocation and distribution of goods and services, which, in their entirety, constitute national economic systems. Historically, the analysis of economic systems has been focusing on the dynamics and comparative characteristics of market economies vs. planned economies and on the political-social/economic distinctions between capitalism and socialism. The

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current dominant form of economic organization across the world leans toward market-oriented mixed economies with varying degrees of state participation and control.

Within the market economies vs. planned economies continuum, state capitalism in a nation is an economic system in which the state participates, through direct ownership, in commercial economic activities and where the means of production are organized and managed as state-owned business enterprises (SOEs). State capitalism also takes place where there is a dominance of corporatized government agencies (those organized along business-management practices) or of publicly listed corporations in which the state has controlling blocks of shares. Marxist literature defines state capitalism as a social system combining capitalism with ownership or control by a state. Under this definition, a state capitalist country is the one where the government controls the economy and essentially acts like a single corporation, extracting the surplus value from the workforce in order to invest it in further production.

Scholars also use the term “state capitalism” in reference to a private capitalist economy controlled by a state. This often means a privately owned economy that is subject to statist economic planning and other forms of government control and regulations. State capitalism has also come to refer to an economic system where the means of production are privately owned, but the state has considerable control over the allocation of credit and investment as in the case of France during the period of dirigisme after the WW2. Current examples of state capitalism can be found in China, Japan, Korea, Singapore, or Brazil. The term “state capitalism” is also used (sometimes interchangeably with state monopoly capitalism) to describe a system where the state intervenes in the economy to protect and advance the interests of large-scale businesses or powerful political interests. Beyond the boundaries of economic control, state capitalism in authoritarian political regimes often relies on non-economic mechanisms, such as subjugated judiciary systems, extra judicial enforcement (oppressive police and security apparatus, paramilitary forces loyal to the government, violation of human rights, political repressions, government dominance in control of mass media, ideological propaganda, etc.). Additional information on democracy and authoritarianism across nations worldwide can be obtained from *Freedom House* (2018).

In the context of interdependency, an economic system correlates with a certain type of social and political system. State capitalism as a system translates into the patterns of economic policy, a targeted system of activities of the state in the field of production, distribution, exchange, and consumption of goods. Such economic policy exists to reflect the interests of society and all its social groups and aims at strengthening the national economy. Economic policy corresponds with the economic strategy of the state that exerts government action in order to achieve its economic goals. There is a close interconnection between politics and economics. Vladimir Lenin, the man behind the Russian Bolshevik Revolution (1917) and the founder of the Soviet Union (1922), famously emphasized that economy manifests itself in politics, and politics is the concentrated expression of the economy. At the same time, economic policies must have primacy over the economy, because without proper political approach the economy is doomed to failure (Ленин, 1921). Lenin’s transitory model of state capitalism in Russia of the 1920s was supplanted by Stalin’s command economy that had been in existence during his three decades in power until the mid-1950s.

Unlike state capitalism, economic nationalism may be part of a national policy, regardless of whether it takes place in the state capitalism or free market economy (Liuhto, 2008). This may be particularly true in foreign policy applications that sometimes diverge from domestic economic policy agenda. As such, foreign policy goes beyond economic issues of international commerce and foreign investment, or trade alliances: it is much broader in scope and complexity to include national security, immigration, strategic alliances and oppositions, military conflicts, bilateral and multilateral political relations, and

other aspects. Economic nationalism manifests itself in trade protectionism, a defensive policy designed to shield domestic producers and markets from foreign competition, or protect domestic consumers, labor markets, natural environment, or social fabric of the nation from adverse foreign impacts. Alternatively, it can take an offensive thrust, when international trade and foreign investment become tools in advancing a broader foreign policy.

National implications resulting from proliferation of state capitalism and economic nationalism can be both negative and positive. On the positive side, state capitalism and economic nationalism may facilitate consensus and unification in national policy development and implementation. On the negative side, they may escalate national regulatory rigidity, costs and risks of doing business, as well as decline in the nation's economic freedom, making this nation less attractive for international trade and foreign investment in the global arena.

Economically, centralized governance can aid economic activity by leveraging technocratic expertise, providing more coherent and uniform policies, and supplying tighter control over how those policies are implemented. On the other hand, decentralized governance offers potential efficiency gains by strengthening local leaders' incentives to create policies that are tailored to local demands and conditions. These questions are particularly acute in the developing world, where the stakes are high, pervasive governance problems often undermine development efforts, and centralization can mean consolidating power in the hands of nondemocratic rulers (Beazer, 2015).

Over the centuries since international trade has gone mainstream to become a vital phenomenon and critical factor in a national political economic development, government's role and policies varied. They have evolved from emphasizing a strong government hand under the mercantilism ideology to free trade under the "invisible hand" doctrine advocated by Adam Smith to arguments propagating limited government involvement and support under the "new trade" school by Paul Krugman and "theory of national advantage" by Michael Porter.

Traditionally, governments have had a responsibility and strong interest in attaining and preserving economic and political strength of their nations in the global arena. To this end, they have sought policy, regulatory, economic, and ideological tools at their disposal. This trend has been especially acute during and immediately after major warfare, at times of global political upheavals and ideological confrontations like the Cold War of late.

Several contemporary national examples of economic nationalism include: Henry Clay's American System, French *Dirigisme*, Japan's use of MITI to "pick winners and losers", China's controlled exchange of the yuan, Argentina's economic policy of tariffs and devaluation in the wake of the 2001 financial crisis and the United States' use of tariffs to protect domestic steel production as well as numerous evolving trade regulatory initiatives to this end by the Trump administration.

Some recent company level cases of economic nationalistic policies rationalized on the grounds of protecting domestic producers from global competition or in a pursuit of national security include: French governmental listing of Danone (France) as a 'strategic industry' to pre-empt a potential takeover bid by PepsiCo (USA); blocked takeover of Autostrade, an Italian toll-road operator by the Spanish company Abertis; proposed takeover of Endesa (Spain) by E.ON (Germany), and the counter-bid by Gas Natural (Spain); proposed takeover of Suez (France) by Enel (Italy), and the counter-bid by Gaz de France (France); US Congressional opposition to the takeover bid for Unocal (USA) by CNOOC (PR China), and the subsequent takeover by Chevron (USA); political opposition in 2006 to sell port management businesses in six major U.S. seaports to Dubai Ports World based in the United Arab Emirates; limits on

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foreign participation and ownership in Russia's natural resource sectors and selected Russian industries, beginning in 2008.

Over the last several years there have been signs of rising economic nationalism and protectionism worldwide. One of them is an increase in the state's share in the national economic activity. OECD research across nations reveals different patterns of the state role and economic activity. One of the goals of this study is to examine the patterns and impacts of direct state participation on the competitiveness and openness of national economies. In this context, the chapter will explore a rising economic nationalism in the world, identify emerging trends and implications for different parts of the world. Economic nationalism today is driven by multiple factors including disparities and imbalances in international trade, political competition, shifts in technological paradigms, financial volatility, lack of global competitiveness (being unable to compete economically, countries (national governments, politicians) sometimes resort to regulatory protectionism).

The main goals of the chapter are to:

- Analyze main drivers and trends in the rising economic nationalism.
- Compare current trends and developments in international economic relations: Russia vs. other BRICS countries.
- Look at a functional relationship between macroeconomic variables, reflecting a level of international integration of the Russian economy and defining the dynamics of in the "economic nationalism" vs. international integration equilibrium.
- Explore the main drivers of economic nationalism in Russia.
- Examine implications for economic growth and transformation of the Russian economy on the macro-regional and micro level stemming from the "New Trade" theory. And
- Draw possible scenarios and recommendations on the development of the Russian economy in the "new mercantilist" era.

## **BACKGROUND: RUSSIA IN THE RETROSPECT**

### **Historical Roots and Political-Economic Background**

Founded in the 12th century, the Principality of Muscovy was able to emerge from over 200 years of Mongol domination (13<sup>th</sup> -15<sup>th</sup> centuries) and to gradually conquer and absorb surrounding principalities. In the early 17<sup>th</sup> century, a new Romanov Dynasty (1613 -1917) continued this policy of expansion across Siberia to the Pacific. Under Peter I (1682-1725), hegemony was extended to the Baltic Sea and the country was renamed the Russian Empire. During the 19th century, more territorial acquisitions were made in Europe and Asia. Defeat in the Russo-Japanese War (1904-1905) contributed to the Revolution of 1905, which resulted in the formation of a parliament and other reforms. World War I led to widespread rioting in the major cities of the Russian Empire and to the overthrow in 1917 of the imperial household. The communists under Vladimir Lenin seized power soon after and formed the USSR. The rule of Iosif Stalin (1928-1953) strengthened communist rule and Russian dominance of the Soviet Union. After defeating Germany in World War II as part of an alliance with the U.S. (1939-1945), the

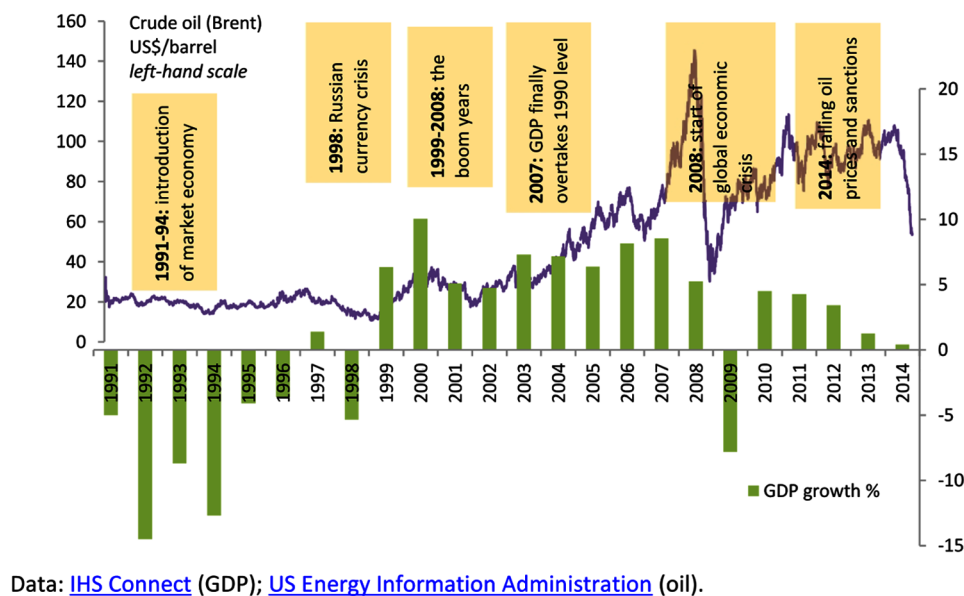
U.S.S.R. expanded its territory and influence in Eastern Europe and emerged as a global power. Mikhail Gorbachev (1985-1991) introduced glasnost (openness) and perestroika (restructuring) in an attempt to modernize communism, but his initiatives inadvertently released forces that by December 1991 splintered the U.S.S.R. into Russia and 14 other independent republics. Following the rule of President Boris Yeltsin (1991-1999), Russia shifted toward a centralized state under the leadership of President Vladimir Putin (2000-2008, 2012-present) (*World Factbook. Russia*, 2018).

Over the past 25 years, Russia underwent dramatic economic changes, with the challenging reforms in the 1990s, the economic boom in 2000s, the global financial crisis and the current stagnation. After a shoking period of 1991 – 1994, there came a short recovery period, which was quickly finished by Russia's economic collapse in 1998. The currency crisis was caused by, among other factors, a large budget deficit (from 5.4% to 42.6% of GDP in 1992 to 1998). Russia's debt default caused the ruble to lose two-thirds of its value.

In 1998-2008, a combination of weak local currency and growing oil prices made the Russian economy more competitive and led to economic recovery and growth with an average of 6.4% per year. However, in 2009 due to the world financial crisis the economy shrank by 7.8% in 2009. Starting from that point, growth resumed at lower rates, turning into stagnation in 2014 and then recession.

Over the years, most of the structural problems of the local economy remain the same: being one of the wealthiest states in terms of natural resources, Russia is still heavily dependent on the global oil prices (Figure 1), which makes the economy fragile and open for crises and slows down modernization, which is needed to restructure the economy and social sphere. Some traditional internal challenges, such as high level of corruption, also slow down national growth. The Russian government has made numerous pronouncements and undertaken steps toward change by launching anti-corruption campaigns, privatising state-owned companies, investing in innovation through specially established institutions, and others.

Figure 1. Key milestones in the Russian economy: GDP growth and oil prices



## Current Macroeconomic Profile

According to Passport (2018), between 2000 and 2012 Russia's per capita income rose from 33% to 51% of the OECD average. A contraction occurred during the Great Recession but a fiscal stimulus valued at about 14% of nominal GDP provided significant support. However, the economy struggled in later years as a result of the oil price collapse and western sanctions. The ruble lost more than half of its value against the dollar while business investment and productivity fell sharply. Russian government responded by implementing massive expenditure cuts, as opposed to revenue mobilization, with social sectors and capital spending being hit hardest. The economy shrank in both 2015 and 2016 but growth returned in 2017 when real GDP rose by 1.5%. Investment and consumption picked up as oil prices began to recover. Improved credit conditions also boosted household spending. In an effort to loosen the link between the economy and the price of oil, Russian government aims to put aside oil earnings above a certain threshold. The potential rate of growth has edged up in the past couple of years but these benefits have been offset by a combination of sanctions, weaker domestic demand and negative demographics (*Russia: Country Profile, 2018*). Meanwhile, Economic Intelligence Unit forecasts Russia's GDP growth between 2018 and 2022 to fluctuate between 1.7% and 1.8%. Russia's ongoing standoff with the West has strengthened statist, nationalist and protectionist trends within the government.

Economic sovereignty - understood as insulating the economy from external shocks – is expected to remain a priority. The main elements of this strategy include a large positive sovereign external asset position, protectionist measures to support domestic manufacturing through import substitution and a cautious approach to foreign investment. (*Russia Country Report, 2018*).

Services, Russia's largest economic sector, currently comprises 62.0% of GDP. The Russian Central Bank's bail out of two large private banks in 2017 points to fragility in the Russian banking system. The Central Bank also plans to create a "bad bank" to deal with US\$19 billion in toxic assets linked to three newly nationalized banks. The real value of tourist receipts declined by 2.0% in 2017 and growth of 0.3% is forecast for 2018 helped by tourists influx attracted by the FIFA World Cup in 2018.

Manufacturing, Russia's second largest economic sector after services, accounts for 13.9% of GDP and employs 14.2% of the workforce. Several international automotive companies operate production facilities in Russia; at least one major firm has closed most of its Russian operations. Western corporate lending has also fallen sharply after the latest recession and U.S. and EU sanctions. Insolvencies in chemicals, agro-processing and other industries have been largely due to the effect of sanctions. There are massive mineral and forest resources with iron ore, coal, copper, aluminum, manganese, salt and precious metals all being produced. As commodity prices rise and borrowing costs come down, investors are exhibiting renewed interest. Higher profits and lower costs of financing are major drivers. Most of Russia's largest metal companies are forecasting stronger spending beginning in 2018.

Russian agriculture sector's 4.7% share in GDP is relatively small, commensurable to its 6.6% share in the national workforce (*World Factbook, 2018*). Although the soil is fertile, years of neglect mean that yields are just a third of those in Western Europe. Farmers are ill prepared to meet the goal of self-sufficiency officials that has been called for in response to western sanctions. For example, up to half of the fruit production from small farms and 20% of industrial vegetable production is lost to spoilage each year. Nevertheless, output rose in 2016 and the upward trend continued in early 2017 (*Russia: Country Profile, 2018*).

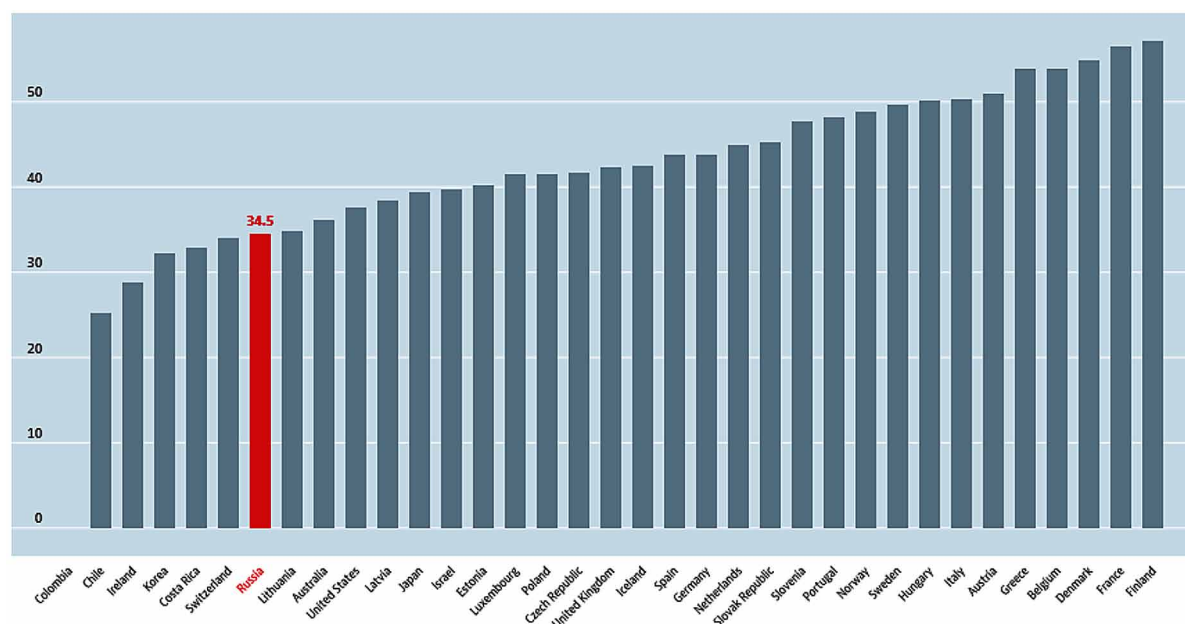
Contrary to some views, the government's role in the Russian economy is relatively less significant comparative to other countries worldwide. For example, in 2015 Russia's government spending as a share of GDP was 34.5%, slightly higher than that of Korea or Switzerland, but still significantly lower compared to other major developed economies (Figure 2). However, historically, Russia has demonstrated a tendency toward supporting its large state owned enterprises (SOEs) at the expense of small and medium size enterprises (SMEs). For example, in the EU, SMEs account for 40% of their respective countries' GDP but in Russia, these firms contribute just 15% (*Russia: Country Profile*, 2018). As an illustration, Figure 2 shows Russia's share of public SOEs in total market capitalization at approximately 33%: although slightly lower than China and the Czech Republic, it is still significantly higher compared to other countries profiled, including the OECD group and the world at large.

## Emerging Trends and Developments

After a deep crisis in the late 1990s, the Russian economy, still remaining resource-dependent, entered a period of stagnation in 2013-2014. . Figure 3 shows that Russia's energy sector generates more than 19% of the GDP, and more than 50% of the state budget (2015).

The World Bank reports (2018) that the Russian economy started to recover in the 2000s due to several positive factors, such as political and macroeconomic stability, rising oil prices, and others. Table 1 illustrates substantial progress in several economic areas, such as total wealth generated (+37%), natural capital increase (+79%), subsoil assets increase (+151%), with oil and natural gas reserves growth (+203,7% and +43,5%), coal, metals and minerals growth, as well as considerable human capital growth (+164,1%) (Russell, 2015).

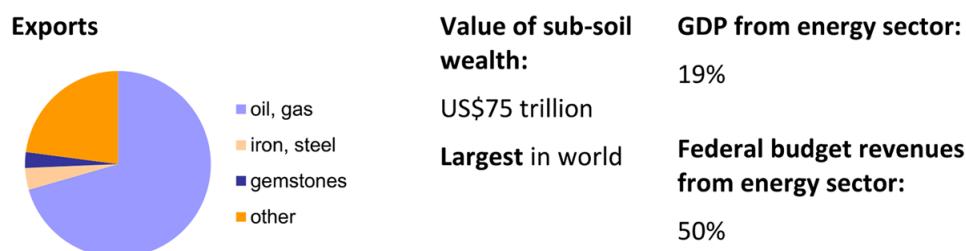
Figure 2. Russia vs. other countries: government spending





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Figure 3. Russia's natural resources



Data: [International Trade Centre](#)

Table 1. Russia wealth dynamics according to World Bank

N°	Millions, Constant 2014 USD	1995	2000	2005	2010	2014	(1995 vs 2014, %)
1	Total wealth	19 820 373	17 333 838	21 320 206	26 973 928	27 140 871	36,9%
2	Produced capital	11 155 211	7 151 127	6 808 744	7 588 799	7 019 370	-37,1%
3	Natural capital	3 757 819	4 164 708	6 481 265	7 238 928	6 748 113	79,6%
4	Forests, timber resources	213 954	193 275	209 172	150 424	130 909	-38,8%
5	Forests, non-timber resources	226 657	226 701	226 567	228 345	228 299	0,7%
6	Protected areas	400 139	491 634	528 055	462 543	398 779	-0,3%
7	Cropland	457 138	349 828	361 553	308 789	267 341	-41,5%
8	Pastureland	268 277	307 913	277 941	235 087	222 120	-17,2%
9	Sub-soil assets	2 191 655	2 595 357	4 877 978	5 853 739	5 500 666	151,0%
10	Oil	1 120 076	1 616 783	2 842 438	3 463 115	3 401 706	203,7%
11	Natural gas	911 373	876 859	1 716 992	1 458 056	1 307 911	43,5%
12	Coal (all grades)	103 263	59 884	192 994	369 676	242 048	134,4%
13	Metals and minerals	56 943	41 831	125 554	562 893	549 000	864,1%
14	Human capital	4 945 194	5 742 571	8 107 139	12 158 525	13 060 605	164,1%
15	Net foreign assets	-37 850	275 432	-76 942	-12 325	312 783	-926,4%
16	Population	148 375 726	146 596 557	143 518 523	142 849 449	143 819 666	-3,1%

Source: Wealth Accounting, 2018.

A comparison with the BRICS countries (*Global Monitoring Report, 2014*), reveals that Russia has substantial wealth base exceeding most of its peers in several areas, including produced capital, subsoil assets, oil and natural gas resources, and human capital.

## Economic Nationalism: Rising Again?

Economic nationalism is hardly a new concept. This set of political and economic measures has been used many times in the past. During its rapid proliferation in the 19<sup>th</sup> century, the U.S. economy was substantially protected from imports with trade barriers (please refer to the tariff rate dynamics in Figure 3). Starting from Friedrich List (Parker, 1827) in the 19<sup>th</sup> century, economic nationalists have opposed economic liberalism and have advocated for a significant role of government intervention in an economy through trade barriers, direct state intervention due to a competition between nations.

Yet, even the strongest advocates of economic nationalism realised negative consequences of the long term state intervention and protectionism, considering protective measures as investments, aimed to support a young emerging industries to foster their growth into competitive global actors.

Generally speaking, in a historical retrospective, all now developed and some of the developing countries have gone through periods of economic nationalism, using a range of methods to sustain and propel their economic growth and global competitiveness.

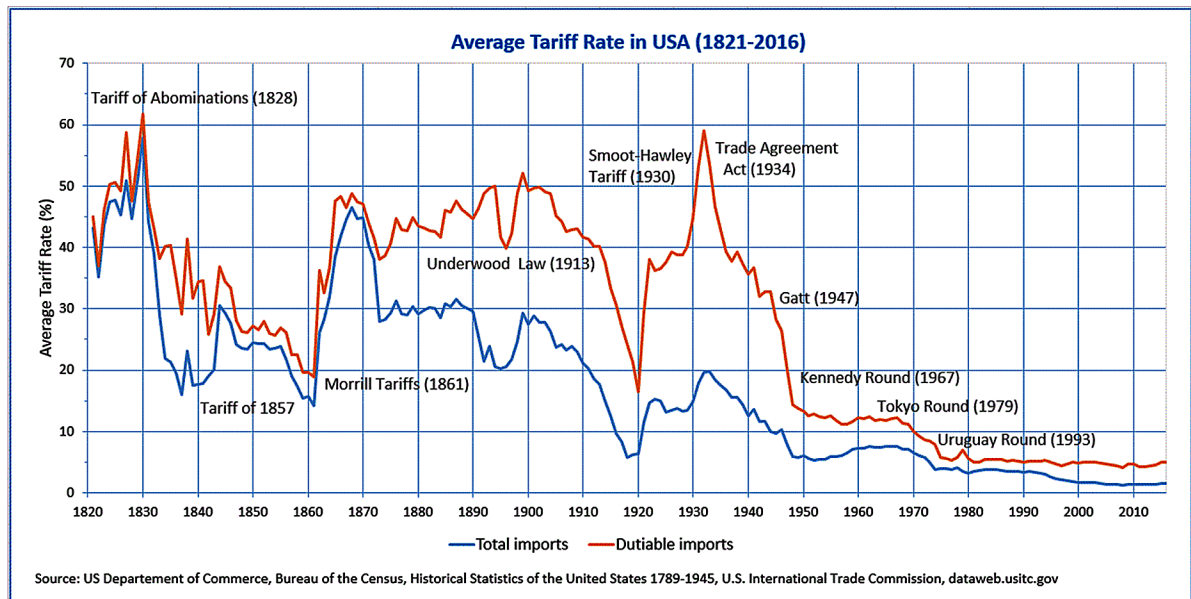
*Table 2. Comparative analysis of the national wealth: Russia vs. other BRICS countries*

Millions, Constant 2014 USD	Russian Federation	South Africa	China	India	Brazil
Total wealth	27 140 871	4 188 153	147 575 561	23 588 627	38 924 621
Produced capital	7 019 370	1 043 041	38 971 412	6 685 444	6 608 318
Natural capital	6 748 113	744 120	20 645 730	6 138 138	7 620 416
Forests, timber resources	130 909	48 604	352 528	47 483	296 059
Forests, non-timber resources	228 299	17 313	394 805	49 296	1 481 053
Protected areas	398 779	20 029	1 159 099	122 241	1 494 315
Cropland	267 341	114 509	9 676 163	2 636 739	1 301 067
Pastureland	222 120	156 576	2 847 942	1 850 555	1 232 137
Sub-soil assets	5 500 666	387 090	6 215 192	1 431 826	1 815 784
Oil	3 401 706	1 022	968 108	284 619	573 470
Natural gas	1 307 911	1 388	128 663	53 181	15 294
Coal (all grades)	242 048	192 849	3 035 740	631 315	5 067
Metals and minerals	549 000	191 830	2 082 680	462 711	1 221 953
Human capital	13 060 605	2 432 338	86 452 180	11 340 780	25 491 104
Net foreign assets	312 783	-31 346	1 506 239	-575 735	-795 217
Population	143 819 666	54 146 735	1 364 270 000	1 295 291 543	206 077 898

Source: Wealth Accounting, 2018.

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Figure 4. Average tariff rates in USA



Economic nationalism was perceived as a helpful tool for those nations, using it in the past, including Great Britain (18<sup>th</sup> century), the U.S. (19<sup>th</sup> century) Germany (19-20<sup>th</sup> century), to gain a market share in the global economy using international trade in the interest of developing their national economies. The first theory of its kind, mercantilism, developed by James Stuart (1770) in the 18<sup>th</sup> century, led Britain to sustainability and global domination.

Today, contrary to the worldwide interest and progress made in free trade and economic integration, economic nationalism is raising again, a sign of a discrepancy in the vision of the global economic balance between leading nations.

And evidenced from history, world's leading nations which holds dominant strategic positions on the global economy benefit most from free trade and become the main promoters of its principles. In the 19<sup>th</sup> century it was Great Britain, in most of the 20<sup>th</sup> century – the U.S. The tenets of open economy and free trade were summarized in 1989 in ten main principles of the Washington consensus (Williamson, 1989). One of these principles states the necessity of trade liberalization: liberalization of imports, with particular emphasis on elimination of quantitative restrictions (licensing, etc.); any trade protection to be provided by low and relatively uniform tariffs.

But after 20 years of the U.S. political economic dominance, there comes a new era of turbulence,; with several competent global economic actors, especially with China as a rising economic powerhouse, American primacy is being challenged.

As one of the consequences, American commitment to free trade appears to be waning, as it no longer benefits the U.S. economy in the current global configuration. Economic nationalism is being propagated by the current administration in Washington D.C. under the “America first” doctrine.

Other global regions and nations are also affected. The EU initially demonstrated great geoeconomic potential by utilising collective bargaining power to protect strategic industries of its member states,

while compelling external trading partners to open their markets (Diesen, 2017). Now it opposes U.S. pressure in trade barriers and implements counter measures.

The Europe 2020 initiative intends to augment the capacity of the EU to intervene in the market to support the businesses of member states, empowering Brussels with powerful tools to hand in the shape of new economic governance (Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth, 2010).

As for the Chinese economic nationalism, it is usually perceived as the greatest challenge to the geoeconomic domination of the West. Again, starting from 1970s China used the state-led industrialisation as the main engine of economic development. So, China also used some classic tools of economic nationalist policies as the lever to support its economic growth and development.

With the rising economy and increasing market share, however, China also becomes a great supporter of free trade, as it benefits its expansionist economy, however being "rational" as they maximise security by acting in accordance with the balance of power logic. The "realist theory" posits that a decentralised and balanced economic system will have greater symmetry and therefore be more stable, rather than fragmenting and destabilising the global economy (Diesen, 2017). The establishment in 2015 of the China Interbank Payment System (CIPS) in parallel and an alternative to the the Worldwide Interbank Financial Telecommunication (SWIFT) serves as a recent illustration of a "rational" of the Chinese economic nationalism..

One can make an interim conclusion that economic nationalism, being an old concept opposing free trade, is becoming more influential at times of extensive rivalry between global economic leaders and has been widely used by main economic powers of the world "to climb the ladder" of the world market. Along the way, the main leader tends to promote free trade as long as it strengthens its strategic position in the world. When the nation's global competitiveness relative to new emerging leaders weakens many countries resort to the arsenal of economic nationalism.

## Russian "Economic Nationalism" in a Comparative Context

What are the drivers and emerging scenarios for the Russian economy in the above context? To answer this question, let's try to assess the level of Russian economic nationalism and its implications for the national economy. Data available from OECD, Worldbank, WTO, and other organizations allow to factor into the picture three main indicators: the level of trade barriers, the level of direct state participation in the economy, and the level of economic freedom. The main indicators of economic health in this assessment include GDP growth, trade balance as a percent of GDP, investment as a percent of GPR, and Competitiveness index. These indicators in this chapter are analyzed in their dynamics and in contrast the "close competitors" – other BRICS countries as well as some developed economies. This analysis here is largely qualitative, however it supported by some key quantitative correlations between the "economic growth and development" and "indicators of economic nationalism" variables.

As follows from Table 3 and a previous discussion, the Russian economy had a good start and a long growth period in 2000-2008, following a sharp drop in 2009 and stagnation after 2012, sliding into further recession in 2015-2016.

As for GDP growth in comparison with it's BRICS peers (Figure 3), Russia in 2015 (-2.83%) is below all of its BRICS peers except Brazil (-3.77%). As seen from Figure 3, one of the main characteristics of the Russian economy is its volatility during the crisis.

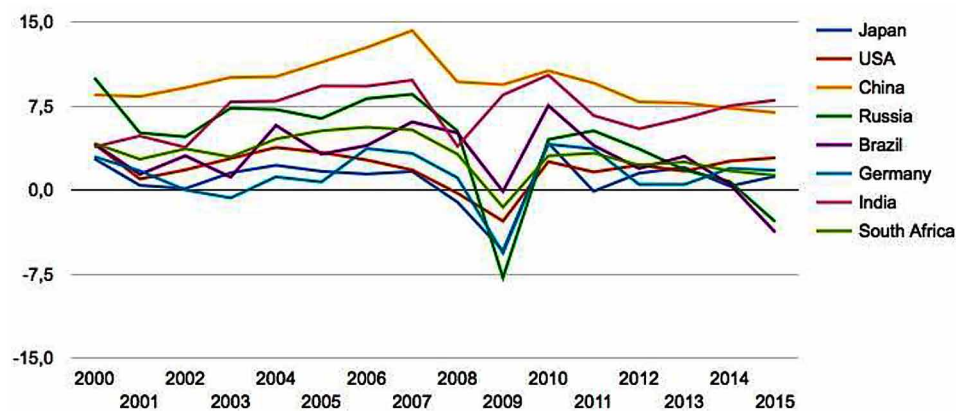
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Table 3. Main indicators of economic development vs. “economic nationalism” of Russia 2000-2016

Index	2000	2005	2010	2011	2012	2013	2014	2015	2016
<b>Economic Growth and Development</b>									
GDP growth, %	10.0	6.4	4.5	5.3	3.7	1.8	0.7	-2.8	-0.2
Trade balance, % of GDP	+20.03	+13.69	+8.08	+8.05	+6.66	+5.39	+6.41	+8.06	+5.16
Investment, % of GDP	18.69	20.08	22.62	24.44	24.54	23.13	22.24	22.37	23.4
Competitiveness index	n/a	n/a	4.15	4.23	4.21	4.19	4.24	4.37	4.44
<b>Indicators of “Economic Nationalism”</b>									
Globalization Index 0-100	53,1	65,73	67,54	65,19	66,97	67,78	65,42	69,06	n/a
Trade openness (exports plus imports as percent of GDP)	68,09	56,71	50,36	48,4	47,78	47,65	48,04	49,39	n/a
Economic freedom score	51,8	51,3	50,3	50,5	50,5	51,5	51,9	52,1	50,6
State participation in the economy, % of GDP	n/a	35%	n/a	n/a	50%	n/a	n/a	70%	n/a

Sources: World Bank, WTO, IMF, OECD data, 2000-2016

Figure 5. GDP growth rate



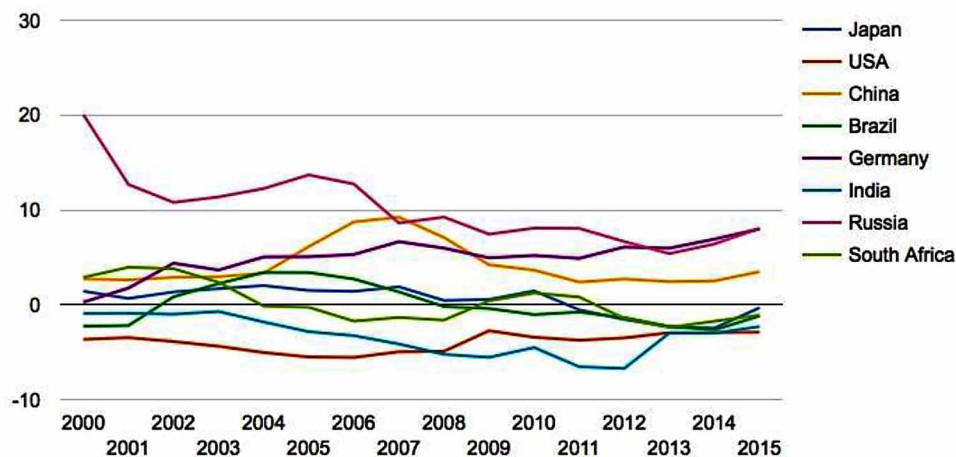
Source: TheGlobalEconomy.com, World Bank

As for the trade balance, Russia is the best performer when compared to the BRICS peers with 8.6% of positive trade balance to GDP and all the others, except China and Germany, in the negative territory.

Russia’s 22.7% of investment to GDP ratio in 2015 is below Japan (24%), China (45.4%) and India (32.9%), but outperforms the U.S. (20.43%), Brazil (17.41%), Germany (19.15%), and South Africa (20.71%). And this ratio has been reasonably stable over the last 15 years.

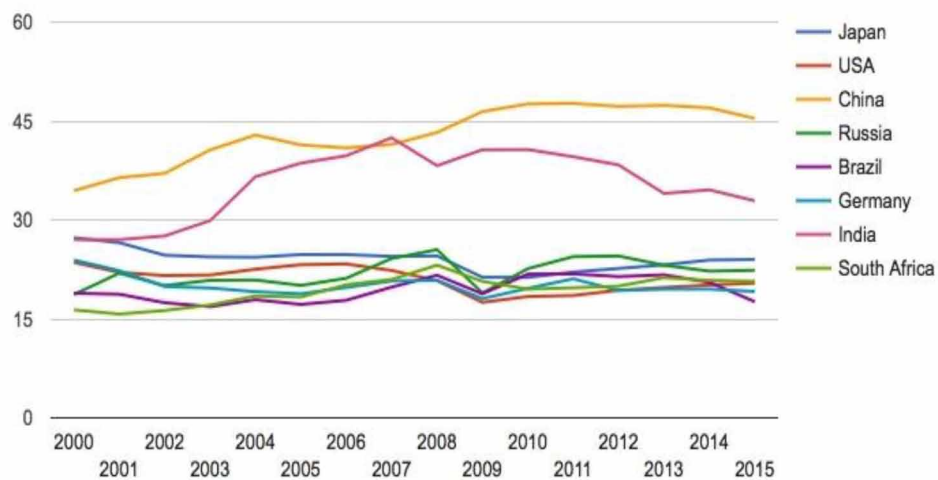
Russia’s overall Global Competitiveness Index is slowly growing from 4.13 in 2006 to 4.44 in 2015, positioning Russia on the 38<sup>th</sup> place in the latest world ranking in 2017-2018 compared to 67<sup>th</sup> place in 2012-2013. While still trailing the world leaders, Russia started to catch up during the last decade.

Figure 6. Trade balance as % of GDP



Source: TheGlobalEconomy.com, World Bank

Figure 7. Capital investment as % of GDP

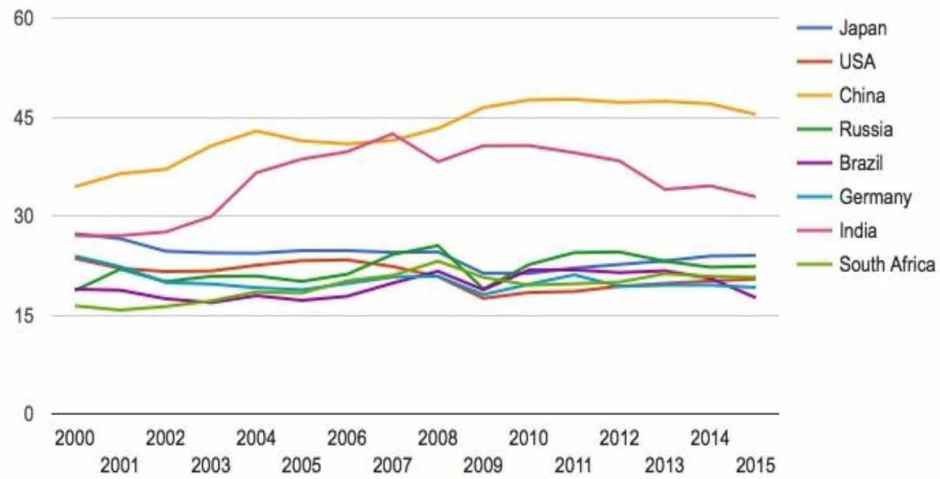


Source: TheGlobalEconomy.com, World Bank

Also, notably, according to the Global Competitiveness Report 2017-2018, although Russia outperforms most of the Eurasian countries in market size, technological readiness, education, infrastructure and macroeconomic stability, it is still suffering traditional weakness in business sophistication and innovation.

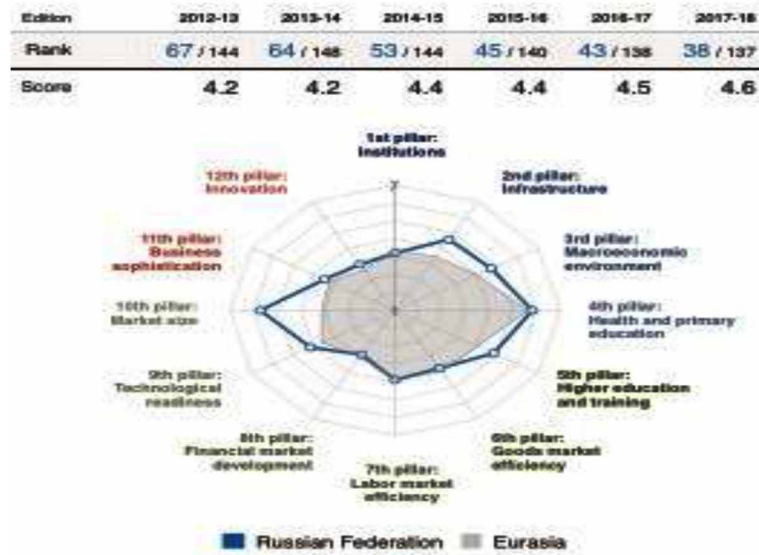
**Russia**

Figure 8. Competitiveness: World Economic Forum Index



Source: TheGlobalEconomy.com, World Bank

Figure 9. Comparative global competitiveness of Russia



In the context of assessing the level of “economic nationalism” it is useful to look at the Globalization Index. This Index published by the KOF Institute headquartered in Switzerland provides some well-regarded and widely used measures of economic, social, and political globalization. Each index reflects the degree of integration of a country with the rest of the world. The Globalization Index as a whole integrates economic, social, and political dimensions of globalization. Higher values denote greater globalization.

As follows from Figure 10, during the last 15 years Russia's Globalization Index has significantly improved, signifying Russia's greater involvement into the global economy, despite sanctions and countersanctions during 2014-2017.

On the comparative basis, Russia is more globalized (69.06) against its BRICS peers with South Africa (68.63) as the closest. However it is lagging behind the world leaders such as the most globalized Germany (86.89). Not surprisingly, the highest score Russia gets on economic (50.95) and social (65.41) globalization, with political globalization lagging behind, ahead of only South Africa and Brazil.

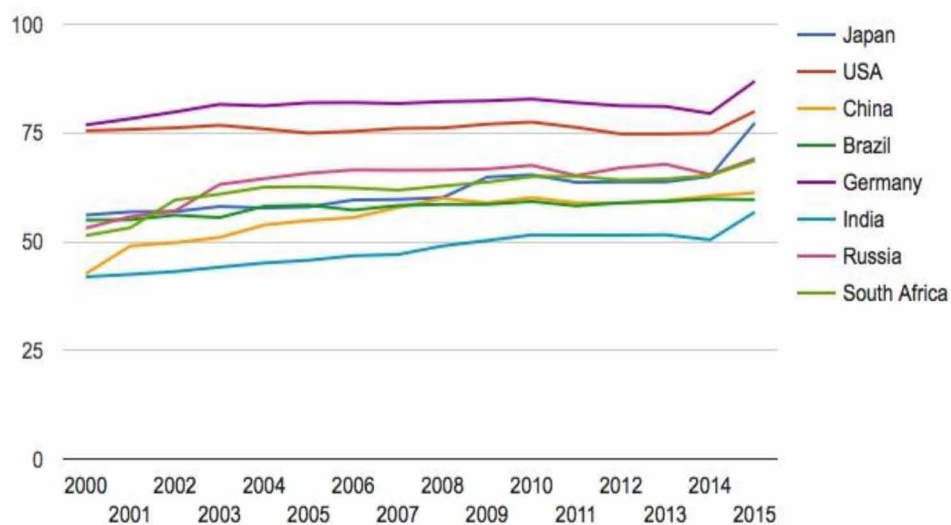
Trade openness, which is calculated as exports plus imports as percentage of GDP is an additional comparison indicator. Figure 11 shows that, based on this metric, Russia seems to be one of the most "trade open" countries among the BRICS peers (49.39), lagging behind South Africa (61.91) and Germany (85.99), although this trade openness decreases overtime, dropping from 68.09 to 49.39.

### Level of Economic Freedom

Looking at international comparisons of economic freedom reveals a gap between the average world level (61.1%) and Russia (58.8%), however this gap has been declining over the last 3 years. Most of the other BRICS countries are below the world average as well: China – 57.8%, India – 54.5%, Brazil – 51.4%, with only South Africa (63%) exceeding the world average.

The level of economic freedom among the world leaders, such as Hong Kong, Singapore and New Zealand, ranges between 84% and 90%. On the opposite end of the spectrum are Cuba, Venezuela, and North Korea with their levels of economic freedom at 32%, 25%, and 6% respectively. Russia ranks 107/180 worldwide in the latest Index of Economic Freedom. During the past decade Russia's economic

Figure 10. Globalization Index

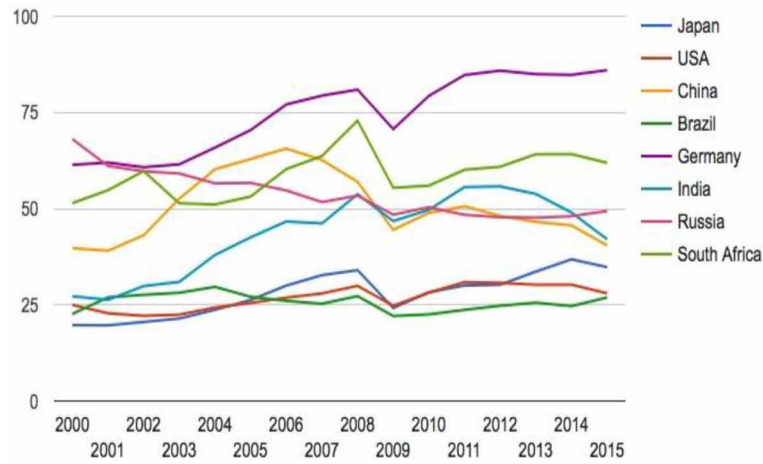


Source: TheGlobalEconomy.com, World Bank



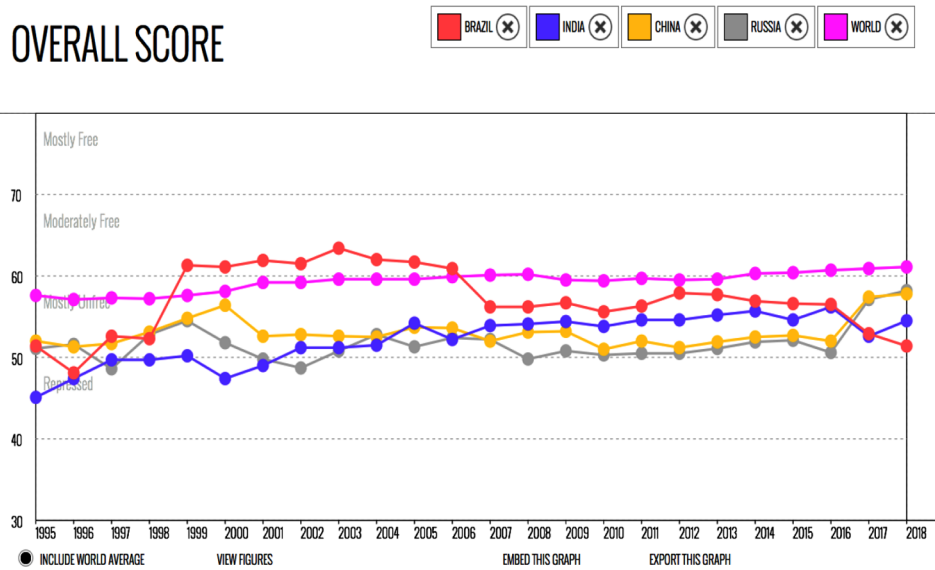
**Russia**

Figure 11. Trade openness



Source: TheGlobalEconomy.com, World Bank

Figure 12. Comparative Index of Economic Freedom



freedom has been hovering within the low 50% range, but over the last two years it improved by about six percentage points to 58% (*Index of Economic Freedom, 2018*).

An assessment of interrelations between the main indicators of economic development and a degree of “economic nationalism” (Table 4) appears inconclusive: on the one hand, “economic nationalism” correlates with an increase in investment as a percent of GDP, enhanced competitiveness and globalization, but on the other hand it is associated with a slowdown in economic growth.

Table 4. Correlations between the variables of economic growth and development and “indicators of economic nationalism”

	GDP Growth, %	Trade Balance, % of GDP	Investment, % of GDP	Compet. Index	Globalization Index	Trade Openness (Exports Plus Imports as Percent of GDP)	Economic Freedom Score	State Participation in the Economy, % of GDP
GDP growth, %		0,78	-0,52	-0,7	-0,76	0,75	-0,19	-0,99
Trade balance, % of GDP	0,78		-0,88	-0,3	-0,87	0,99	0,33	-0,70
Investment, % of GDP	-0,52	-0,88		-0,1	0,70	-0,89	-0,88	0,44
Competitiveness index	-0,75	-0,28	-0,12		0,36	0,05	0,24	1,00
Globalization Index	-0,76	-0,87	0,70	0,4		-0,90	-0,24	1,00
Trade openness (exports plus imports as percent of GDP)	0,75	0,99	-0,89	0,0	-0,90		0,30	-0,71
Economic freedom score	-0,19	0,33	-0,57	0,2	-0,24	0,30		0,57
State participation in the economy, % of GDP	-0,99	-0,70	0,44	1,0	1,00	-0,71	0,57	

More specifically:

- There appears to be a positive correlation between trade openness on the one hand, and GDP growth and positive trade balance on the other hand.
- A strong correlation was found between investment as percent of GDP and the Globalization Index.
- Interestingly, no correlation was found between trade openness and the Global Competitiveness Index.
- Remarkably, there is a negative correlation between investment as a percent of GDP and trade openness and economic freedom.
- There is a positive correlation between state participation in the economy and investment and a strong correlation between state participation, the Global Competitiveness and the Globalization indices.
- At the same time, state participation is negatively correlated with economic growth and trade balance.

These findings allow to conclude state participation itself may play a different role at different stages of the national economic development: it can play a role of accelerator for some economic variables (investment, improved competitiveness due to consolidation of economic sectors and industries) and act as a “brake” (resulting in slower GDP growth rates). Additionally, what needs to be taken into consideration is that a high economic growth rates in Russian at the beginning of the 2000s was a result of recovery after a steep plunge at the end of the 1990s.

## State Participation in the Economy: A Conscious Choice or Necessity?

Another metric of economic nationalism is the level of direct state participation in the economy. According to OECD research, the pattern of direct state participation in the economy in the form of state owned enterprises SOEs between OECD members countries and non-OECD countries differs significantly, resulting in different approaches toward economic development and distribution of powers in political-economic governance.

SOEs are important participants of many national economies (*The Size and Sectoral Distribution of State-Owned Enterprises*, 2017). They frequently operate in sectors, which serve as critical infrastructure for business, such as transportation, public utilities, finance. Many SOEs, including big international corporations, are active internationally, which leads to discussions on their critical impact on fair trade and competition. The level, at which SOEs influence competition, is also a matter of discussion in the context of “economic nationalism”.

Russian SOEs comprise a significant part of the economy, ranging, according to available data (FTS, 2018), from 35% in 2005 to 70% in 2015, depending on the methodology used. OECD studies estimate this share to be significantly above the world average.

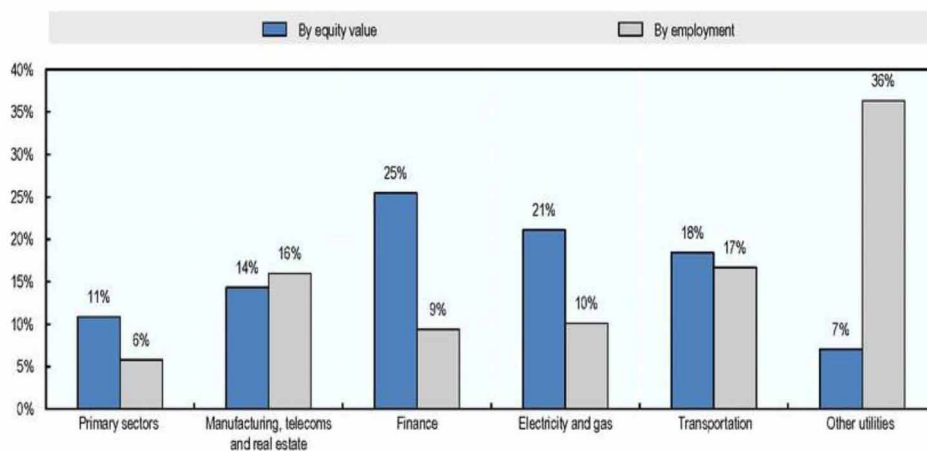
After the collapse of Soviet Union in the 1990s nearly 70% of the economy (by GDP) has been privatised. However, since 2000, since Vladimir Putin accession to power, state ownership has made a comeback. Private assets, especially in the oil and gas, banking and transport sectors have been taken and returned to enterprises with a direct or indirect state controlling interest - mostly through buyouts, sometimes through outright expropriation (the Yukos case), or recently in the case of Bashneft. As a result, in 2012 the state-owned sector was estimated at around nearly 50% of GDP, compared to an international average level of 30% (Tsepelyaeva & Yeltsov, 2012) and is significantly exceeds an average for OECD countries (Figure 8).

The state ownership level ranges from 40-45% in the oil sector (up from 10% in 1999 — Rosneft), 49% in the banking sector (Sberbank, VTB), 73% in the transport sector (Russian Railways, Aeroflot), and Gazprom, which produces most of Russia’s gas, owns the distribution network, and has a monopoly over exports. Considering the dynamics, in 2000 -2015 Russia has transitioned from predominantly private to predominantly state-owned economic model.

While some sectors are nearly dominated by the state, its influence is additionally reinforced through the system of procurement, which leads to additional concentration of economic power in the hands of the biggest corporations, directly or indirectly controlled by the state. The main challenge is – does this model facilitate innovation, development and economic prosperity?

On average, Russian state-controlled companies are less efficient than their fully privately owned counterparts, with labour productivity as low as 30% of the sector average in some industries (Tsepelyaeva & Yeltsov, 2012). The main reason for this is the same for all SOEs in the world: commercial goals tend to be ranked as a second priority to a government policy implementation. For example, Gazprom financed US\$2.2 billion for the Sochi Winter Olympics in 2014, Rosneft finances social programmes in the regions of where it operates, and this list can continue. But even more importantly, after a series of mergers and acquisitions such state owned monopolies become a dominant power, the rain maker in their industry and suffocate a competition, leading in the long run to a lack of innovation and a decline in the overall competitiveness of the industry.

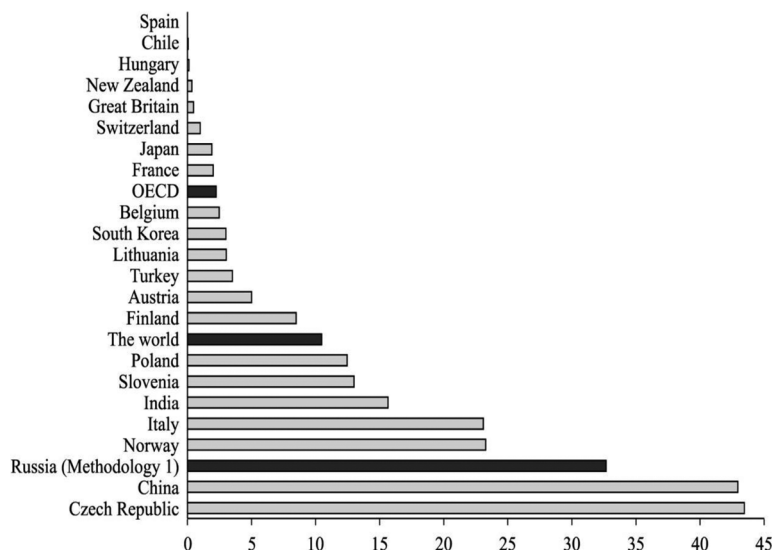
Figure 13. Sectoral distribution of SOEs



Abramov et al. (2017) conducted a study using a sample of 114 largest Russian companies. The study found that while Russia’s share of public SOEs in total market capitalization stands at 33% (Figure 14), the share of public SOEs in total employment is disproportionately low – only 5% (Figure 15). The Abramov et al. report an increase in participation of the state in the Russian economy beginning in the mid-2000s. The authors argue that this phenomenon was not accompanied by a strengthening in the positions of major SOEs in total Russian market capitalization, sales, and employment. Their findings identify two key trends in public sector development as it relates to SOEs.

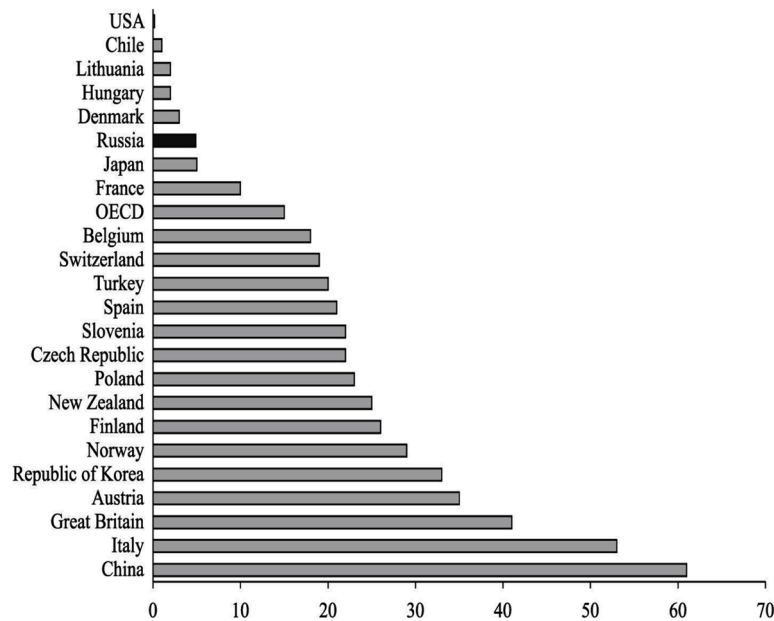
From 2000 to 2008, there was a specific trend towards a quantitative expansion of the public sector, which was clearly manifested by its capitalization trends. However, this trend later changed and the share of SOEs among key economic indicators stabilized or decreased somewhat. In 2007, the trend in SOE

Figure 14. Russia vs. other countries: share of public SOEs in total market capitalization



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Figure 15. Russia vs. other countries: share of public SOEs in total employment



market capitalization changed; from 2006 to 2014, the share of SOEs in total capitalization dropped substantially from 52.6% to 39.3%. From 2006 to 2014, the share of revenues and total employment by major SOEs increased moderately from 9.5% to 11.1% and from 4.3% to 5.0%, respectively.

Abramov et al. (2017) report that the number of companies operating in the public sector in Russia, decreased from 2010 to 2016, but the level of direct and indirect involvement of the state in the economy, particularly in specific sectors (through major state-owned banks and state corporations), remained high. This implies that the strengthening of the state's role in the economy entered a new, qualitative, stage. This new role manifests itself in the following forms: -an increased role of state-owned organizations in the distribution of financial resources and in control over economic agents; -the activation and acquired regulatory functions for newly created vertically integrated organizations in a number of industries, state corporations and other development institutions; -the transfer of non-public state-owned company property into capital, "pseudo-privatization" processes; and -the expansion of spheres (control areas) of government regulation rather than a simple increase in the shareholdings owned by the state in the capital of major public companies.

According Abramov et al. (2017), increased involvement of the state in the economy did not have a positive impact on the market price of public SOE shares that were directly or indirectly owned by the state. The market value of shareholdings directly owned by the state declined from RUB 4.7 trillion in 2006 to RUB 3.5 trillion in 2014 (34%) and shareholdings that were indirectly owned by the state declined from RUB 2.9 trillion to RUB 2.2 trillion (32%). The trend towards reduced capitalization in the Russian stock market between 2008 and 2014 has affected both state-owned and private companies. However, the capitalization of SOEs decreased faster than the capitalization of private joint-stock companies, although major SOEs received more government support during the period under review. The share of total Russian stock market capitalization for SOEs reached nearly 40% and remains one of the highest in comparison with OECD countries, which averages slightly more than 2%.

In terms of labor productivity per employee, the SOEs in the Abramov et al. (2017) lagged far behind private companies within the sample, although from 2006 to 2014, this gap has slightly narrowed. In terms of this criterion, the SOE indicator was slightly higher than the 50% demonstrated by private companies, while major public SOEs in the sample far surpassed non-public SOEs considered to be state-owned and mixed-ownership companies by Rosstat (Russia's federal statistical agency, GSK).

Russian SOEs include companies that are directly and, in varying degrees, indirectly owned by the state: they differ significantly in terms of their performance. In terms of labor productivity, SOEs indirectly owned by the state were found by this study to lag behind private companies, but noticeably surpassed SOEs that were directly owned by the state. Concurrently, indirect state ownership, to a certain extent, acts as an alternative to privatization; it can be created by transferring shareholdings owned by the state to independent commercial entities, such as Rosneftgaz, state corporations, and other development institutions, or by state-owned entities that acquire SOEs shareholdings in the market. From this perspective, the higher performance efficiency of SOEs that were indirectly owned by the state may indicate that the state acquires the shareholdings of more efficient SOEs, which ultimately limits their privatization opportunities, i.e., their transition to a private business. In addition, the authors' calculations demonstrate that from 2006 to 2014, the capitalization of SOEs indirectly owned by the state decreased faster than for companies that were directly owned by the state (Abramov et al., 2017).

## Russia's Global Integration at the Regional Level

With wide variation at the regional level, there is a huge differentiation between the Russian regions in terms of population, territory, as well as economic development and integration into the world economy. Figure 16 contain the "heat map" of Russian regions in terms of export volumes.

Among the leaders are Moscow (\$63,8 bil USD out of \$139,4 bil. USD exports nationwide), Tumen – the oil producing leader (\$8,67 bil), Petersburg (\$6,6 bil), Kemerovo (\$5,17 bil), and Tatarstan (\$4,57 bil). A close look to the economic indicators of Tatarstan, for example, shows significant impact that exports have on the regional economy. So, the leading regions of Russia seem to be well integrated into the world economy and use global integration for their growth and prosperity.

## Russia Global Integration at The Industry Level: Metallurgy, IT

Industry related dynamics portray a very different situation. Looking at the structure of Russian exports reveals a market dominance of low value added items, such as mineral fuels, oils, and distillation products (48% of total exports nationwide), commodities (15%), iron and steel (5,2%), aluminium (1,9%), with machinery, a relatively higher value added export group, taking only 2,4%. This could be perceived as an additional challenge to the economy, as it is getting stuck in resource dependency. Figure 11 is illustrative of the dominance of resource – oriented exports, with oil, natural gas, and various commodities comprising 63% of the Russian overall national exports in 2017. However, several sectors, such as metallurgy, IT, some machinery and equipment sectors are well integrated into the world economy, offering globally competitive goods and services. According to a Deloitte study, export – oriented economic sectors are the most optimistic about their future: among those with the share of export operations above 25% and the number of employees above 5,000 the share of "optimists" is 74%, in comparison with 64% among the rest (*Overview of the Russian industrial production sector*, 2017).

## Russia

Figure 16. Russian regional export rating

Объем экспорта, млрд \$ 0,00 63,80



Table 5. Example of «regional globalization» level in Russia: Tatarstan region

Index	2000	2005	2010	2016
RDP growth, %	72%	23%	13%	4%
Trade balance, % of RDP	-	55,8%	54,3%	41,5%
Investment, % of RDP	24,0%	28,9%	32,8%	32,8%
Foreign direct investment, % of RDP	-	2,5%	12,6%	1,9%
Export, % of RDP	-	52,5%	47,3%	32,2%

Sources: GKS, IMF data, 2000-2016

## Russia: Long Term Goals and Economic Priorities

What are some plausible future scenarios for Russia in the context of economic nationalism vs. economic liberalism? Will it engage some of “economic nationalism” policies further, or pursue integration approach (global or regional)? The answer of course depends on many factors, including the geopolitical landscape, global and regional economic dynamics. At the same time, most of the strategic economic initiatives and political trends are point out to further integration into the world economy. During the recent approval of the Prime minister in May 2018, President Putin stated, “Our internal consumer should buy world class goods and services. If we will lock ourselves inside the country and salt ourselves like cucumbers in a barrel, nothing good will come out of that” (Demshenko, 2018). At the same speech he noted that promotion of local goods on the international markets boosts internal production.

Meanwhile, the biggest challenge to this course of action comes from the current political situation, sanctions and countersanctions regime, which altogether put all the international connections and business commitments under ongoing pressure and feeds protectionism.

Table 6. Main indicators of the metallurgy Russian and IT sectors.

Index	2000	2005	2010	2015	2016	2000	2005	2010	2015	2016
	Metallurgy					IT				
Industry growth, %	-	31%	19%	14,8%	-1,2%	-	15%	13%	11,9%	5,8%
Investment, % of GDP	-	4,0%	3,6%	2,6%	3,3%		10,3%	7,3%	5,9%	6,0%
Industry GDP/Country GDP	-	18,3%	14,8%	14,1%	13,4%	-	10,2%	9,1%	8,1%	8,2%
Exports, %	21,7	16,8	12,7	11,9	13,3	-	-	-	-	-
Imports, %	8,3	7,7	7,3	6,7	6,4	-	-	-	-	-

Sources: GKS data, 2000-2016

As for the state participation in the economy, there is strategic goals are also set in favor of shift to a more balanced economy. Understanding this long-term risk of stagnation, Russian government has launched a privatisation program in 2011, with the target to disinvest from non - oil sector by 2016, ‘with the exception of natural monopolies and defence -related companies’ (On the long term state economic policy, 2012). However, in practice privatisation program led to a redistribution of economic power between state controlled companies (example of Bashneft privatisation as the latest), or selling off only minority shareholdings. As a result, the level of state ownership is in fact increasing.

## CONCLUSION

Examining the Russian economy in a 15th year comparative retrospective leads to the following conclusions in the economic nationalism perspective:

- With geoeconomic power shifting East and re-emergence of the “new economic nationalism” Russia has an opportunity to redefine its niche in the interdependent global economy.
- Russian economy seems to be reasonable well integrated into the global economy, both relative to its BRICS peers and even to some developed countries. Some indicators, while being reasonably respectable, show negative dynamics (for example, trade openness). At the same time, the competitiveness of the Russian economy is gradually improving, with a stable trend in investment as percent of GDP.
- The structure of Russian trade still needs improvement: Russian exports is still comprised mostly of low value added items, such as mineral fuels, oils, distillation products, and commodities.
- The most significant sign of the emerging paradigm of “economic nationalism and state capitalism” in Russia is the growing degree of direct and indirect state participation in the economy, rising from 35% in 2005 to approximately 70% in 2015.
- Over the last 15 years, the “state capitalism” model combined with a significant level of integration into the world economy and fueled to a large extent by favorable global prices on oil and have supported economic growth, development and facilitated Russia’s global competitiveness. On the other hand, after the economic boom of the 2000s, Russian economy is now slowing down and bouncing between stagnation and recession. With this, a sizeable share of state - owned



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economy (fluctuating between 50 and 70%) in the long run can lead to slowing down internal competition and innovation and could become an obstacle to sustainable growth and development.

- If the current model of resource-oriented state capitalism is not transformed into a more competitive internally and externally, dynamic and innovative mixed model, Russia could face serious challenges in international markets.
- The leading Russian regions seem to be well integrated into the world economy and use global integration for their growth and prosperity.
- At the industry level, those industries, enjoying a higher level of global integration (a share of export) and higher share of private ownership, appear to be much more competitive and sustainable, than state-owned, internal market-oriented ones.
- There are several possible development scenarios for the Russian economy:
  - **Conservative Scenario:** Self - isolation, with the declining trade openness, more projects in the field of “import substitution.”
  - **Moderate Scenario:** Integration in the global economy remains on the same level, with the focus on supporting “friendly” states and own regional integration projects, the dominance of resource-oriented exports is slowly challenged by other industries (IT, machinery e.t.c.), further integration is carefully checked and discussed (two steps forward, one step back).
  - **Liberal Scenario:** further integration into the world economy, liberalization of trade and ongoing improvements in business climate to facilitate investment.
- Under the current political trends and conditions, moderate scenario is most likely within the nearest 3-5 years.

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## Chapter 6

# Developing Institutions for the New Space Race: Examining the Privatization of Space Exploration and Its Implications for International Business

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### **ABSTRACT**

*This chapter examines the dynamic of the major actors in today's new space race. The initial space race featured nation-states as the primary actors. However, the current space race has undergone privatization and now features corporations as additional key players, along with developing nations. The result is the semi-private commoditization of a public good that crosses through different hemispheres, as well as competition between actors from both the firm and state level. Building on world systems theory and institutional theory, this chapter argues that the privatization of space exploration mandates the construction of inter-hemispheric institutional frameworks that apply globally. A descriptive case study that juxtaposes India and SpaceX offers foundational insight into how inter-hemispheric institutions are created. Given the challenging parity between state sovereignty and global consensus and its influence on firm behavior, this chapter proposes an exploratory examination of the processes and strategic choices behind inter-hemispherization to incite future scholarship.*

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## INTRODUCTION

As the world continues to globalize, there is a constant race for resources (Mahtaney, 2013; Porter, 2003). All actors (e.g., individuals, governments and corporations) are in a competition for the small volume of remaining resources, while simultaneously searching for new ones (Boulhol, De Serres, & Molnar, 2008; Kwon, 2012). Considering the limited amount of remaining natural resources, there has been an increasing attention on planets other than earth (Devezas et al., 2012). Moreover, there has been an increasing curiosity amongst scientists, governments, firms and individuals on space and inter-hemispheric travel (Berryman, 2002; Devezas et al., 2012). Whether for its mysterious uncertainty or for the potential that it holds in terms of societal advancement, there has been an increased effort to understand and explore the remainder of the solar system (Bainbridge, 2009; Ehrenfreund et al., 2012). In fact, it has been more than a century since individuals started using private funding to promote space exploration, even before significant government support (MacDonald, 2017). As the curiosity expands, so too does the need for a more nuanced understanding, from both a practitioner and academic perspective, of the consequences of the new space race (Devezas et al., 2012). From a historical perspective, the space race was a surrogate war between states, built on the premise of a primary payoff of national prestige for nations that were able to reach other planets (Berryman, 2002; Brown, 2011). Today, however, the space race is increasingly privatized, as corporations have become key players (Burnett, 1997; Reibaldi & Grimard, 2015). The result is a new dynamic and a potential institutional void. Thus, it is critical to parse out the impacts of the new race on both the private companies involved, as well as the states.

The new space race, like having the world's tallest building, is now a competition between developing countries and private companies (Devezas et al., 2012). Developing countries seek to demonstrate and advance their position and prestige in the world system (Ansdell, Ehrenfreund, & McKay, 2011; Shahrokhi & Harwell, 1989). It is important to note that these 'competitions' were established by the modern superpowers as demonstrations of their superiority through use of surrogate warfare (Brown, 2011). But, as developing states have entered the global competition for power, so too have western-born private corporations, in place of the developed countries they represent (Karlgaard, 2012; Musk & Pelley, 2012). This is not to suggest that developed countries do not have an interest in space exploration, but rather that they participate through funding and supporting private corporations from their respective nations (Reibaldi & Grimard, 2015). Thus, the privatization of the space race invites a new competitive dynamic between states and corporations with relative parity, rather than classic intra-state competition. As such, it is imperative that scholars understand the impact that this competition has on both sets of actors. Is it possible for governments to establish inter-hemispheric institutions? If so, what institutions would exist? If not, where will corporations involved find the institutional structures that guide behavior for firms as they enter space? Do western-born corporations possess an advantage from sharing a formative identity with the original space racers? The purpose of this chapter is to offer preliminary descriptive evidence into the institutional structures and frameworks that dictate how corporations behave, and further, what strategies they employ as they undertake the mission to enter the space race with developing nations. We argue that the semi-privatization of space mandates the need for the development of inter-hemispheric institutional frameworks. Thus, this chapter serves as an invitation to expand upon this burgeoning research program.

We posit that both western-born firms and developing countries are operating with partially-developed institutions created by the original space racers, namely the modern world superpowers (Friedman, 2007; Swift, 2009). But, western firms are the beneficiaries of these existing norms and favorable en-

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vironments, whereas developing countries are at a disadvantage, having not been a part of constructing these institutions (Buzan, 2008; Wallerstein, 1993). Thus, western firms have a head start in access to institutional knowledge and personnel that developing countries may not have. Nevertheless, developing countries are seeking to utilize this modern space race to gain power and legitimacy in the current world system (Ansdell et al., 2011; Ehrenfreund et al., 2012). Despite the potentially detrimental conditions that developing countries may experience (e.g. weak institutions, lower levels of GDP and higher political instability), these countries are attempting to take part in the space race (Ehrenfreund et al., 2012; Ocampo, 2011). As such, we argue that both developing nations and western private firms are creating the inter-hemispheric institutions for the modern space race.

Despite being a small-n case study, this chapter offers several valuable contributions to both the international business and international relations' literatures. Within international business, scholars operating through the institutional theory framework seek to understand how the regulatory, normative and cognitive institutions shape and assuage firm behavior (Dimaggio & Powell, 1983; North, 1990). We expand upon this theoretical outlook by suggesting that as western-born firms enter space, and become inter-hemispheric, they play a role in shaping the institutional framework. Since space is a common good - not owned by any actor - it is critical to dissect the main determinants of inter-hemispheric institutions. Thus, we utilize this chapter to promote future scholarship. Moreover, we contribute to the field of international relations by suggesting that the classic conception of intra-state competition for common goods needs to be re-examined as the world becomes privatized (Goldgeier & McFaul, 1992; Lake, 2009). Thus, we build upon the classic tenets put forth by international relations and extend them to incorporate the interactions between states and corporations, through the lens of the modern space race.

The remainder of this chapter will be organized as follows. Section two will outline institutional theory from international business, world systems theory from international relations, and offer a theoretical justification for the examination of the privatization of the space race. Section three provides the logical argument and the corresponding foundation for future research. Section four will utilize case study evidence that juxtaposes space exploration missions of India and of SpaceX to support for the logical arguments made within the chapter. Section five will serve as the conclusion of the chapter. Further, it will offer the limitations and managerial implications.

## **INSTITUTIONS, WORLD SYSTEMS AND THE NEW SPACE RACE**

### **Institutional Theory**

Within international business, institutional theory suggests that firm behavior is shaped and guided by institutions (Dimaggio, 1988; Phillips & Tracey, 2009). Institutions are "the rules of the game" (North, 1990: 3). Although firms do not always have to follow the rules outlined by the institutions, the institutions provide structure and guidance (Dau, Moore, & Soto, 2016; Marinova, Child, & Marinov, 2012; Scott, 1987). Moreover, institutional scholars have provided evidence to suggest that clearer and stronger institutions are beneficial for firm profitability and survival (Dau, 2012; Dau, Moore, & Soto, 2016; Khoury, Cuervo-Cazurra, & Dau, 2014). The rationale behind this claim is that if a firm knows the rules, they can function more efficiently, since market uncertainty is reduced (Cuervo-Cazurra & Dau, 2009).

Further, institutions are made up of three primary dimensions: regulatory, normative and cognitive (Busenitz, Gómez, & Spencer, 2000; Dau, Moore, & Bradley, 2015; Dimaggio & Powell, 1983). Regulatory institutions consist of the legal and codified frameworks within a society (Laffont & Tirole, 1990). Normative institutions deal with how actors should, or ought to, act (Dau, Moore, Soto, & LeBlanc, 2016; Dimaggio, 1988). Cognitive institutions are structured on how actors want to act (Lawrence et al., 2002; Nasra & Dacin, 2010). Together, these three dimensions make up the overall institutional framework of a given environment.

Additionally, it is important to note the ways in which institutional theory has been expanded and altered to account for the multinational company (Pearce & Papanastassiou, 2006; Phillips & Tracey, 2009). As firms began crossing national borders, scholars were forced to recognize how multinational companies differ from domestic companies with regards to the intersection between the corporation, home and host countries, and the distinct institutions (Cantwell, Dunning, & Lundan, 2010; Narula & Dunning, 2010). As the space race becomes privatized and companies are now crossing hemispheres, it is imperative that scholars acknowledge how the inter-hemispheric company will interact with existing institutional structures, or create new ones, and then amend theory appropriately.

## **World Systems Theory**

Within international relations literature, world systems theory offers a way to understand how the international system is organized (Wallerstein, 1993, 2004). In this framework, there is a hierarchy of countries: the core, the semi-periphery and the periphery (Chase-Dunn, 2006; Kardulias, 2010). Classically, each of these levels is based off socio-economic development and power, as both can be used as leverage (Wallerstein, 2004). Further, nations within each of the different levels has a different level of influence and role within the world system (Bogucki, 2001).

It is also important to iterate that the system dictates the global-level institutions that guide state-level behavior (Clark, 2005; Iriye, 2004; Johnston, 2001). Much like institutional theory from international business, world system theory offers a framework for understanding why states (instead of corporations) act the way they do (Chase-Dunn, 2006; Lake, 2009; Wallerstein, 2004). Core countries are the most socio-economically developed (Wallerstein, 2004). Within the classic world system structure, these countries have the most power. Thus, in terms of global institutions that shape state-level behavior, the core countries have the most leverage (Gowan, 2004). They have the most influence in terms of establishing the regulatory, normative and cognitive structures for the world system. (Sorinel, 2010) The semi-periphery countries are less socio-economically developed than the core countries (Gomez, Torgler, & Ortega, 2013). Thus, they have less economic and political leverage. They have less leverage than core countries, but more than periphery countries (Litan, Masson, Pomerleano, Group, & Fund, 2001; Peet, 1992). Finally, the periphery countries have the least economic and political leverage. Although international organizations, like the United Nations, have given the peripheral countries more influence than before, these countries still have the least impact on the global-level institutional structures (Iriye, 2004; McCormick, 1980).

As the space race becomes privatized and inter-hemispheric interactions increase, however, it is critical that scholars understand how the institutions that guide the world system will change (Helmke, Levitsky, & Galvan, 2011; Kingston & Caballero, 2009). Hegemonic stability theory, a sub-theory of world systems theory, suggests that the most powerful countries establish the norms and institutions (Kwon, 2012; Webb & Krasner, 1989). Further, it suggests that these countries will establish systems that

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afford them the primary benefit (Gowa, 1989; Milner, 1998; Snidal, 1985). Thus, in the current world system, the core countries are those with the most power and leverage in terms of norm and institution setting (Lake, 2009; Park, 2005). Therefore, the norms established by the core will recognize its own interests first. As a result, these norms and institutions also confine the path of the countries that do not have the same levels of influence and power.

## **Theoretical Justification for the Examination of the Privatization of the Space Race**

When the multinational corporation began to proliferate, extant literature had to be amended and expanded upon to understand how crossing borders and institutional frameworks would impact firm behavior (Buckley, 2011; Dunning & Pitelis, 2008; Narula & Dunning, 2010). Similarly, as the multinational corporation becomes inter-hemispheric, subsequent changes to existing literatures are necessary to understand how these firms will act and how institutions will be formed. Thus, we use this chapter to invite future research on this burgeoning research agenda.

Currently, space is a common good (Burnett, 1997; Devezas et al., 2012). Space is not owned, or governed, by one entity. As a result, the institutions that shape the new space race are undefined (Macdonald, 2008). The new space race exists largely between developing countries and western-born companies (Ansdell et al., 2011; Musk & Pelley, 2012). Developing countries, following in the footsteps of the old superpowers, are attempting to use the new space race to demonstrate their appropriateness in being counted among the core countries and in search of international influence (Ehrenfreund et al., 2012). Western-born companies, looking to enter space exploration, also have a foot in this race but enjoy a beneficial starting point since their home countries created the existing, but dated and undefined, institutions guiding space exploration. This competition between states and corporations provides an opportunity for the current world system to shift. This creates a dynamic parity between private enterprises in the developed world and governments in the developing world. This parity mandates both intellectual and practical examination to cultivate an inter-hemispheric institutional framework.

## **THE NEW SPACE RACE: INTER-HEMISPHERIC INSTITUTIONS**

When firms first began crossing borders, it mandated the creation of international business as a discipline, as well as subsequent shifts in existing theories that studied firm behavior (Narula & Dunning, 2000; Pearce & Papanastassiou, 2006). It was necessary for extant literature to be extended to understand how firms that enter multiple institutional and geographic environments behave (Buckley & Casson, 2003; Phillips & Tracey, 2009). As firms are now entering new hemispheres, a similar extension is needed. The purpose this chapter, specifically the following logical discussion, is to invoke a new research program that allows for future scholarship to better understand the intersection of inter-hemispheric institutions, developing countries and private firms. Given the infancy of this field of research, this chapter serves as a valuable foundation for this nascent topic.

World systems theory, from international relations, helps to understand how the world is ordered and how states interact with each other (Chase-Dunn, 2006; Wallerstein, 2004). Within this framework, states are the primary actors (Bogucki, 2001). They are organized into core, semi-periphery and periphery categorizations. Each of these categorizations has a different level of influence with the creation of the

global institutions and norms (Wallerstein, 2004). The amount of influence that each has is based off a combination of economic, social and political power (Sending & Neumann, 2006; Tiberghien, 2014). Although states can move between the levels, upward mobility is limited due to the hierarchical and dependent structures created by the system itself (Lake, 2009). In other words, core countries usually remain in the core because they have the most influence in establishing the regulatory, normative and cognitive institutions that shape global order, thus solidifying their positions (Sorinel, 2010; Wallerstein, 2004). Nevertheless, states outside of the core continue to try to ascertain power and leverage to mobilize vertically.

Institutional theory scholars, from international business, suggest that strong institutions are beneficial for firms (Dau, 2012; Khoury et al., 2014). When institutions are clear and strong, they provide order and stability that firms need to make the most informed decisions to operate efficiently amidst market uncertainty (Dau, 2013; Kotabe & Mudambi, 2003). Moreover, they are formed primarily by national governments; but individuals, firms and other organizations also play a role in their formation (Nasra & Dacin, 2010; North, 1991). Space exploration, then, offers a unique challenge and opportunity for both firms and nations. Space is a public good. It has no formal ownership or control and thus, no current formal institutions. This represents an institutional void that firms and states must operate amidst. Since space transcends both national and international level actors, it is imperative that scholars examine the way that these inter-hemispheric institutions are formed.

World systems theory, specifically through the lens of the Cold War and the space race of the 1970s, suggests that surrogate warfare is an implication of cognitive institutions (Garthoff, 2001; Oreskes & Krige, 2014). Space race is a competition that offers both hard and soft rewards. Not only does winning provide the material reward of control over the domain, but it also has soft rewards like prestige, reputation and legitimacy (Bainbridge, 2009; Baum, 2009). From these soft rewards, winners of surrogate warfare gain the advantage of shaping institutions, specifically cognitive ones. From this, we contend that the modern space race offers potential benefits to both developing countries and private western firms. It can provide developing countries accolades that they need to mobilize within the current world system and attain more power to influence other countries. Simultaneously, it provides private western firms (that often operate with the financial backing and interests of their home countries) the ability to accrue reputation and wealth. As such, both entities have a stake in the modern space race and creating the inter-hemispheric institutions that surround it.

We posit that since the modern space race is a competition between developing countries and western-born firms, it is likely that these are the two primary actors that are shaping the newly forming inter-hemispheric institutions. However, the model set by the first space race, and simultaneous historical contexts, likely positions the two main groups of actors at different starting points (Brown, 2011; Wallerstein, 2004). Since the United States is a key player within the world system, arguably the world's hegemon, it has increased influence in establishing global-institutions and norms. Further, the institutions and norms it (and other western countries) sets, serve to benefit it and its actors, such as firms. As a result, the current global-institutions asymmetrically benefit core countries, like the United States, and their firms (Wallerstein, 2002; 2011). This gives these firms more leverage and power, and a more advantageous starting point in terms of creating inter-hemispheric institutions. In other words, these firms already have reputation and legitimacy that provide them leverage and knowledge for institutional setting.

Conversely, developing countries still grappling for international leverage and vertical mobilization seek to play a part in constructing the inter-hemispheric institutions to shift the current world order.



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Based on historical context and the current world system, however, these countries have disadvantageous starting point, since they have lower levels of influence and leverage (Brown, 2011; Wallerstein, 2004). Nevertheless, the current space race is unique in that its competitors consist of both state and non-state actors. As such, it is critical to understand this asymmetry and parity between developing countries and western-born firms.

As previously noted, world systems theory argues that global institutions and world order are formed based on the core, semi-periphery and periphery structure (Chase-Dunn, 2006; Wallerstein, 2004). With the current space race, however, developing countries have to contend with corporations from developed countries in order to set inter-hemispheric institutions and order (Heynen, Hossler, & Herod, 2011; Wang, 2006). Based on the classic tenets of world systems theory, institutions are formed to benefit the establishing actors (Helmke et al., 2011). Since the modern space race represents an institutional void, and offers prestige and legitimacy, it is likely that developing countries and corporations looking for mobility in the world system schema would use the space race as a surrogate war for power in establishing inter-hemispheric institutions. Further, however, future scholarship needs to build upon this knowledge to understand exactly *how* and to *what extent* each actor will be able to influence the creation of inter-hemispheric institutions.

Thus, the purpose of this chapter is to invite future scholarly endeavors to examine how developing countries and private corporations operate in this arena, and how they contend for influence in the creation of inter-hemispheric institutions. Predicting future behavior of private corporations and developing nations on this matter is not straightforward. Evaluation of current international protocols, conventions and treaties for other similar goods, such as international waters and Antarctica for example, is a step forward towards the design of regulatory and normative procedures for space exploration. Surprisingly, there is scant empirical or theoretical work on inter-hemispheric institutions. As such, this chapter provides a valuable foundation for this burgeoning research program.

## **CASE STUDY EVIDENCE**

SpaceX juxtaposed with ISRO (Indian Space Research Organization) provides key insight into institution generation and interactions between private firms and developing countries. The United States' success in the original space race conveyed upon them the mantle of primacy, facilitating their starring role in the initial creation of the institutions and norms that laid the foundation for successive attempts at space exploration (Brown, 2011; DeVolpi, 2014). If primacy permits the propagation of norms and institutions, then influence determines the ability to enforce them (Buzan, 2008; Chase-Dunn, 2006). Thus, the combined primacy and influence of core countries has begun to write the 'rulebook' for space exploration.

The Space Race of the Cold War represented a surrogate war between the Soviet Union and the United States where the achievement of scientific prowess reflected the worth of the respective ideologies and states (Marlin, 1987; Swift, 2009). This paradigm established a cognitive norm of competition around the endeavor, and imparted an element of urgency onto the future of space exploration (Friedman, 2007; Oreskes & Krige, 2014). The end of the old Space Race allowed new actors to take prominence (Ansdell et al., 2011). Space programs of developing countries such as India began to compete with private corporations springing out of developed countries (Ehrenfreund et al., 2012; Indian Space Research Organization).

Firms such as SpaceX possess several structural advantages in the New Space Race. First, they were born out of the same normative system and culture as the original victors of the space race. In terms of institutions, this means a compatible and translatable set of rules that firms benefit from by growing up within the scope of the institutional environment (Burnett, 1997; Devezas et al., 2012). For instance, the rigor and safety standards as well as the history of trial and error efforts on the part of the United States Government laid the foundation for western private corporations to craft their own standards and procedures around. These requirements are reinforced by process of obtaining contracts from NASA; meeting their standards for cooperation and contracts from NASA means playing by the rules they established for the security of their resources (Bouchey, 2014). The flow of personnel also constitutes an environmental benefit for private corporations. The Public Private Partnership (PPP) establishes a norm of interplay between the public and private sector in specific fields (Anderson, 2013). These corporations offer an attractive career transition from the public to private sector creating and overlap in the institutional knowledge and network of these spheres (Guthrie, 2015). This means a consistent exchange in personnel between the public sector and private corporations that creates a pool of institutional knowledge.

SpaceX and other private corporations have vital access and proximity to norm enforcers that they can use to benefit themselves (Thompson, 2011). The United States remains one of the principal actors in the regulation and institution enforcement in space (Devezas et al., 2012; MacLeish & Thomson, 2010). SpaceX can influence official actors through a variety of channels (Musk, 2014). The shared networks examined above provide one area in which the private sector can influence governments, as the personal interactions of individuals can be crucial in developing norms (Finnemore & Sikkink, 1998). Private firms boast the economic clout for unquestionable influence (Karlgaard, 2012). The chief personalities of private space enterprises are major players in the economy of the United States. Elon Musk and Jeff Bezos provide the lion's share of the funding for the space projects from their personal fortunes built on their respective enterprises (Andersen, 2014; Vance, 2012). Musk can tap into the deep pockets of Tesla etc. and Bezos routinely sells fractions of his Amazon stock to fund Blue Origins (Cofield, 2017). Their ability to lobby the government and leverage their job-creation power gives corporations increased ability to set norms. Not only do personnel and institutional overlaps exist, but, as evidenced by Elon Musk's albeit short-lived appointment Donald Trump's advisory committees, elites in these firms have access to official channels and the enforcers of institutional norms (Andersen, 2014; Thompson, 2011). The appointment to official positions demonstrates a trust between the new generation of space racers and the institutional establishment.

In addition to access and proximity, SpaceX operates with considerable support from government. SpaceX fought for the right to launch satellites for the Pentagon and contracts with NASA (Roberts, 2015). Famously, SpaceX was the first corporation to transport cargo to the International Space Station on behalf of the US. These contracts constitute a major source of revenue for SpaceX and reinforce the mutual relationship between the public and private spheres (Lossner, 2013; Bachman, 2017). The tradition of a state taking credit for advances originating in the private sector allows the US to derive prestige from the advances of SpaceX. These shared victories buttress the surrogate war value of continued western domination of space.

Private corporations have much greater flexibility than developing nations. Firms like SpaceX can incorporate in the ideal economic environment, seeking out a developed technology sectors and fertile hiring field (Musk & Pelley, 2012; Thompson, 2011). Western corporations also benefit from the free trade regime whose antecedents are grounded firmly in the west (Hurrell, 2006; Kwon, 2012). The US's relatively free movement of people and immigration patterns invites a wider array of backgrounds to con-

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tribute to space projects (Sanchez-Ancochea, 2006). Elon Musk himself is of South African and Canadian descent, but he deliberately chose to incorporate in the United States, capitalizing on the advantages of a developed country (Andersen, 2014; Vance, 2012). The ability to sponsor visas and poach human assets from other countries is an advantage that most national space programs are unable to perform; when the aims of a state's space program are nationalistic, inviting foreigners to participate could be seen to undermine those goals (MacLeish & Thomson, 2010; Reibaldi & Grimard, 2015). SpaceX is also more flexible than state space programs in its ability to generate funds (Musk & Pelley, 2012). SpaceX is funded by the private fortune of its founder and contracts with governments, but crucially, it also receives private investment from Founders Fund, Draper Fisher Jurvetson, and Valor Equity Partners and Google and Fidelity in subsequent instances of fundraising. (SpaceX.Com, 2012). These diverse opportunities for funds create a more agile budget than relying on politically generated budgets.

Space programs of developing countries enter the arena with individual capabilities, weaknesses and advantages, but on an essentially uneven footing with entities of the West (Ansdell et al., 2011; Leloglu & Kocaoglan, 2008). Governments are notoriously parsimonious with technology, especially when that technology can be laterally related to military use (Leloglu & Kocaoglan, 2008). This creates an essential disconnect between the parties in the original space race, those with the institutional knowledge and experience, and those countries just now breaking into the game. A 2011 law forbade the bilateral exchange of information between NASA and China's national space programs and the 2013 Kepler Conference was roundly criticized for banning Chinese nationals (Sample, 2013). Though the scientific community is less jingoistic than national personalities, the reticence still significantly handicaps those outside the developed world with space ambitions.

National space programs like ISRO are considerably less flexible than private firms in a variety of ways. Positions in national space programs are usually restricted to nationals of that country (Bloomberg 2016). The political, economic and economic climates of developing countries are typically less stable than that of developed countries, which makes space exploration a more tenuous pursuit. Further, reliance on a national budget that must spread itself over more traditional affairs of state such as defense and social services threatens the slice pie space programs can receive (Steinfeld, 2011). In developing countries such as India, where complaints are leveled about per capita income and overtaxed infrastructure, billions of dollars a year for space exploration is harder to justify to the political will (Wild, 2013). Nevertheless, developing countries like India continue to enter the space race to augment leverage and mobilize within world system.

## **DISCUSSION AND CONCLUSION**

The purpose of this chapter is to discuss the intersection between developing countries, western-born corporations and the creation of inter-hemispheric institutions through the lens of the modern space race (Devezas et al., 2012). This chapter suggests that much like the creation of international business as a discipline and the subsequent need to extend existing theories to respond to firms crossing borders national borders, there is a similar need to understand and adapt existing theories as firms cross hemispheric lines (Narula & Dunning, 2010; Phillips & Tracey, 2009). We assert that the two main players in the modern space race are private corporations, likely from advanced markets, and developing countries. These actors have the greatest potential gain. Further, although developed countries also have an interest in space exploration, they can engage in the race through joint efforts with private corporations from their

respective nations. Moreover, we argue that these actors enter the space race for legitimacy, prestige and reputation, based on past precedent set in the original space race (Berryman, 2002; Brown, 2011). Additionally, we posit that the space race represents a surrogate warfare for the creation of inter-hemispheric institutions. Institutions are usually set to benefit the creators (Helmke et al., 2011; Przeworski, 2004). As such, we suggest that the modern space race represents an opportunity for these actors to both augment reputation and establish institutions that could further benefit them. Remarkably, there is limited empirical or theoretical scholarship on the interplay between western-born firms, developing countries and inter-hemispheric endeavors. This chapter highlights this research lacuna, and thus welcomes future scholars to build upon the logical foundation laid by this chapter.

By examining the relationship between western-born firms, developing countries and inter-hemispheric institutions, this chapter offers several important theoretical contributions. Moreover, given the infancy of the research program it also serves as a valuable launching point for future scholarship. When companies began expanding across national borders, existing theories had to be amended (Pearce & Papanastassiou, 2006; Phillips & Tracey, 2009). We suggest that a similar expansion is needed as companies begin entering new hemispheres. We posit that a helpful starting point is through the lens of world systems theory from international relations, which offers a discussion of the use of surrogate warfare to maintain power and leverage (Chase-Dunn, 2006; Wallerstein, 2004). Further, as evidenced by the historical backdrop of the Cold War and the original space race, the modern space race provides an opportunity for competitors to develop institutions, gain leverage and eventually mobilize within the world system. As such, we argue that the two biggest players in the modern space race, namely developing countries and private firms, are utilizing the modern space race as a platform to construct inter-hemispheric institutions through surrogate warfare to create cyclical benefits. This has critical implications for both international business and international relations literatures, given the parity between the two actors.

The logic and contextual evidence provided within this chapter also has critical implications for both practitioners and policy makers. As the modern space race continues, it is imperative that managers and CEOs understand the role that firms can play in setting inter-hemispheric institutions, as well as how they can be impacted by them. Often, firms are reactive. We suggest, however, that as firms enter new hemispheres, they can take a more proactive role in establishing institutions. Thus, practitioners need to understand how to engage in this surrogate warfare, that was classically a function of the state, to most efficiently cultivate inter-hemispheric institutions. Policy makers can also gain critical insights from this chapter. We suggest that mobility within the world system schema is possible through institution setting, specifically within the cognitive realm that deals with questions of how actors want to act. Policy makers and government officials could view the modern space race as a chance to establish new institutions that are more inclusive and allow for more mobility amongst actors. This could mitigate the arguably damaging effects left by historical surrogate wars and the dependent structure of the current world system.

This chapter provides valuable insights that can be expanded upon in future research. Given the novelty of the topic, this chapter is a launching point for future empirical and theoretical examination. It would be beneficial to complement this case study with an examination of other types of private companies that have entered the space race. This would allow for a richer comparison of the primary actors to highlight the different elements of the competition for the creation of inter-hemispheric institutions. Further, it would be fruitful to examine other industries that have similar parities between corporations and states, such as arctic exploration, to better understand the creation of institutions amidst this parity. Additionally, this research program could be expanded upon by carrying out interviews not only with companies that have entered the space race, but also with large companies that have not. By examining

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why some companies do not enter the space race, there could be a more holistic understanding of the cost-benefit analysis that firms carry out before they cross into different hemispheres. Moreover, it would be beneficial to continue to trace the influence that both companies and developing countries have on the creation of formal inter-hemispheric institutions, if they arise, in subsequent years. Since this research program is in its infancy, there is expansive possibility for valuable scholarship.

As actors of all levels continue to find intrigue and opportunity in space, there is increased academic and practitioner based relevance in gaining a richer understanding of inter-hemispheric relations. Private western companies and developing countries are the pioneers of the modern space race (Ehrenfreund et al., 2012; Vance, 2012), but there is relatively limited research on how these actors are either impacted by, or are impacting, the creation of institutions for this new environment. Thus, this chapter serves as a preliminary study aimed at provoking future research aimed at understanding how inter-hemispheric institutions will be formed and who will form them as we continue to travel further into space.

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## Chapter 7

# Implications of the African Continental Free Trade Agreement (AfCFTA) on the Economy of African States

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### ABSTRACT

*The failure of some African Union member-nations including Nigeria to endorse the African Continental Free Trade Agreement (AfCFTA) that would create one of the largest free trade areas in the world has provoked a lot of controversies that are yet to be resolved. While some of the relevant stakeholders in the countries that have refused to sign the treaty are urging the heads of their countries' governments to withhold assent until when all the contending issues regarding the AfCFTA are amicably settled, others desire to have the agreement signed in order to harness its benefits for the continent. As the controversies rage, it appears that the implementation of the much awaited agreement has been put on hold, thus thwarting the progress of the continent. This chapter therefore wades through the controversies and points the way ahead for the AfCFTA to be acceptable by all.*

### INTRODUCTION

In this globalization era, there is no denying the fact that the economies of the world have become increasingly linked, through expanded international trade in services as well as primary and manufactured goods, through portfolio investments such as international loans and purchases of stock, and through direct foreign investment, especially on the part of large multinational corporations (Todaro & Smith 2011, Giddens & Sutton 2013). These linkages have had a profound effect on the developing world as the developing countries import and export more from each other, as well as from the developed countries.

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Globalization is one of the most frequently used terminologies in the discussion of development, trade and international political economy (World Bank 2000, Anderson, Cavanaugh & Lee 2000, Saach 2000, Rodrik 1998, Dollar & Kraay 2000). From the economic standpoint, it is a process by which the economies of the world become more integrated, leading to a global economy and, increasingly, global economic policy making (Giddens 2001, Todaro & Smith 2013), for example, through international agencies such as World Trade Organization.

The emergence of international or multinational firms has been largely due to the globalization efforts which have created the new market opportunities of these firms. However, there has come to be, in recent times, a new trend of economic nationalism that tends to limit their operations worldwide. Championed by some developed countries and the 'Third World' the objective is to support economic activity and promote social cohesion. Some manifestations of economic nationalism are attempts to block foreign competition or acquisition of domestic companies.

Rising economic nationalism, according to Jaruzelski (2017), could encourage the continuation of protectionist policies in many countries which may affect corporate decisions about Research and Development. For example, China has pursued trade and intellectual property practices that many companies and global institutions consider overly restrictive. These include industrial policies and nontariff measures that in some cases favour domestic over foreign companies, the dominant positions of state-owned enterprises in some sectors, unequal access to subsidies and financing, and inadequate protection and enforcement of intellectual property rights.

Disparte and Wagner (2016) averred that the trend toward economic nationalism has been fueled by greater global income inequality, growing dependency on individual commodities for government revenues, too many countries hitching their economic fortunes on China, and an increasing propensity for oil producing countries to continue to produce oil outside proscribed multilateral agreements. The new wave of economic nationalism, which has prompted an increasing number of governments (developed and developing) to nationalize or re-nationalize strategy assets, will likely lead to an increase in the expropriation of more foreign assets in the oil and gas industry, manufacturing, and other sectors, acquisition of domestic companies affiliated to the multinational firms, decrease in trade, and foreign direct investment.

Over the years, it has become fashionable for nations to enter into free trade agreements at the regional, continental and global levels to facilitate economic growth, as well as ease the free movement of people and factors of production across national boundaries. Free trade, the importation and exportation of goods without any barriers in the form of tariffs, quotas, or other governmental restrictions to international trade promotes liberalization, and allow each country to specialize in the goods it can produce cheaply and efficiently relative to other countries. Such specialization enables all countries to achieve higher real incomes (Irwin 1996).

In the past several decades, trade optimists have come to terms with the benefits of trade liberalization hence the tendency to downplay the role of international demand in determining the gains from trade and focus on the relationship between trade policy, export performance, and economic growth (Lal & Rajapatirana 1987). They argued that trade liberalization (including export promotion, currency devaluation, removal of trade restrictions, and generally "getting prices right") generates rapid export and economic growth because free trade provides a number of incentives:

1. It promotes competition, improved resource allocation, and economics of scale in areas where developing countries have a comparative advantage. Costs of production are consequently lowered.

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2. It generates pressures for increased efficiencies, product improvement, and technical change, thus raising factor productivity and further lowering costs of production.
3. It accelerates overall economic growth, which raises profit and promotes greater saving and investment and thus further growth.
4. It attracts foreign capital and expertise, which are in scarce supply in most developing countries.
5. It generates needed foreign exchange that can be used to import food if the agricultural sector lags behind or suffers drought or other natural catastrophes.
6. It eliminates costly economic distortions caused by government interventions in both the export and foreign exchange markets and substitutes market allocation for the corruption and rent-seeking activities that typically result from an overactive government sector.
7. It promotes more equal access to scarce resources, which improves overall resource allocation.
8. It enables developing countries to take full advantage of reforms under the World Trade Organization (WTO).

They also argued that even though export promotion may at first be difficult with limited gains – especially in comparison with the easy gains of first – stage import substitution - over the long run, the economic benefits tend to gain momentum, whereas import substitution faces rapid diminishing returns.

However, in spite of the many promising possibilities of free trade, barriers to free trade continue to exist. Irwin (2005) noted that removing a trade barrier on a particular good hurts the shareholders and employers of the domestic industry that produces that good hence some of the groups that are hurt by foreign competition wield enough political power to obtain protection against imports. According to the United States International Trade Commission (2004), the U.S gain from removing trade restriction on textiles and apparel would have been at most twelve billion dollars in 2002 alone. This no doubt would have been a net economic gain after deducting the losses to firms and workers in the domestic industry. Yet, domestic textile producers were able to persuade Congress to maintain tight restrictions on imports.

Realizing the essence of free trade cooperation and its attendant benefits, the African Union (AU) in 2012 resolved to establish the African Continental Free Trade Agreement (AfCFTA). Consequently, African Head of States and Governments set a deadline of 2017 for the treaty's implementation. The AfCFTA also known as the "Kigali Declaration" plans to take advantage of Africa's 1.2 billion population and its more than \$2 trillion combined Gross Domestic Product (GDP) to create a single continental market for goods and services.

The AfCFTA treaty covers goods, services, investment rules and procedures on dispute settlement, including a range of provisions to facilitate trade, reduce transaction costs, provide exceptions, flexibilities and safeguards for vulnerable groups and countries. The agreement is expected to liberalize services and aims to tackle the so –called "non – tariff barriers" which hamper trade among African countries, such as long delays at the border. Free movement of people and the use of a single currency could become part of the treaty (Okonji 2018p.2). the United Nations Economic Commission for Africa (UNECA) has estimated that the agreement's implementation could shore up intra – African trade by 52 percent by 2022, compared with trade levels in 2010 (Witschge 2018).

There is however a strong opposition to the treaty. Those opposed to the AfCFTA see it as an indirect colonization from Europe, arguing that the move will give unfettered access to goods manufactured outside the continent into the market, thereby creating a dumping ground. This chapter thus examines the implications of the African Continental Free Trade Agreement (AfCFTA) on the economy of African states. The objectives of the chapter are:

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1. To show the benefits that will accrue to African nations if the agreement is signed by all and implemented.
2. To highlight the likely impact of the AfCFTA on the economy of African countries.
3. To show the need for all relevant stakeholders to collaborate to make the treaty workable for the general interest of the continent.
4. To recommend ways to make the AfCFTA acceptable to African Union member – nations.

The next discussion will feature the following sections: background, main focus of the chapter (issues, controversies and problems), solutions and recommendations, future research directions and conclusion.

## **BACKGROUND**

### **Overview of Trade Agreements**

As the world economies become more integrated following the ending process of globalization, nations (developed and developing) have continued to sign trade pacts of agreements with one another. These pacts are intended to boost economic development at a global scale. The nations that have come together, to agree on the terms of trade between or among them determine the tariffs and duties that countries impose on imports and exports. An agreement according to infoplease.com (2018), may cover all imports and exports, certain categories of goods, or a single category. The United States have so far engaged in some 320 trade agreements with various nations.

Imports are goods and services produced in a foreign country and bought by domestic residents. That includes anything shipped into the country even if it is by the foreign subsidiary of a domestic firm. If the consumer is inside the country's boundaries and the provider is outside, the good or service is an import. Exports on the other hand are goods and services that are made in a country and sold outside its borders. That includes anything shipped from a domestic company to its foreign affiliate or branch (Amadeo, 2018). Trade agreement regulates international trade between two or more nations. Therefore, all trade agreements affect international trade.

The essence of formal trade agreements is that they outline what is agreed upon and the punishments for deviation from the rules set in the agreement. Trade agreements therefore make misunderstandings less likely, and create confidence on both sides that cheating will be punished; this increases the likelihood of long-term cooperation. An international organization, such as International Monetary Fund (IMF), can further incentivize cooperation by monitoring compliance with agreements and reporting third countries of the violations. Monitoring by international agencies may be needed to detect non-tariff barriers, which disguised attempts at treating trade barriers (Grossman, 2016).

### **Types of Trade Agreements**

Three types of trade agreements have been identified. They are unilateral trade agreement, bilateral trade agreement and multilateral trade agreement. Unilateral trade agreement occurs when a country imposes trade restrictions and no other country reciprocates. This also allows countries to decrease or loosen the amount of trade restrictions. This is something that does not happen often and could put the country in a disadvantaged position to compete with others. According to Amadeo (2018), the United

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States and other developed countries only do this as a type of foreign aid. They want to help emerging markets strengthen certain industries. The foreign industry is too small to be a threat. It helps the emerging market's economy grow, creating new markets for its U.S exporters.

The second is classified as bilateral trade agreement (BTA). Bilateral trade agreements are signed between two sides, where each side could be a country (or other customs territory), a trade bloc or an informal group of countries (or other customs territories). When both countries loosen their trade restrictions to help out businesses so that they can prosper better between the different countries this definitely helps lower taxes and it helps them converse about their trade status. The sticking point usually centers around key protected or subsidized domestic industries. For most countries, these are in the automotive, oil or food industries. The United States has 16 bilateral trade agreements. The Obama administration before leaving office was negotiating the world's largest bilateral agreement with the European Union known as the Transatlantic Trade and Investment Partnership (Amadeo, 2018).

Multilateral trade agreements are signed between more than two sides (typically neighboring or in the same region). These agreements are the most difficult to negotiate. The greater the numbers of participating countries, the more difficult the negotiations are. They are also more complex, since each country has its own needs and requests. Once negotiated, multilateral agreements are very powerful. They cover larger geographic area. That confers a greater competitive advantage on the signatories. All participating countries also give each other most favoured nations status. They agree to treat each other fairly and equally.

The largest multilateral agreement is the North American Free trade Agreement (Government of Canada, 2017). It is between the United States, Canada and Mexico. The agreement came into force on January 1, 1994. Their combined economic output is \$20 trillion. NAFTA quadrupled trade to \$1.14 trillion in 2016 (CFR, 2018), but it also cost between 500,000 to 750,000 U.S jobs. Most were in the manufacturing industry in California, New York, Michigan and Texas (Amadeo, 2018). NAFTA was also said to have affected adversely the economy of Mexico and Canada (Wallach, 2014).

Recently, Mexico's economy minister, Idefenso Guajardo said he was pushing for a quick deal with US officials in the renegotiation of the North American Free Trade Agreement (NAFTA), with a breakthrough on new rules for the auto industry still elusive. Since restarting last July, the talks have focused on settling differences between Mexico and the United States at the center of US President Donald Trump's complaint that NAFTA has undercut US manufacturing to Mexico's benefit. Trump has threatened to withdraw from the 24-year- old trade pact between the United States, Mexico and Canada if it is not reworked to the advantage of the United States. He hopes to reduce the US trade deficit with lower-cost Mexico and claw back jobs, particularly in the auto industry (Gesinde, 2018 p.32).

The Mexican economy minister said the idea of the discussion is to finish the agreement as soon as possible as he entered the latest NAFTA talks at the offices of US Trade Representative Robert Lighthizer in Washington, adding that it is better to have a good agreement than a fast one. Mexico and the United States have said that they are close to resolving remaining bilateral issues in the revamp of the trade pact. However, a day earlier Guajardo has said the two sides might be able to reach agreement in "hours". Canada has been waiting for the Mexican and US teams to reach common ground on autos before rejoining the negotiations. US and Mexican officials say they will push for a deal that could open the door for Canada to return. The Trump administration wants to be able to impose national security tariffs on future Mexican production from new auto assembly and parts plants, according to auto industry officials. That has caused friction at the talks (Gesinde, 2018 p.32).



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The United States has one other multilateral regional trade agreement known as the Dominican Republic – Central America Free Trade Agreement (CAFTA-DR). The CAFTA-DR is the first trade agreement between the United States and a group of smaller developing economies: Costa Rica, Dominican Republic, Guatemala, Honduras, Nicaragua and El Salvador. The CAFTA – DR promotes stronger trade throughout the region and along American Southern border. It eliminated tariffs on more than 80 percent of U.S exports. Combined, the countries in the CAFTA-DR represent the United States 16<sup>th</sup> largest goods trading partner, with \$53 billion in total (two way) goods trade in 2015. Exports totaled \$29 billion while imports totaled \$24 billion. The U.S goods trade surplus with CAFTA-DR countries was \$5 billion in 2015. According to the department of commerce, U.S. goods exports to CAFTA – DR supported an estimated 134,000 jobs in 2014 (USTR, 2018).

The Trans-Pacific Partnership would have replaced NAFTA as the world’s largest agreement but in 2017, president Trump threatened to withdraw the United States from it blaming NAFTA for the decline in U.S manufacturing jobs (Macleans. ca, 2018).

However, Brodwin (2017) says Trump’s claim does not hold water because the decline in U.S manufacturing jobs has been going on for a long time starting around 1952. He argued that the 40 years before 1992, when NAFTA took effect, the U.S lost more than half its manufacturing jobs.

## **Role of the World Trade Organization in Trade Agreements**

Once agreements have move beyond regional level, they usually need help. The World Trade Organization steps in at that point. It is an international body that helps negotiates global trade agreements. Once in place, the WTO enforces the agreements and responds to complaints. The WTO currently enforces the General Agreement on Tariffs and Trade. The world almost received greater free trade from the next round, known as the Doha Round Trade Agreement. If successful, Doha would have reduced tariffs across the board for all WTO members. Unfortunately, the two most powerful economies refused to bulge on a key sticking point. Both the United States and the European Union resisted lowering farm subsidies. These subsidies made their food export prices lower than those in many emerging market countries. Low food prices would have put many local farmers out of business. When that happens, they must look for job in overcrowded urban areas. The U.S and E.U refusal to cut subsidies doomed the Doha round. It is a thorn in the side of all future world multilateral agreements.

The failure of Doha paved the way for China to gain a global trade foothold. It has signed bilateral trade agreements with dozens of countries in Africa, Asia and Latin America. Chinese companies receive rights to develop the country’s oil and other commodities. In return, China provides loans and technical or business support. China and Africa as Pingjian (2018p.14) notes have always been a community with a shared future. China – Africa relations have become more important with increasing common interests. Advancing China – Africa cooperation represents the trend of the times and the will of the Chinese people. China no doubt has proved itself to be a reliable partner of Africa by always walking the talk. The follow up actions and the implementation of the outcomes of the Johannesburg Summit, including the “ten cooperation plans” and the forum on China – Africa Cooperation (FOCAC) Johannesburg Action Plan (2016 – 2018), have produced fruitful results as expected. At the 2018 Beijing Summit of the Forum on China Africa cooperation (FOCAC), Chinese President XI Jinping pledged a financial commitment of \$60 billion to further develop Africa.

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Basically, the benefits and obligations of trade agreements apply only to their signatories. In the framework of the World Trade Organization, different agreement types are concluded (mostly during new members' accessions), whose terms apply to all WTO members on the so-called most-favoured basis (MFN), which means that beneficial terms agreed bilaterally with one trading partner will apply also to the rest of the WTO members.

All agreements concluded outside the WTO framework (and granting additional benefits beyond the WTO MFN level, but applicable only between the signatories and not the rest of the WTO members) are called preferential by the WTO. According to WTO rules these agreements are subject to certain requirements such as notification to the WTO and general reciprocity (the preferences should apply equally to each of the signatories of the agreement) where unilateral preferences (some of the signatories gain preferential access to the market of the other signatories, without lowering their own tariffs) are allowed only under exceptional circumstances and as a temporary measure (WTO, 2018).

The trade agreements called preferential by the WTO are also known as regional (RTA), despite not necessarily concluded by countries within a certain region. As at July 2007, the agreements in force were 205. But this has increased to 287 as at May 2018. The WTO has further classified these agreements into the following types:

1. Goods covering: Basic preferential trade agreement (a.k.a. partial scope agreement), free trade agreement, and customs union; and
2. Services covering: Economic Integration Agreement - any agreement, including a basic PTA, that covers also services.

Trade agreements are most often politically contentious because they are likely to change economic customs and deepen interdependence with trade partners. Increasing efficiency through "free trade" has therefore become a common goal. For the most part, governments are supportive of further trade agreements.

There have however been some concerns expressed by the WTO. Former Managing Director of the WTO, Pascal Lamy, said the proliferation of RTA is breeding concern about incoherence, confusion, exponential increase of costs for business, unpredictability and even unfairness in trade relations (Lamy 2007). The position of the WTO is that while the typical trade agreements (called preferential or regional by the WTO) are useful to a degree, it is much more beneficial to focus on global agreements in the WTO framework such as the negotiations of the Doha round. Nevertheless, the anti-globalization movement opposes such agreements almost by definition, but some groups normally allied within that movement, e.g. green parties, seek fair trade or safe trade provisions that moderate what they perceive to be the negative effects of globalization.

## **Trade Agreements and Global Economy**

Trade agreements have a major impact on trade investment worldwide. In fact, they are responsible for shaping business relationships among companies across the globe. In order to succeed in the international environment, small business exporters need to be aware of the impact trade agreements have had and will have on their businesses. Likewise, lenders must be familiar with trade agreements in order to better understand the needs and financial concerns of their customers (Manzella, 1999). But why are trade agreements flourishing? The answer according to Manzella (1999) lies in their broad array of benefits.

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Some countries, he noted have established free trade agreements and are in the process of expanding them, while other countries have established customs unions and common markets. This development is having a profound effect on small businesses worldwide. A free trade area is formed when two or more nations establish preferential trade liberalization policies by eliminating or substantially reducing trade barriers among themselves. A customs union surpasses free trade liberalization policies by establishing a common external tariff for non-members. A common market goes even further. Members eliminate restrictions on the movement of labour and capital among each other. Additionally, members may harmonize national policies to some degree, including monetary, fiscal and social policies, and concede a degree of political and legal control to a single ruling authority.

Porter (1998), explains that the principal economic goal of a nation is to produce a high and rising standard of living for its citizens. Porter contends that the ability to do so depends on the productivity with which a nation's resources are employed. Productivity is defined as the value of the output produced by a unit of labor or capital. It depends on both quality and features of products and the efficiency with which they are produced. As such, the ability to export many goods produced with high productivity allows a nation to import many goods involving lower productivity. This is desirable because it translates into higher national productivity.

In pursuit of both increased productivity and international competitiveness, governments must promote trade without barriers — or free trade — without which the economic growth of a nation will be stunted. Free trade promotes the following:

1. The creation of economies of scale;
2. An increase in efficiency and competitiveness;
3. A reduction of resources used in the production of goods; and
4. A higher standard of living.

Froning (2000) also identifies the following as some of the benefits of free trade:

1. It offers consumers the most choices and the best opportunities to improve their standards of living.
2. Free trade promote innovations because, along with goods and services, the flow of trade circulates new ideas; and
3. By supporting the rule of law, free trade also can reduce the opportunities for corruption.

Most free trade agreements (FTAs) owe their success at least in part, to prior reductions in trade barriers between the parties to the agreement. For example, integration and cooperation in the iron, steel, coal, and nuclear energy sectors set a precedent for Western Europe to tear down barriers in other sectors. The U.S.-Canada Free Trade Agreement was preceded in 1965 by the Automotive Products Trade Act (APTA), which allowed duty-free trade between the United States and Canada in almost all motor vehicles and parts. This resulted in extensive integration of motor vehicle production between the two countries. Likewise, many U.S. firms are taking advantage of Mexico's maquiladora program and U.S. tariff provision 9802.00.80, demonstrated by the growing use of assembly operations in Mexico by these firms. The provision allows for the elimination of duty on goods co-manufactured in both countries (Manzella, 1999).

The progeny of this marriage – Mexico’s maquiladora program and U.S. tariff provision 9802.00.80 — has resulted in more internationally competitive industries. This has made business and government leaders in both countries see that the elimination of remaining barriers through a U.S.-Mexico FTA would benefit each country even more. Canadian leaders, too, saw the advantage of access to low-cost Mexican labour for its producers and access to Mexico’s burgeoning market for its products. Consequently, Canada opted for the North American Free Trade Agreement (NAFTA).

The benefits of free trade have been proven through a variety of pacts throughout the world. In 1983, New Zealand and Australia implemented an accord liberalizing trade between them. For the three years preceding the accord, Australian exports to New Zealand grew at an average of 10 percent each year. After implementation, through fiscal year 1985, exports rose 18 percent annually. New Zealand’s exports to Australia also increased as trade barriers declined (AHC New Zealand, 2018).

Between 1959 - 1969 trades within the European Community (EC), the forerunner to the European Union (EU), rose by 347 percent. In contrast, trade outside the EC rose by only 130 percent. In this same period, U.S. global trade rose by 124 percent, while Canadian global trade rose by 130 percent. The value of Spain’s bilateral trade with Portugal increased more than 79 percent the first year the two joined the EC (1986). During the first 10 years of Britain’s membership in the EC (1973 - 1983), the U.K.’s exports to the other member states grew by 28 percent per year, while its imports increased by 24 percent. Trade with the rest of the world during this time period went up 19 percent per year. The best example of free trade is the unobstructed trade among states in the United States. As a result, the United States is unquestionably the wealthiest single market and an extremely efficient producer of goods and services (Manzella, 1999)

## **MODELS OF ECONOMIC GROWTH**

### **The Neoclassical Counterrevolution: Markets Fundamentalism**

Beginning from the 1980’s, the political ascendancy of conservative governments in the United States, Canada, Britain, and West Germany came with a neoclassical counter revolution in economic theory and policy. In developed nations, this counter revolution favoured supply-side macroeconomic policies, rational expectations theories, and the privatization of public corporations. In developing countries, it called for freer markets and the dismantling of public ownership, statist planning, and government regulation of economic activities. Neoclassicists obtained controlling votes on the boards of the World Bank and the International Monetary Fund. In conjunction and with the simultaneous erosion of influence of organizations such as the International Labour Organization (ILO), the United Nations Development Program (UNDP), and the United Nations Conference on Trade and Development (UNCTAD), which more fully represent the views of delegates from developing countries, it was inevitable that the neoconservative, free-market challenge to the interventionist argument of dependence theorists would gather momentum.

The central argument of the neoclassical counterrevolution is that under development results from poor resource due to incorrect pricing policies and too much state intervention by overly active developing-nation governments. Rather, the leading writer of the counterrevolution school, including Lord Peter Bauer, Deepak Lal, Ian Little, Harry Johnson, Bela Balassa, Jagdish Bhagwati, and Anne Krueger, argued

that it is this very state intervention in economic activity that slows the pace of economic growth. The neoliberals argue that by permitting competitive free markets to flourish, privatizing state-owned enterprises, promoting free trade and export expansion, welcoming investors from developed countries, and eliminating the plethora of government regulations and price distortions in factor, product, and financial markets, both economic efficiency and economic growth will be stimulated. Contrary to the claims of the dependence theorists, the neoclassical counter revolutionaries argue that the developing world is underdeveloped not because of the predatory activities of the developed world and the international agencies that it controls but rather because of the heavy hand of the state and the corruption, inefficiency, and lack of economic incentives that permeate the economics of developing nations. What is needed, therefore, is not a reform of the international economic system, a restructuring of dualistic developing economies, an increase in foreign aid, attempt to control population growth, or a more effective development planning system. Rather, it is simply a matter of promoting free market and laissez-faire economics within the context of permissive government that allow the “magic of the marketplace” and the “invisible hand” of market prices to guide resource allocation and stimulate economic development. They point both to the success of economies like South Korea, Taiwan, and Singapore as “free market” examples and to the failures of the public-interventionist economies of Africa and Latin America (Bauer, 1984; Lal, 1985; Little, 1982; Portes 1997, Taylor 1997; Onis, 1995)

The neoclassical counterrevolution can be divided into three component approaches: the free – market approach, the public-choice (or “new political economy”) approach, and the “market-friendly” approach. Free-market analysis argues that markets alone are efficient-product markets provide the best signals for investment in new activities; labour markets responds to these new industries in appropriate ways; and producers know best what to produce and how to produce it efficiently; and product and factor prices reflect accurate scarcity values of goods and resources now and in the future. Competition is effective, if not perfect; technology is freely available and nearly costless to absorb; information is also perfect and nearly costless to obtain. Under these circumstances, any government intervention in the economy is by definition distortionary and counterproductive. Free-market development economists have tended to assume that developing-world markets are efficient and that whatever imperfections exist are of little consequence.

Public-choice theory, also known as the new political economy approach, goes even further to argue that government can do (virtually) nothing right. This is because public-choice theory assumes that politicians, bureaucrats, citizens, and states act solely from a self-interested perspective, using their power and the authority of government for their own selfish ends. Citizens use political influence to obtain special benefits (called “rents”) from government policies (e.g., import licences or rationed foreign exchange”) that restrict access to important resources. Politicians use government resources to consolidate and maintain positions of power and authority. Bureaucrats and public officials use their positions to extract bribes from rent-seeking citizens and to operate protected business on the side. Finally, states use their power to confiscate private property from individuals. The net result is not only a misallocation of resources but also a general reduction in individual freedoms. The conclusion, therefore, is that minimal government is the best government. (Grindle & Thomas 1991; Streeten, 1993; Sen 1995)

The market-friendly approach is a variant on the neoclassical counterrevolution associated principally with the 1990s writings of the World Bank and its economists, many of whom were more in the free-market and public-choice camps during the 1980s (Singh 1994). This approach recognizes that there are many imperfections in developing-country product and factor markets and the government do have a key role to play in facilitating the operation of market through “nonselective” (market-friendly)

interventions – for example, by investing in physical and social infrastructure, health care facilities, and educational institutions and by providing a suitable climate for private enterprise. The market-friendly approach also differs from the free-market and public-choice schools of thought by accepting the notion that market failures are more widespread in developing countries in areas such as investment coordination and environmental outcomes. Moreover, phenomena such as missing and incomplete information, externalities in skill creation and learning, and economies of scale in production are also endemic to market in developing countries.

### **Robert Solow's Neo-Classical Economic Growth Model**

The Solow's (1956) model assumes the production of a single composite commodity in the economy. Its rate of production is denoted by  $sY(t)$  which also represents the real income of the community. Part of the real income is consumed and the rest is saved and invested.

The proportion of the real income saved is denoted by  $s$  and it is regarded as constant. Thus the rate of saving would be  $sY(t)$ , i.e., the product of propensity to save and the real income. The community's stock of capital in "t" period of time is denoted by  $K(t)$  and it takes the form of accumulation of the composite commodity. Net investment refers to the rate of increase in capital stock and is denoted by  $dK/dt$  or  $K^t$ . So the basic identity between saving and investment can be expressed as

$$K^t = sY \dots \quad (1)$$

The production function representing the various technological possibilities can be expressed as

$$Y = F(K, L) \dots \quad (2)$$

where  $Y$  refers to real output,  $F$  stands for functional relationship,  $K$  and  $L$  represent the factors capital and labour respectively. Substituting the value of  $Y$  in (1) we get

$$K^t = sF(K, L) \dots \quad (3)$$

where  $K^t$  is the stock of real capital at the point of time  $t$ .

This equation (3) contains two unknown quantities. We need to know demand for and supply of labour as well as capital so that we can find out the equilibrium value of the capital-output ratio. One way to close the system would be to add a demand-for-labour function showing that marginal physical productivity of labour equals real wage rate and another relation can be supply-of-labour equation. The latter can take the general form of making labour supply a function of real wage ( $W$ ). For solution, there should be three equations for three unknown variables  $K, L, W$ .

Equation (3) represents the supply side of the system. Now we have to spell out the demand side of the system too. Solow's demand side of the system is obtained from the supply of labour to the economic system being offered for employment which influences the wage rate and hence the capital intensity of production.

Solow has written the supply of labour in the following form:

$$L(t) = K_0 e^{nt} \dots \quad (4)$$

## ***Implications of the African Continental Free Trade Agreement on the Economy of African States***

This relation tells that supply of labour  $L_{(t)}$  is equal to the number of labourers who offer for employment. As population growth is the result of exogenous factors, so the assumption is that labour force increases at a constant relative rate  $n$ . Assuming technical neutrality,  $n$  represents Harrod's natural growth rate. The right hand side of equation (4) shows that the labour force increases at the compound rate ( $n$ ) from period 0 to period  $t$ .

Relation (4) can also be explained in another way. This relation can be viewed as a supply curve of labour. It says that labour force grows at an exponential rate ( $n$ ) and its supply curve at a particular time is completely inelastic because full-employment is assumed to be perpetually maintained.

In other words, the labour supply curve is a vertical line which shifts to the right as the labour force available for employment increases. Then the real wage rate adjusts so that all available labour force is employed. The real wage rate ( $w$ ) is determined by the equality of marginal wage with marginal productivity and it is expressed as

$$W = dF(K,L)/dL$$

With the introduction of marginal productivity equation written above, Solow's system is complete one, as there are 3 unknowns and three equations. Substituting the value of  $L(t)$  in equation (3), we get the following relation

$$K^t = sF(K, L_0 e^{nt}) \dots \tag{5}$$

Solow regards this as the basic equation for his growth model because it helps in determining at any time the volume of capital stock needed to provide employment to all the available labourers. In other words, the solution of this equation gives the time profile of growth of the community's capital stock which would fully employ the available labour. Once we know the time path of capital growth and that, of the labour force, i.e.  $K$  and  $L$ , we can compute from the production function the corresponding time path of real output. The time path of real wage rate ( $w$ ) is determined by the marginal productivity equation written earlier.

Prof. Solow has summed up his argument as follows: "At any moment of time, the available labour supply is given by equation (4) and the available stock of capital is also a datum. Since the real return to factors will adjust to bring about full employment of labour and capital, we can use the production function of equation (2) to find out the current rate of output. Then the propensity to save tells us how much of net output will be saved and invested. Thereby we know the net accumulation of capital during the current period. Added to the already accumulated stock this gives the capital available for the next period and the whole process can be repeated."

### **Possible Growth Patterns**

In order to observe whether a particular rate of capital accumulation is always consistent with the given growth rate of labour force, we must study the growth equation (5) for the qualitative nature of its solutions. We know that without specifying the exact shape of the production function, we cannot hope to find out the steady state solution. To do so Solow has introduced a new variable, the capital-labour ratio,  $r$

$$r = \frac{K}{L} \left[ \frac{K}{L} \text{ capital-labour ratio} \right]$$

or  $K = rL$

or  $K = r \times L_0 e^{nt}$  [ $\therefore L = L_0 e^{nt}$  from equation (4)]

Differentiating it with respect to time (t), we get

$$\frac{dK}{dt} = r \times L_0 e^{nt} \times n + L_0 e^{nt} \times \frac{dr}{dt}$$

$$\frac{d}{dx} (uv) = u \cdot \frac{dv}{dx} + v \cdot \frac{du}{dx}$$

or  $K' = nrL_0 e^{nt} + L_0 e^{nt} \cdot r' \frac{dk}{dt} = K'$

$$\frac{dr}{dt} = r'$$

Substituting the value of  $K'$  in equation (5), we get

$$\begin{aligned} sF(K, L_0 e^{nt}) &= nr L_0 e^{nt} + L_0 e^{nt} r' \\ &= L_0 e^{nt} (nr + r') \end{aligned}$$

$$sL_0 e^{nt} F\left(\frac{K}{L_0 e^{nt}}, 1\right) = L_0 e^{nt} (nr + r')$$

Dividing both sides by  $L_0 e^{nt}$  we get

$$sF\left(\frac{K}{L_0 e^{nt}}, 1\right) = nr + r'$$

or  $r' = sF\left(\frac{K}{L_0 e^{nt}}, 1\right) - nr$  [ $L_0 e^{nt} = L$ ]

$$= sF\left(\frac{K}{L}, 1\right) - nr$$
 [ $K, L = r$ ]

$$= F(r, 1) - nr$$

Thus  $r' = sF(r, 1) - nr$  ... (6)

Equation (6) is the fundamental equation which can be used for illustrating the various growth patterns. In this equation, r is the capital-labour ratio (K/L), n is the relative rate of change in labour force (L'IL), F(r, 1) represents output per worker.

In other words, SF(r, I) is the total product curve showing the various levels of output when various capital-labour ratios (r) are employed with one unit of labour. Equation (6) clearly shows that the rate of change of capital-labour ratio (r') is the difference of the two terms SF(r, I) and nr.

In Fig. 1, capital-labour ratio is shown on the horizontal-axis and the difference between sF(r, I) and nr is shown on the vertical axis. The ray drawn through the origin with slope n represents the function nr. The total productivity curve is the function of sF(r, I). This curve is passing through the origin and is convex in shape. The convexity of the curve represents diminishing marginal productivity of capital. E is the point of intersection of the ray nr and the curve sF(r, I). At this point of intersection nr = sF(r, I) and r'' = 0. When r'' = 0, the capital-labour ratio would be constant and the stock of capital would expand at the same rate as the labour force i.e. n.



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Once the capital-labour ratio  $r^*$  (i.e. the capital-labour ratio in the equilibrium position) is established, it will be maintained, as capital and labour will grow in the same proportion. Because of the operation of constant returns to scale, the real output will also grow at the same relative rate  $n$ , and output per head of labour force (i.e. average productivity of labour) will also be constant. So  $E$  is the point of steady growth and  $r^*$  "is the desired capital-labour ratio which can maintain the steady growth.

Path of Divergence:

Now we study the behaviour of capital-labour ratio if there is a divergence between  $r$  and  $r^*$ .

There are two possibilities:

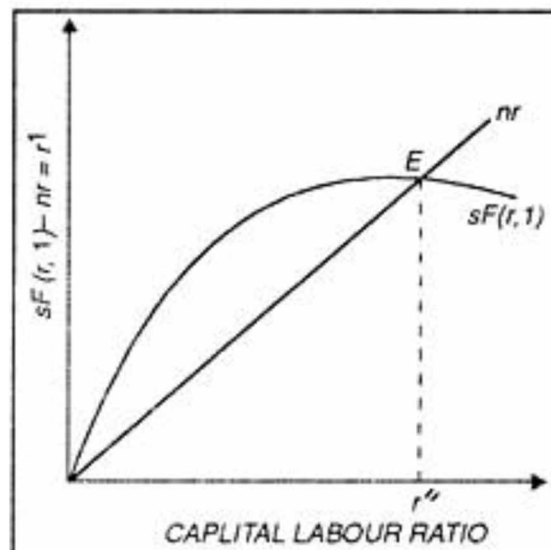
When  $r > r^*$

When  $r < r^*$

Take the first possibility when  $r > r^*$ , this can occur when the economy happens to be to the right of the equilibrium point  $E$ . Under this situation  $nr > sF(r, 1)$  and from equation (6) we can see that as  $r$  moves towards  $r^*$  "equilibrium will be established again at  $E$  and steady growth would be maintained. On the opposite, when  $r < r^*$  this can occur to the left of intersection point  $E$ . Under this situation,  $nr < sF(r, 1)$  and  $r$  will move towards  $r^*$ .

Equilibrium will again be established at point  $E$  and steady growth will be maintained. Thus the equilibrium value of  $r^*$  is stable. The instability of the Harrod-Domar model is gone. Prof. Solow has summed up the discussion thus: "whatever the initial value of the capital-labour ratio, the system will develop towards a state of balanced growth at the natural rate. The time path of capital and output will not be exactly exponential except asymptotically. If the initial capital stock is below the equilibrium ratio, capital and output will grow at a faster pace than the labour force until equilibrium value is approached. If the initial ratio is above the equilibrium rate, capital and output will grow more slowly than the labour force. The growth of output is always intermediate between those of labour and capital." But it should be

Figure 1. The Solow model



understood that the stability position shown in Figure 1 is not inevitable. It all depends upon the shape of the productivity curve  $sF(r, I)$ . This point is illustrated with the help of Figure 17.6. In this figure, the productivity curve  $sF(r, I)$  intersects the ray  $nr$  at three different points  $E_1$ ,  $E_2$  and  $E_3$ . Corresponding to these three points of intersection the capital-labour ratios are  $r_1$ ,  $r_2$  and  $r_3$ .

Inspection of these points shows that  $E_1$  and  $E_3$  are the stable equilibrium while  $E_2$  is an unstable equilibrium because production curve  $sF(r, I)$  is intersecting  $nr$  from above.  $E_2$  is a point of unstable equilibrium because the production curve is intersecting  $nr$  from below. Let us now discuss as to how the stable equilibrium is maintained. Suppose the initial capital-labour ratio is less than  $r_2$  (i.e. anywhere between  $r_1$  and  $r_2$ ), the system will revert to the equilibrium at a low capital-labour ratio i.e.  $r_1$ .

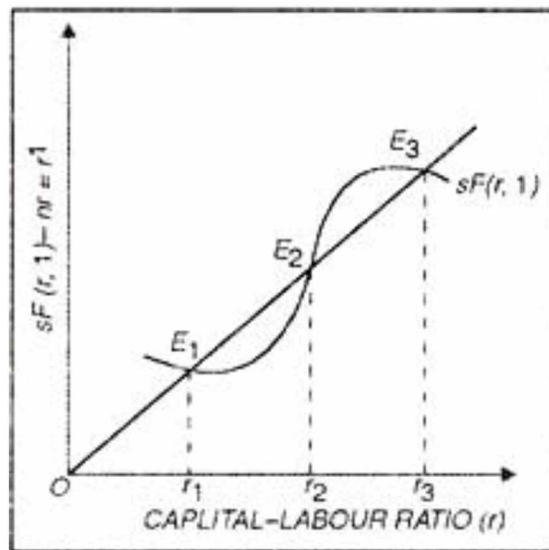
Correspondingly the rate of increase of output will be low. On the contrary, if the initial capital-labour ratio is more than  $r_2$  (i.e. anywhere between  $r_2$  and  $r_3$ ), then the system will move forward and would ensure the cumulative growth and equilibrium will be established at a higher capital-labour ratio i.e.  $r_3$ .

Prof Solow has observed in this connection:

“The relevant balanced growth equilibrium is at  $r_1$  for any initial ratio anywhere between 0 and  $r_2$ ; it is at  $r_3$  for any initial ratio greater than  $r_2$ . The ratio  $r_2$  is itself an equilibrium growth ratio but an unstable one; any accidental disturbance will be magnified over time.”

The main conclusion of Solow’s analysis is that “when production takes place under the usual neo-classical conditions of variable proportions and constant returns to scale, no simple proposition between natural and warranted rates of growth is possible. There may not be any knife-edge. The systems can adjust to any given rate of growth of labour force and eventually approach a state of steady proportional expansion.”

*Figure 2. Multiple equilibria in the growth path steady growth*



## **Theoretical and Practical Importance of the Solow's Model**

Solow model is neo-classical in character, and it is evident from Solow's own comments: **"I have been deliberately as neo-classical as you can get."** Solow's model is a synthesis of the classical and modern views. This model retains the basic assumptions of the classical model i.e., existence of full employment and perfect competition etc. and removes the difficulties and rigidities associated with the post- Keynesian growth analysis. Thus, it is a full-employment model which at the same time attempts to maintain the conditions of steady growth.

The model has its practical importance. It seeks to maintain full-employment through choice of the appropriate technique. The various routes to full-employment via fiscal, monetary and population policies, leaves the nation some leeway to choose whether it wants high employment with high capital investment (rapid growth and low consumption) or the reverse or some mixture of both. An important advantage of this model of growth is that it provides a theoretical apparatus of exploring these practical possibilities.

The major contribution of this model is to establish the automatic stability of neo-classical growth path through the market adjustment mechanism. The major attraction of this model lies in its sweep and simplicity. Solow's model has been a major landmark in the history of growth economics in that it opened up the discussion of technical progress into growth models of the neo-classical variety.

## **Implications of the AfCFTA for the Continent**

The AfCFTA has met stiff opposition from some African states especially Nigeria. At the forefront of the opposition to the treaty in Nigeria is the Nigeria Labour Congress (NLC). The congress has described the signing of the treaty as extremely dangerous because it would open the country's seaports and other businesses to unbridled foreign interference and domination. NLC President, Ayuba Wabba said the AfCFTA will lead to massive job loss, closure of businesses and incapacitation of local technological advancement. He berated the Minister of Industries, Trade and Investment, Dr Okechukwu Enelamah for spear heading the agreement, which was roundly rejected when it was christened Economic Partnership Agreement (EPA).

In Wabba's argument, the AfCFTA seeks to open Africa's seaports, airports and other businesses to foreign dominance. According to him, the Nigerian local business community and organized labour have not been consulted even when the government directed the promoters of the agreement to do so. He noted that the NLC found it confronting that at a time nations, including the United States are resorting to protectionism in defence of their local businesses and protection of jobs, Nigeria and Africa have the courage to want to fling open its doors, windows and roof tops. Wabba added:

*We have no doubt this policy initiative will spell the death knell of the Nigerian economy. Accordingly, we urge Mr. President not to sign the agreement either in Kigali or anywhere. We believe our national interest is at stake and nothing should be done to compromise this*

The Manufacturers Association of Nigeria (MAN) also rejected the move to sign the treaty until proper consultations and inputs of all interest groups have been received on issues concerning market access and enforcement of rules of origin were addressed. MAN President Frank Udemba Jacob urged the government to continue to withhold its sign-on to the agreement until a credible outcome from an ongoing study initiated by the government on the matter was received. He said that Nigeria could be-

come the key driver of improved volume of intra-Africa trade if rules of origin, countervailing measures, dispute settlement, amongst others, were addressed. According to him, the only way to guarantee this positive proposition was to ensure that the negotiating team was guided by a credible and strategic study.

The MAN chief reiterated that concerns on the implications of signing the agreement, which had been raised since March, 2018 had not been addressed. He said:

*We are concerned about the impact of AfCFTA on the nation's tax structure, the government revenue, the welfare of over 180 million Nigerians and its impact on the industrialization and economic development aspirations of Nigeria. For the avoidance of doubt, we again request that Mr. President should not sign the AfCFTA until the outcome of a credible study so indicates.*

Ademola Oyejide, a professor of economics at the University of Ibadan, Nigeria, conducted a study that predicts that Nigeria will experience minus 0.4 per cent change in real income, minus 16.7 per cent change in border tariff revenue, and minus 0.2 per cent change in trade, if Nigeria enters into the AfCFTA deal now. Also, he revealed that changes in real wages of unskilled agriculture labour will be minus 0.54 per cent, that of unskilled non-agriculture labour will be 0.12 per cent, and that of other skilled labour will be 0.4 per cent. These indices are below those of better structured South African economy that will gain more from AfCFTA.

The Professor, in the analytical study between Nigeria and South Africa, concluded that Nigeria would be a bigger loser in the free trade agreement than South Africa. He said that the real income of South Africa would be 0.7 per cent, tariff on revenues would be 5.9 per cent while in terms of trade, South Africa would record 1.2 per cent.

*By comparison, South Africa's trade in industrial products is dominated by intra-industry trade in similar products, which tends to exhibit much less swings in price changes. As a result, AfCFTA – induced changes are much less likely to challenge the growth trajectory of the economy of South Africa*

Oyejide recommended that the negotiation mandate should include phasing the liberalization process, offensive agenda, defensive agenda and balance of concessions (Okon, 2018).

At a policy roundtable discussion on “Business Environment and Exercise Duty: Maximizing Economic Opportunities through Effective Anti-illicit Trade Enforcement” organized in Lagos by the Initiative for Public Policy Analysis (IPPA) participants cautioned that to curtail the activities and the ills of illicit trade ravaging the country's economy, the government should not rush into signing the controversial AfCFTA. They advised government not to succumb to pressure to sign the agreement until some identified grey areas have been taken care of.

## **Need for Ratification of African Continental Free-Trade Agreement**

The critical importance of the Continental Free Trade Area Agreement, which has been signed by a majority of countries on the continent, but ratified by only a handful, cannot be over-emphasized. It is imperative that the 22-minimum number of country ratifications, required to bring it into effect, be met as soon as possible. A major deficit of Africa's economic development has been the low level of intra-Africa trade that has characterized the performance of the continent's economy up till now. In 2000, intra-regional trade accounted for 10 per cent of Africa's total trade, and increased marginally to 11 per

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cent in 2015. Trading amongst members of the European Union, for example, amounted to 70 per cent in 2015. It is extremely important for African leaders to demonstrate strong political will to operationalize the African Common Market for the welfare of the 1.2 billion people in the continent. It is hoped that Africa's largest economy, Nigeria, will very soon assent to this agreement. Nigeria, with her dynamic population, sense of enterprise of her people, and the size of her economy, is an automatic leader of any regional or continental market. West Africa, with a current population of 350 million, is set to reach a population of 500 million in 20 years. Africa's population, likewise, will increase from 1.2 billion to 2 billion people in 20 years. This means that, genuine regional and continental market in Africa should be in the mutual interests of Nigeria, Ghana, South Africa and other big players. These markets will present immense opportunities to bring prosperity to Africans with hard work, creativity and enterprise.

## **MAIN FOCUS OF THE CHAPTER**

### **Issues**

The AfCFTA has been described by experts and the African business community as the best thing to happen to the continent because it will give rise to one of the world's largest, if not the largest, free trade area given the population of the continent and her business activities. AfCFTA is seen as the biggest trade agreement to evolve since the establishment of the World Trade Organization (WTO). The draft agreement commits countries removing tariffs on 90 percent of goods, with 10 percent of "sensitive items" to be phased in later.

However, the failure of some African Union (AU) member states including Nigeria with the biggest market in Africa, to endorse the agreement has raised concerns about the implementation of the treaty. So far, 45 out of the 55 countries in Africa have signed the treaty. The countries are: Rwanda, Niger, Angola, Central Africa Republic, (CAR), Chad, Comoros, Congo, Djibouti, The Gambia, Gabon, Ghana, Kenya, Mauritania, Mozambique, Algeria, Seychelles, Cote D'Ivoire, Equatorial Guinea and South Africa. Others include: Morocco, Swaziland, Benin, Burkina Faso, Cameroon, Cape Verde, Democratic Republic of Congo, Guinea, Liberia, Libya, Madagascar, Malawi, Mali, Mauritius, South Sudan, Uganda, Egypt, Ethiopia, Sao Tome and Principe, Togo and Tunisia, among others. The eight others yet to endorse AfCFTA are: Nigeria, Zambia, Tanzania, Burundi, Eritrea, Botswana, Lesotho and Namibia.

Countries that are delaying their signatures have requested for more time to widen and deepen domestic consultations to determine the likely impact of the treaty on their economies. They have promised not to sign any agreement that will not fairly and equitably represent their interest and that of other countries in the continent.

### **Controversies**

Controversies have continued to trail the lack of consensus of AU member – nations on the signing and implementation of AfCFTA. Some argued the treaty will impact on government revenue and social welfare. The elimination of all tariffs among African countries, they believe, will erode the trading states' treasury by up to \$4.1 billion annually and deepen poverty, with millions of Africans exposed to starvation and death. Others, particularly poorer economies, are afraid the benefits in the free trade area may not be equitably distributed.

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Nigeria's Chief Trade Negotiator / Director-General Nigerian Office for Trade Negotiation (NOTN), Stage 1 of the AfCFTA, Ambassador Chiedu Osakwe, however, said the treaty would create a single market, progressively reducing restrictions to trade in goods and services, based on the agreed modalities of a 90 percent level of ambition, a 10 percent level of exclusion and sensitive list, as well as identified priority sectors for trade in services. According to him, the AfCFTA potential is considerable with an estimated population increase in Africa to 4 billion and a GDP increase of \$25 trillion by 2050.

### **Problems**

There has continued to be a groundswell of opposition against the African Continental Free Trade Agreement (AfCFTA). As a result of the opposition, there has come to be series of controversies following the refusal of some African countries to endorse the treaty for fear that it will stifle business growth in their individual countries and expose their economies to foreign interference and dominance. While some want their countries to withdraw assent pending when all the contending issues are resolved, others are desirous of seeing the treaty signed so that the benefits can start trickling in.

In the midst of the controversies, there seems to be little motion and less momentum as far as AfCFTA is concerned. There is a clear indication that the implementation of the treaty may not be soon as expected. With the stalling of the signing of the agreement by the rest countries in the continent, the world's biggest trade treaty has suffered a major setback.

### **SOLUTIONS**

In view of the continued opposition against the AfCFTA by some African Union member – nations and the controversies it has provoked, the following solutions are hereby proposed:

1. There is need to carry along all relevant stakeholders in the African business community to resolve all the contending issues surrounding the AfCFTA.
2. Those who are yet to sign the agreement should be reassured continuously by the AfCFTA negotiating team that the treaty will not undermine the emerging small scale and medium enterprises (SMEs), exporters and local manufacturers whose products will compete unfavourably with the imported ones under the umbrella of AfCFTA.
3. Most of the African Union (AU) member – nations who reneged on signing the agreement are yet to develop their export markets and as a result, they do not have specialty in any exportable product. There is therefore the need for such countries to begin to develop their export markets in order to become active players as soon as the treaty becomes implementable.

### **RECOMMENDATIONS**

Based on the issues and problems discussed in this work, the following recommendations have become necessary.

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1. There is urgent need for African countries to collaborate effectively in ensuring that the treaty works for the general good of the continent.
2. The relevant stakeholders (development and trade experts, organized private sector and labour unions) in the countries that are yet to endorse the treaty should speak positively of the AfCFTA and encourage their respective countries head of government to sign the treaty in the interest of their citizens.
3. While working to remove the impediments responsible for stalling the signing process by some AU member-nations, all suspicious issues should be put on the table and renegotiated to pave way for mutual understanding and eventual acceptance by all.
4. A modality for sharing the annual welfare gain estimated to hit \$16.1bn in the not too distant future should be worked out to ensure that the benefits accruing from the trade cooperation are fairly and equitably distributed.

## **FUTURE RESEARCH DIRECTIONS**

In line with the overall theme of the book “International Firms’ Economic Nationalism and Trade Policies in the Globalization Era”, this chapter discusses the implications of the African Continental Free Trade Agreement on the economy of African states. This work aligns with the book’s title. This chapter is optimistic that if endorsed by all, the treaty will spur economic development in the respective African countries. Therefore, it will be unnecessary to further delay the signing of the agreement which is described as a watershed in the continent’s business activities.

The model which captures the essence of this chapter is the stakeholder collaborative model. Collaboration among different actors is not only paramount, but it is also the sole route to successfully address the challenges we face (Kuenkel 2015) in today’s business environment. The African business ecosystem is no exception. A strong commitment to collaboration and collective efforts across sectors in the continent is needed to solve the challenges plaguing the AfCFTA and to make it work.

As the promoters of the treaty collaborate with stakeholders to ensure it gets back on track, it is imperative that they commit to harnessing the combined efforts of government, civil societies, labour and the organized private sector to remove the obstacles in the way of AfCFTA, How they are able to do this and realize their objectives will form the core of future research directions.

## **CONCLUSION**

It is abundantly clear that the AfCFTA will benefit all the countries in the continent if they all commit to making it work. Granted most of them experience difficulties (infrastructural deficit, weak industrial base, economic reverses and harsh operating business environment) that may tend to obviate the prospect of the treaty for their citizens, the time to get things right is now.

Nigeria and other African countries that are foot dragging should sign the AfCFTA and take the lead in the various discussions and processes leading to the formulation of modalities for the implementation of the agreement. The various negotiation teams should be guided by their own peculiar situation. Delaying the signing may in future make them operate from ‘outside the box’ which will be detrimental

to their own interest. There are enormous potentials in the treaty to be tapped if the countries operate from 'within the box'.

It is sad to note that smaller African countries that are far less endowed with natural and human potentials like Nigeria have strategically positioned themselves to benefit from the initiative. Our globalized world cannot afford to wait for Nigeria and the rest while they drag their feet over the signing of the document which has so much to offer the people in enhancing their socio-economic wellbeing. This is also the time for all stakeholders in the continent to come together and forge a common front in assisting the negotiation team in piloting their countries position to convince other AU member states.

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## **KEY TERMS AND DEFINITIONS**

**Economic Growth:** Is the increase in the market value of the goods and services produced by an economy over time.

**Free Trade Agreement:** It regulates tariffs and other trade restrictions between two or more countries.

**General Agreement on Tariffs and Trade (GATT):** Is a legal agreement between many countries whose overall purpose is to promote international trade by reducing or eliminating trade barriers such as tariffs or quotas.

**International Trade:** It is the exchange of capital, goods and services across international borders or territories.

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**Multinational Corporation:** Is a corporate organization that owns or controls production of goods or services in at least one country other than its home country.

**Trade Deficit:** A trade deficit is an economic measure of international trade in which a country's imports exceeds its exports.

**Trade Liberalization:** It is the removal of restrictions or barriers on the free exchange of goods between nations.

**Trade Policy:** It refers to the regulations and agreements that control imports and exports to foreign countries.

## Chapter 8

# Implications of the European Union (EU)–African, Caribbean, and Pacific Partnership Agreements on Economic Nationalism: The Case of Zimbabwe

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### **ABSTRACT**

*This chapter seeks to understand the EU-ACP trade relations under the economic partnership agreement (EPA) arrangement and its implications on economic nationalism of developing nations with specific reference to Zimbabwe. The research strongly leans on the view that EPAs have little or no economic benefit to the ACP. Even though the EU tagged the ensuing trade relationship with the ACP as partnership, in the real sense, it is more of paternalism. This is especially so as the EU dictates the terms and the pace of the negotiation, owns the incentives (in the form of aid and technical assistance), and either dispenses or withdraws it at will, depending on the “behavior” of the ACP countries. In order to benefit from EPAs, ACP countries must fund their own economies. ACP states should also address internal political challenges before committing to multiple economic fronts such as the EPAs.*

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## **INTRODUCTION**

The European Union (EU)'s trading relations with the seventy seven members of the African, Caribbean and Pacific (ACP) countries have historically been framed by a series of conventions. Some of the conventions granted unilateral preference to the ACP countries on the EU market using the Most Favoured Nation (MFN) principle which states that a nation will choose who it wants to offer trade preferences (Fontagné, Laborde, and Mitaritonna, 2008). Although the ACP countries are among the most vulnerable countries in the global trading system, the conventions nevertheless violated World Trade Organisation (WTO) rules as they established unfair discrimination between developing countries and therefore a change was required.

The pace of globalisation is increasing, with unprecedented flows of goods, services and people between countries and companies. Levels of overseas investment and foreign ownership have risen dramatically, alongside far-reaching changes in technology, production and corporate organisation. National economies and companies are becoming ever more interdependent, and emerging economies such as China and India are competing in world markets in a way that few could have imagined in the 20<sup>th</sup> century (Cooper, 2007).

For the purposes of negotiations, the seventy seven ACP countries have been grouped into six negotiation regions (West Africa, Central Africa, Eastern and Southern Africa, the Caribbean and the Pacific) based on existing regional integration institutions (Heron and Siles-Brügge, 2011). All these regions established Free Trade Areas (FTA) for goods between the EU and various ACP countries that are compatible with the provisions of Article XXIV of GATT. The objectives of this study are to assess the impact of EPAs in ACP economies, analyse the regional economic trade agreements for ACP countries under the EU-EPAs arrangement and to understand the benefits of EPAs to ACP countries.

ACP States have consistently noted that the European Union has not given adequate attention to the development chapters in the interim EPAs.<sup>42</sup> Many ACP States have expressed reservations at the heavy pressure from the European Union to sign EPAs even while they may not represent the best interests of ACP countries. The EPAs were scheduled to be implemented by 1 January 2008. However, owing to lack of agreement in negotiations between the European Union and ACP, the EPAs were not concluded within the specified period and both parties decided to enter into "interim agreements" instead that conformed to WTO rules on trade in goods (European Commission, 2017).

EPAs were introduced to resolve non-reciprocity and the Generalised Scheme of Preference (GSP) were introduced to move the EU-ACP agreements forward after stalling over EPA's. The GSP allows vulnerable developing countries to pay less or no duty on exports to the EU, giving them total access to the EU markets and contributing to their growth. After the collapse of the Doha Agreement in 2015 questions have been raised over the future of the EPAs, and multilateral cooperation to addressing global disparities in development and trade (Financial Times, December 21, 2015). Economic Partnership Agreements (EPAs) respond to the need for change: they take a new, more comprehensive approach, tackle all barriers to trade, mostly through re-enforcing regional integration and addressing supply-side constraints, and form secure, World Trade Organisations (WTO)-compatible trade arrangements.

### **The Concept of Economic Nationalism**

Economic nationalism is a set of practices to create, bolster and protect national economies in the context of world markets (Pryke, 2012). Most of the literature that mentions economic nationalism directly refers

to and gives examples of protectionist measures in the trade area of economic nationalism, including goods and services. According to Fölster (2009), economic nationalism in trade is often used by EU governments to prevent “companies from changing economic environments.” This threat mainly includes the increase of foreign competition in companies, from which the state wants to protect the domestic market. Trade protectionism has been a debatable issue in the EU for some time, even before the financial crisis. While in the UK the markets have been relatively open to foreign investors in telecoms, construction and energy companies, economic nationalist measures appear in continental Europe more often, according to Cooper (2007). Foreign takeovers are prevented in France through the creation of corporate ‘national champions’ in the energy sector, and Germany has protected their national champions from being taken over by foreign ownership (Cooper, 2007). While Fölster (2009) has recognised that member states have initiated their own responses to the financial crisis through economic stimulus packages in order to maintain economic stability in the domestic market, the research of Bussière (2010) has indicated that no member of the WTO has resorted to extensive protectionist measures or trade restrictions.

Economic nationalism is a modern form of protectionism, which has surfaced in many different parts of the world. Protectionism can be considered as the opposition to the free movement of goods, services, capital or people (for reasons other than genuine national security). Economic nationalists denounce free trade and invariably criticise globalisation, viewing it as responsible for the economic, social and cultural ills affecting the nation. Economic nationalism runs counter to the forces of globalisation, which drive the dismantling of economic barriers between nation states (Cooper, 2007). One of the primary means of combating economic nationalism in the current era is through multilateral institutions. The WTO offers the framework to reach agreement on world trade, although this has proved elusive up to now. The EU, with its powers to enforce the single market and take action against recalcitrant nation states, provides a means to combat economic nationalism. But, as the well-known commentator Fareed Zakaria points out, the critics of the EU in the UK and the USA are often “those who most fervently support capitalism and free trade”, yet the EU’s opponents on the Continent tend to be people who fear globalisation (Zakaria, 2003).

The steady growth in free trade has been integral to the process of globalisation. Globalisation has been one of the most discussed concepts in recent years, and is certainly one of the dominant forces of the present era. Broadly speaking, globalisation refers to integration of economic activities across borders, so that nations become interdependent. David Henderson, former chief economist of the Organisation for Economic Co-operation & Development, defines it more precisely as “free movement of goods, services, labour and capital, thereby creating a single market in inputs and outputs” (Wolf, 2004).

## **THEORETICAL FRAMEWORK**

This section focuses on the dependency theory which is used to understand the EU-ACP trade agreements. The proponents of dependency theory argues that the ACP’s underdevelopment is a result of its continued dependency on the developed countries for aid and technical assistance.

### **Dependency Theory**

The dependency theory emerged around 1950s as a reaction to modernisation theory which was biased towards the developed countries. It prescribed that developing states need to follow Rostow’s five stages

of development for them to develop. Manyeruke (2011, p. 226) argues that “modernisation theorists view EPAs as key in bringing about development to developing countries when resources and technology are transferred. On the other hand dependency theorists view such arrangements as promoting dependency and neo-colonialism. The proponents of dependency theory argued that Africa’s underdevelopment is a result of its continued dependency on the developed countries. ACP countries continue to rely on financial and technical assistance from the EU in the form of EPAs. For example in the Zimbabwean case where the EU sponsored a training workshop for negotiators through TRADES Centre. The EU offered to pay airfares for the negotiators whom it engaged starting September 2004. Further, funding for the ACP negotiations is being done under the European Development Fund (EDF). The Fund has been operational since 1957. The issue of failure by the Zimbabwean Government (and some of the ACP states) to mobilise funds for the studies and negotiations compromises its position since its strategies cannot remain confidential from the donor (Manyeruke, 2011).

Such financial dependency makes ACP states vulnerable to exploitation in the EPA negotiations hence their views cannot be effectively put forward. It is from such situations that the proponents of dependency theory prescribe for South to South cooperation which is now evident with some of the ACP countries opting for the Look East trading arrangements which have less conditions attached to trade agreements. Due to the rise of China and the Asian Tigers some ACP states are now focusing on partnering these global actors rather than the EPAs with the EU. These developments have curtailed the conclusion of EPAs with ACP. In addition dependency theorists encourage delinking of ties with the developed countries which is however, not possible in the globalisation era where economies are intertwined. Fontagné, Laborde and Mitaritonna (2008, p.16) in their analysis of EU-ACP agreements concluded that:

*On the one hand there is the EU, one of the richest regions in the world, where ACP countries do not count much in terms of trade. On the other hand ACP negotiating groups are a combination of relatively poor developing countries and LDCs, most of which are highly dependent on the trade relationship with the EU. This dependence is a central aspect when considering the potential losses in import taxes that EPAs may engender and the potential negative impacts of any deterioration in market access should EPAs not be concluded.*

## **Origins of EU-ACP Economic Arrangements**

After most African countries gained independence, European states sought to normalise relations through economic and political cooperation. David (2000, p. 11) declared that “Europe would with increased resources be able to pursue one of its essential tasks; the development of African continent.” It is evident that Europe took the task of developing Africa through economic cooperation. This has further led to the concepts of development aid to developing countries. It can also be argued that having lost direct control of the colonies and their resources at independence, Europe now sought to maintain access and control of the former colonies through neo-colonialism. Development aid to ACP countries has not always translated into economic development in receiving countries as the aid is attached to prefabricated conditions. These conditions are not reflective of domestic policies and interests of receiving countries, but rather suit the policies and interests of developed countries.

David (2000, p.11) articulates that the Treaty of Rome signed in 1957 ‘made a provision for the association of the Overseas Countries and Territories (OCTs) with the embryo European Community.’ In this context, Europe-Africa relations were initially under the banner of an OCT Association. The purpose

of the association was to foster the economic and social development of the countries and territories and to establish close economic relations. Evident from this assertion is the fact that Europe desired to maintain its influence over its former colonies to continue accessing their colonial market benefits. Arguably, the Treaty of Rome of 1957 effectively laid the basis for the creation of economic cooperation between the EU and ACP countries. It is from this Treaty that the two Yaoundé Conventions and the four Lomé Conventions evolved from the point of negotiating the new ACP-EU Partnership Agreements signed in Cotonou. However, despite the progress made in establishing these aforementioned agreements and the successes attained under them, various internal and external factors within these conventions led to their collapse and have impeded on the conclusion of EPAs between the two sides.

To support OCTs, the European Economic Community (EEC) set up the European Development Fund (EDF) to disburse funds. According to Bartels (2007, p.726) the fund was intended to be spent on public investments in particular hospitals and educational facilities and other economic investments. The fact that Europe was and has remained as the founder and funder of the economic cooperation with African states has resulted in the cementing of financial dependency of the ACP countries.

## **Yaoundé 1 and 2 Conventions**

The association system in the form of the OCT was replaced by the Yaoundé 1 of 1963 and Yaoundé 2 Convention of 1969. These were the first formal arrangements which began in 1963 and covered mainly French speaking African countries. The main reason for the creation of Yaoundé Agreement was to support the newly created states or developing countries. David (2000, p.11) argued that Yaoundé 1 and 2 conventions covered eighteen Associated African states and Madagascar. The two constituted a learning process, not only in terms of partnership (the setting-up of joint institutions) but also in terms of contractual systems. It is evident that the birth of these conventions laid the ground for cooperation between the EU and ACP states based on contractual terms. Unfortunately the crafters of these contracts (at most the EU) remain as full beneficiaries while the other partners (ACP states) lose as they are not the initiators in the process. Under the Yaoundé 1 and 2, the field of action was related essentially to trade and financial and technical cooperation. At a sectoral level, funding was granted principally to economic and social infrastructure projects (David, 2000). Some of the projects included the construction of road networks, schools and dams.

Gligor (2011, p.16) states that under Yaoundé 1, preferential trade arrangements were granted to some goods to be imported in the European Economic Community (EEC) space. The Convention facilitated industrial goods made in the African states to be exported into the EEC. For the agricultural products, it was a little bit more difficult to have imports from Third World Countries (TWCs), because the European farmers had to be protected as well through the Common Agricultural Policy (CAP). The acceptance of imports from the TWCs was based on the principle of reciprocity. A lot of European products were exported to African countries and this extended the economic market. To a greater degree, TWCs opened up more to European imports than Europe did to TWCs. This saw TWCs compromising their local sectors in the face of increased competition while Europe maintained protectionist systems in agriculture.

Under the Treaty of Rome and Yaoundé 1-2 Agreements, the international community argued that the EEC's Common External Tariff (CET) would divert trade from non-associated to associated countries. The perception of non-associated developing countries was that they were suffering from the Community's special preferences for the associated countries (Bartels, 2007, p.726). Such factors led the Community to revise its policy and negotiate successor agreements under Lomé.



## **Lomé 1-4 Conventions**

The increase in membership on the part of the EEC and the attainment of independence by some ACP states necessitated the formation of the Lomé Conventions 1 to 4. According to David (2000) expansion of the EEC to include new members such as the United Kingdom, Spain and Portugal had a considerable influence on the Lomé policy. Further, the Maastricht Treaty which enshrined development cooperation policy as one of the elements of the Common Foreign and Security Policy (CFSP) naturally laid the groundwork for the political dimension of the new Cotonou Agreement. With the increase in membership, the scope of the economic partnership also broadened. The development of the Yaoundé's policy into Lomé was to result in a larger number of partners and a diversification of objectives (David, 2000). Manyeruke (2007, p.225) indicated that the Lomé Conventions came about as a result of the need by ACP states to create a New International Economic Order (NIEO) which could result in clear procedures, mechanisms and adjustments that would promote fair economic relations between the developed and developing countries. As such the Lomé agreements were attempts to redress the historical economic trade imbalances of the past. Spero (1985, p.245) asserts that Lomé 1 increased aid to the ACP states and gave them a greater voice in aid management. The agreements provided for preferential access for ACP products to EEC markets without reciprocal advantages for EEC products. Although the ACP countries are at the top of the list in enjoying preferential market in the EU market, the ACP states are at the bottom of the list when it comes to exports to European markets (Manyeruke, 2007 p.226). However, dependency theorist such as Paul Baran, the NIEO is just a change in name and not a change of the capitalist system which continue to favour the developed states while developing states continue to under-develop.

According to David (2000), the Lomé conventions were formally recognised under the rules of General Agreement on Trade and Tariffs (GATT). These were recognised under Article 24 of GATT read in conjunction with Part 4 of that agreement, to allow one way free trade areas or under waiver of the GATT, non-discrimination obligation which was available under both the Enabling Clause and Article 25 of GATT. This Article under GATT provides the legal basis for the foundation of the trade conventions.

Manyeruke (2007, p.225) argued that during the Cold War, the Lomé Conventions became strategic partnerships against the Union of Soviet Socialist Republic (USSR). David (2000, p.12) further notes that the 1970s were characterised by a triumphant pro-Third World attitude, bitter East/West confrontation and rising commodity prices (first oil crisis). Hence, it can be noted that the bipolar system made it impossible for political cooperation between EU-ACP states, as some ACP states were non-aligned politically, others had the communist influence, while some tended to be following the capitalist web. Lomé 1 Convention of 1975 was signed between nine European countries and 46 ACP countries. The focus of Lomé 1 and 2 was to address issues of infrastructure and agricultural-programme funding. It marked a new model of North-South development based on partnership and solidarity (David, 2000). The model however, did not translate to sustainable development in the ACP states. Therefore questions continue to be raised on whether ACP states should continue to tie themselves in such partnerships under EPAs.

Unlike the Yaoundé agreement, Lomé 1 to 4 were based on non-reciprocal trade which included the concept of aid and trade. According to Manyeruke (2000, p.226) the non-reciprocal trade preferences were based on the present 'development needs' of ACP states as described in the Lomé 1 Convention. This arrangement is inconsistent with the Most Favoured-Nation (MFN) rule which is the fundamental principles of the World Trade Organisation (WTO). Further the Lomé systems were hinged on the principle of mutual obligations which entailed issues on human rights, democracy, corruption and good governance (Manyeruke, 2000). It is evident that the developed countries laid down certain conditions

to developing states thereby tightening their ideological grip to promote their interest at large. These conditions are contrary to the 1975 Georgetown Agreement which institutionalised the ACP group and gave it a permanent structure of the General Secretariat. At political level, it was proclaimed that each State has the right to determine its own policies (David, 2000, p.12). Any state that would violate set principles such as human rights and good governance would not be eligible to qualify for the benefits under the economic partnerships arrangements.

## **The Stabilisation of Export Earnings (STABEX) System**

STABEX was created in 1975 under the Lomé Agreement. This was an initiative aimed at protecting developing countries against fluctuations in export earnings. Stiftung (2000, p.8) asserts that “the STABEX scheme provided assistance to agricultural dependent ACP economies when faced with unforeseen yet specified levels of export earning losses from specific agricultural exports.” Similarly Bartels (2007, p.738) states that in principle, this system was supposed to provide repayable loans to make up temporary shortfalls in export earnings of basic commodities. STABEX suffered from a long-term decline in commodity prices, leading to unpaid loans and insufficient funds in the system, and turned into simply yet another subsidy. The failure to repay the loans only served to further strain the EDF. It can be argued that if STABEX ended up having the impact of a subsidy, it unintentionally ended up violating WTO rules on subsidies. Spero (1985, p.245) posits that STABEX was a scheme meant to stabilise the export earning of the associated states from twelve key commodities. In addition, it can be noted that the STABEX scheme also fostered dependency on funds from the EU by ACP states.

David (2000, p.13) notes that the STABEX system was later replaced by the Promotion of Mineral Production and Exports (PMPE) mechanism which was of the same type as STABEX but related to mining-product resources. To its credit, the PMPE mechanism was more effective in that it focused on a particular sector unlike the broader STABEX system. Stiftung (2000, p.8) asserts that the PMPE scheme provided similar support for mineral dependent economies when faced also with unforeseen yet specified levels of export earnings loss from specified mineral exports. The STABEX and PMPE were non-programmable aid instruments under Lomé 4.

The Lomé 1 Agreement was succeeded by the Lomé 2 Agreement which was signed in October 1979. According to Spero (1985, p.245) the negotiations over Lomé 2 Agreement proved difficult as the ACP states tried unsuccessfully to expand the convention substantially. The main provision under Lomé 2 was the increase in aid of nearly 70 percent, an expansion of STABEX of almost 50 percent, and greater industrial cooperation between Europe and ACP states. The problem that came up in the Lomé 2 Agreement was that it provided trade concessions which were minor to developing countries which mainly focused on agricultural products and processed goods.

In addition to Lomé 1-3, Moreau (2000) asserts that Lomé 4 recognised that the debt situation of ACP countries had worsened and viewed the aid as an obstacle to development and economic reform. As a result, the European Community tied a portion of its financial aid to the undertaking and implementation of structural reform. This suggests that prior conventions between the EU and ACP countries contributed to the debt crisis which was also buttressed by Structural Adjustment Programmes (SAPs) advocated for by the International Monetary Fund (IMF) and the World Bank. The combined effect of the debt trap and SAPs worsened the dependency situation of ACP countries. In addition to widening the debt crisis, the Green Paper (1995, p.12) acknowledged that trade preferences did not improve ACP countries export performance. During the Lomé conventions ACP market share declined from 7 percent in 1976 to 3

percent in 1998. Except in a few cases, most countries were unable to diversify exports. Moreau (2000, p.6) asserts that approximately 60 percent of total exports are concentrated on only ten products. The failure of ACP countries to diversify and in turn increase exports impedes on sustainable development in ACP countries. It can be noted that legal complications contributed also to the collapse of the Lome conventions. According to SEATINI (2005) the legal challenges under GATT were that they favoured ACP states and excluded other developing countries. The argument was that preferences to developing countries should be accorded to all developing countries rather than a group of developing countries.

### **Cotonou Agreement of 2000**

With the end of the cold war, the EU could now focus on development issues. The ACP-EU Partnership Agreement was signed between 77 ACP countries and the EU in June 2000 in Cotonou (Benin). The Cotonou Agreement will end in 2020 and contains a clause allowing it to be revised after every five years. ACP-EU cooperation is based on two main pillars that are economic and trade co-operation; and aid (Nalunga, 2004, p.1). According to Ong'wen (2004, p.7) the Cotonou Agreement breaks the solidarity of ACP countries by creating regional differentiation through negotiation of EPAs, introduces reciprocity, and it seeks to be WTO compatible. Gligor (2011, p.23) contends that the main objective of Cotonou Partnership Agreement is to reduce and eventually eradicating poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy. The basic principle of the agreement is equality of the partners and ownership of the development strategies. The aspect of ACP countries being partners and owners of their own development strategies was a significant shift from previous arrangements in which the EU prefabricated arrangements and imposed them on ACP countries.

McQueen 1998 cited by Manyeruke (2007, p.227) asserts that the Cotonou agreement has five pillars of partnership. These are (i) comprehensive political dimension with key emphasis on human rights, democratic principles and political dialogue in addressing issues of mutual concern, (iii) participatory approaches by promoting non-state actors involvement in the implementation of projects, (iv) A strengthened focus on poverty reduction, and (v) a new framework of trading arrangements that will pursue trade liberalisation between the parties and formulate provisions in related issues, and (v) a reform on financial co-operation. The principle which focuses on human rights, democracy and good governance has to some extent contributed to the delays in the conclusion of EU-ACP cooperation given that some ACP member states are viewed by EU as politically immature in these areas. In reality political reform or maturity is not an overnight issue but rather procedural. Furthermore it is also difficult to attain given that the imposers of the conditions are the ones who judge or measure the degree of political reforms in the receiving countries. In addition the inclusion of non-state actors is also dependent on the relations between the non-state actors and the state.

According to Gligor (2011, p.23) the Cotonou Agreement introduced some important innovations such as the suspension of financial aid in the case of violation of human rights, democracy and the rule of law. Provisions were included in the Cotonou Agreement to ensure the input of non-state actors in ACP countries in the policy process. It was acknowledged that civil society and the private sector are essential elements in promoting economic development. This saw an increase in the scope of engagement of the EU and ACP acknowledging that economic development is also premised on national stability and that the focus of power is no longer solely the state but non-state actors are also centres of influence and power. The Lome Convention and its successor were based on non-reciprocal preferential access.

Reciprocal EPAs arrangements therefore became compatible with the WTO trade regulations. However, though the EPAs are compatible to WTO rules and regulations they still continue to work to the advantage of developed countries as they are the major drivers in the negotiating process of EPAs. For the past few years, the European Union has pressured African Union Member States to conclude EPA negotiations or face the withdrawal of the preferences they currently enjoy under the Lomé conventions (Magsig, 2014). This is mainly because the non-reciprocal and preferential trade agreements under the Lomé conventions are incompatible with the WTO (Matambalya and Wolf, 2001).

## **State of EPA Negotiations**

EPAs are legally binding bilateral contracts between the EU and individual African countries (McDonald, Lande and Matanda, 2013). EPAs represent a fundamental shift in the trading relations between the two parties, from a nonreciprocal preferential trading regime under which ACP countries could export almost freely to the EU while maintaining their own restrictions on EU imports, to one requiring reciprocity in liberalization, albeit with a certain degree in asymmetry in commitments, in line with rules of the WTO. The EU started negotiating EPAs with six ACP regions which were self-defined by the ACP countries in 2003 (Vollmer, 2009). These regions include the Caribbean (CARIFORUM), Central Africa (CEMAC), South-East Africa (ESA), West Africa (ECOWAS), Southern Africa (SADC), and the Pacific. The trade structure of these regions often reflects dependency on just a few products.

Regional integration is a key element in EPAs. In theory, regional integration reduces transaction costs and monopolistic behaviour, enhances efficiency through increased competition and creates new opportunities for exploiting economies of scale. Larger markets can reduce the economic and political risk premium (a major concern in many African countries) offering the opportunity to attract more investment. In this way regional integration encourages the formation of an interdependent relationship between economic and political gains, leading to the maximisation of welfare. Because of these potential welfare effects of regional integration, which have been experienced by the EU, the Cotonou Agreement regards regional integration as a 'key instrument for the integration of ACP countries into the world economy' (Article 35.2).

The top four exported products of the six ACP regions are mineral oil, cocoa, fish and timber (West Africa), diamonds, mineral oil, aluminium and fish (Southern Africa), mineral oil, timber, bananas and cocoa (Central Africa), textiles, fish, diamonds and sugar (East Africa), ships, corundum, ethanol and sugar (Caribbean), and palm oil, sugar, copper and coffee (Pacific region). In most cases, these products account for at least two-thirds of total exports. The schedule for negotiations was tight, since the WTO waiver expired in December 2007 (McDonald, Lande and Matanda, 2013). In most cases this was insufficient time to finalise full EPAs. Therefore interim agreements were concluded in most cases on a sub-regional or bilateral level. The course of negotiations differs between the regions. For the Caribbean region, a full EPA including trade in services was finalised in December 2007. The agreement implies a market opening of 61 percent within 10 years and 82.7 percent within 15 years. The members are: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Surinam, and Trinidad and Tobago (Makhan, 2012).

For Eastern and Southern Africa two sub-regional interim agreements were concluded with the East African Community (EAC) and Eastern and Southern Africa (ESA). The agreement for EAC implies a market opening of 64 percent within 2 years, 80 percent within 15 years and 82 percent within 25 years.

The members are: Burundi, Kenya, Rwanda, Tanzania, and Uganda. The extent of market opening differs among the members of the other agreement between 80 percent for Comoros and 97 percent for Seychelles. The members are: Comoros, Madagascar, Mauritius, Seychelles and Zimbabwe. The other countries of this region can use market access to the EU under the Everything but Arms initiative (EAI) for Least Developed Countries (LDCs). These include Djibouti, Eritrea, Ethiopia, Malawi, Somalia, Sudan, and Zambia (Kondo, 2012). The sub-regional interim agreement for Southern Africa implies a market opening of 86 percent within 2 years except for Mozambique which is required to open 80.5 percent within one year. The members are: Botswana, Lesotho, Mozambique, Namibia, and Swaziland. Unfortunately South Africa has not entered the agreement yet (Keijzer and Bartels, 2017).

From a development perspective it would be extremely helpful if the major economic driver of the region formed part of the agreement. Angola can continue to use market access through Everything but Arms. In the Pacific region a sub-regional interim agreement has been concluded with Papua New Guinea and Fiji. It implies a market opening of 88 percent within 15 years in the case of Papua New Guinea and 80 percent in the case of Fiji. The other non-LDCs of this region include Cook Islands, Marshall Islands, Micronesia, Nauru, Niue, Palau, and Tonga. Trade in goods is relatively not important for this region; the agreement is therefore expected to have its focus on trade in services (Makhan, 2012). East Timor, Kiribati, Samoa, Solomon Islands, Tuvalu, and Vanuatu can use market access under Everything but Arms.

In Central Africa, only a bilateral agreement with Cameroon was finalised in early 2008. The agreement includes market opening of 80 percent within 15 years. The remaining non-LDCs of this region are Congo-Brazzaville and Gabon, both continuing to negotiate own agreements. Chad, Central African Republic, DR Congo, Equatorial Guinea, and Sao Tome were granted market access under Everything but Arms (Mataboge, 2015). In West Africa, bilateral agreements have been signed only with Cote d'Ivoire and Ghana. The agreements imply market opening of 70 percent within 10 years for Cote d'Ivoire and 80 percent within 15 years for both Cote d'Ivoire and Ghana. The vast majority of exports of the region come from Nigeria which is a non-LDC where exports are dominated by oil and gas. The other countries of this region include Benin, Burkina Faso, Cape Verde, Gambia, Guinea, Guinea Bissau, Liberia, Mali, Mauritania, Niger, Senegal, Sierra Leone, and Togo, all of which are LDCs and can use market access under Everything but Arms (de Melo and Tsikata, 2014).

## **Compatibility of EPAs With WTO Laws**

The compliance of EPAs with the rules of the WTO is still a matter of controversy. EPAs need to be designed in a manner that they are compatible with WTO provisions. This is especially true for Article 36 (1) of Cotonou Agreement. This principle has to be seen in the light of Article 39 (3) of the Cotonou Agreement which states that WTO rules have to be interpreted in a flexible way to take the different levels of development in the various ACP countries into account (Bassilekin, 2007). This provision is in line with the EU's opinion that the existing WTO rules are flexible enough for the trade framework between the two parties. In contrast, ACP countries call for a modification of the WTO regime which would not only affect EPAs, but also other North-South agreements (Dihm, 2007).

The Most Favoured Nation (MFN) clause which is the cornerstone of GATT obliges each member state to extend any advantage given to another state unconditionally and instantly to all other WTO members (Mavroidis, 2005). This obviously is contrary to the principle of special and differentiated treatment the EU and the ACP nations agreed in the Cotonou Agreement. An exception of this rule is the Enabling Clause which was adopted in 1979 as part of the Tokyo Round of the GATT. This provision allows de-

veloped countries to grant enhanced market access to developing countries that also extend the market access granted to developed countries (Bosche, 2005). However, this special and differentiated treatment applies to all developing countries and cannot be provided exclusively to the ACP block. Therefore, the Enabling Clause is not applicable to EPAs (Desta, 2006). The justification for these discriminatory agreements is contained in Article XXIV of GATT. It allows members of the WTO to establish free trade areas and custom unions within certain rules. As stated above, EPAs are designed to form FTAs between the EU and the regional ACP groups, and are therefore covered by Article XXIV of GATT.

## **RESEARCH DESIGN AND METHODOLOGY**

Qualitative methodology was used for the study while a case study research design was adopted. A case study offers a means of investigating complex social units consisting of multiple variables of potential importance in understanding the phenomenon in its totality (Stake, 2005). Zimbabwe was used as the case study to find out whether the EU-ACP EPAs are benefitting ACP countries economically or the EU is taking a paternalistic stance. Data collection methods used included key informant interviews and documentary search. Key informant interviews were held with the Director Multi-lateral Affairs in the Ministry of Foreign Affairs, Director Economic Planning in the Ministry of Economic Planning and Investment Promotion and Director in the Ministry of Industry and Commerce, and Chief Executive Officer, ZIMTRADE. Interviews with these key respondents focused on how EPAs are disrupting regional integration of ACP countries; implications of EPAs on Zimbabwe and how the Zimbabwean industry is benefitting from EPAs; value of EPAs and their contribution to Zimbabwe's economic development and selected ACP countries. Documentary search was used provide the historical overview of prior economic partnerships arrangements between the EU and developing countries. In this respect the research analysed documents such as the WTO reports and EU-ACP EPAs agreements and minutes of their meetings.

## **DATA PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS**

### **Understanding of EU-ACP Economic Partnership Agreements (EPAs)**

EPAs are a scheme to create free trade area (FTA) between the EU and ACP states (Giesbert, Pfeiffer and Schotte, 2016). EPAs were introduced under the trade pillar of the CPA which governs relations between the EU and the ACP. Murray-Evans (2015) contends that EPAs represent a sea change in trade relations between the EU and the ACP. EPAs do not introduce reciprocity into trade preferences, but are rather organised on a regional basis, with the aim of promoting regional integration within the ACP. McDonald, Lande and Matanda (2013) argued that EPAs are a set of important trade agreements between the EU and their former colonies in Africa, Caribbean and the Pacific.

The Director in the Ministry of Industry and Commerce shared the same sentiments by indicating that:

*EPAs are trade and development agreements negotiated between the EU and African, Caribbean and Pacific (ACP) partners engaged in regional economic integration processes.*

## **Difference Between the Past EU-ACP Partnerships and the Current EPAs**

The Director for Multilateral Affairs in the Ministry of Foreign Affairs multilateral affairs noted that there was not much of a difference as they are a process dating back to the signing of the Cotonou Agreement, while the Director in the Ministry of Industry and Commerce industry director indicated that:

*EPAs are a drastic shift from the former ACP relationship with the EU that existed from the Yaoundé Convention (1963) through to the Cotonou Partnership, which was based on non-reciprocal duty free preferential access for most of ACP exports to the EU market.*

The EPAs date back to the signing of the Cotonou Agreement. They were a response to continuing criticism that the non-reciprocal and discriminating preferential trade agreements offered by the EU are incompatible with WTO rules (Giesbert, Pfeiffer and Schotte, 2016). The economic relationship between the then European Economic Community (EEC) and the ACP was established in 1963 in Yaounde. In 1975 under the Lome agreement, the EU gave the ACP unilateral trade preference in various agreements. These preferences were combined with financial backing under the European Development Fund (EDF). This however, did not result in economic development in ACP countries. The reasons for this are varied. They range from lack of adequate industrial infrastructure in the ACP and dependence on extractive or primary exports that are prone to price fluctuations on the international market.

From the EC's perspective, ACP countries were faced with supply side constraints, lack of good governance and institutional building, as well as the disadvantage of unilateral preferences which made ACP economies incompetent, yet highly protected. With the expiry of the Lome agreement at the end of the 20th century, the EC proposed a new trade and development regime. This became known as the Cotonou Agreement and came into force in 2000. It radically changed the trade relations in the process. The Cotonou Agreement envisaged the creation of reciprocal trade agreements between the EU and the regional blocs of ACP countries by establishing the EPAs. EPAs were supposed to be agreements covering not only trade in goods and services but also other issues such as competition, government procurement, intellectual property and trade facilitation.

## **Interests Served by EPAs**

The Chief Executive Officer for Zim-Trade noted that:

*The Economic Partnership Agreements between the EU and African, Caribbean and Pacific countries and regions aim at promoting ACP-EU trade-and ultimately contribute, through trade and investment, to sustainable development and poverty reduction.*

EPAs go beyond conventional free-trade agreements, focusing on ACP development, taking account of their socio-economic circumstances and include cooperation and assistance to help ACP countries to benefit from the agreements. Chakanya (2011) asserts that EPAs were aimed at creating a shared trade and development partnership backed up by development support which will through gradual and controlled liberalisation in goods over a reasonable period of time and a set of rules on sectors such as services and investment, contribute to development, growth and job creation.

The EC seems more concerned with trying to make the ACP countries adhere to its trade policy than addressing the development concerns of their trading partners, who are being pushed to agree to EPAs by fear of losing market access rather than by the prospect of improving their economic future (Kondo, 2012). Unless the EU listens to the alternative proposals made by African countries, the underlying conflict between EU and ACP perspectives on the best trade and industrial strategies for Africa's development will continue to blight EU-ACP relations.

### **Contribution of EPAs' to ACPs' Economic Development**

Besides Zimbabwe being part of EPAs, regional partners are its major import and export partners. The impact of EPAs have been muddled by the need by ACP states to balance the need for development and the need to protect home industry in the face of market liberalisation. EPA contract is considered to be between unequal partners and one which would have a devastating impact on Zimbabwe (Chakanya, 2011). The EU's argument is that EPAs will enable Zimbabwe's market access to the EU to grow by one percent but the reality is that government revenue loss could be as much as 15 percent. All sectors in the economy including agriculture would lose revenue, affecting people's livelihood through increases in poverty and unemployment (Bossuyt, Keijzer, Medinilla and Tollenaere, 2016). Zimbabwe has enjoyed preferential duties and zero duty for selected commodities in the EU market. Its major exports to the EU include tobacco, iron and steel, cotton, meat products, precious stones, sugar and confectioneries. The major imports from the EU include chemicals, manufactured goods, and machinery and transport equipment. However, the hostile political relations between Zimbabwe and the EU have soured trade relations and flows (IMF, 2015).

The EU is insisting on 80 percent of liberalisation of the goods market in African EPA countries. They present this as a fair and development friendly asymmetrical liberalisation (Bartels and Goodison, 2011). The liberalised categories can be important sectors in which countries can build their own productive capacity to supply domestic and regional markets. EPAs would mean that regional markets for those sectors are exposed to direct unfettered competition with EU goods (Kondo, 2012). This is exacerbated by the EU's reluctance to allow adequate infant industry safeguards and its insistence on restricting the use of export taxes and export restrictions. As a result, countries run the risk of remaining commodity exporters with limited employment benefits and generating little revenue, instead of moving up the value chain and diversifying their economies (Kondo, 2012).

### **Effects of EPAs on ACP Regional Groupings**

In his response the Director for Multilateral Affairs in the Ministry of Foreign Affairs indicated that:

*Multiplicity of membership affects trade negotiations and regional integration for sustainable economic development. The situation does not only drain the already scarce resources but also impact negatively on the efficiency of trade administration.*

By losing resources through overlapping membership, ACP states are tied back to dependency on the developed countries for financial assistance. The main thrust of EPAs which is smooth integration of ACP countries into the world economy cannot be attained; worse still the conclusion of EPAs remains



## ***Implications of the European Union (EU)-African, Caribbean, and Pacific Partnership Agreements***

delayed due to competition and mistrust among ACP states. In support of this, the European Parliament (2012, p.29) stated that:

*Overlapping membership result in a dilution of already scarce human and technical resources, high administrative costs and inconsistent obligations.*

This puts most ACP states at a disadvantage in that EU states are not aligned to many regional economic groupings and in overlapping membership. EPAs also threaten to break up existing African regional groupings. In order to negotiate EPAs, some countries have been forced to join new regional bodies causing a lot of strain and raising questions about the viability of long established economic and political blocs such as COMESA, ECOWAS, EAC and SADC. Part of the problem is that some African countries are members of more than one regional grouping, yet the EU insists that an individual state can only be a member of a single trading arrangement with the EU and it is imperative that the problems raised by overlapping membership must be resolved by those concerned (Nielson, 2004). Zimbabwe, although a member of SADC, decided to negotiate the EPA as part of ESA, breaking with its traditional SADC grouping. Consequently Zimbabwe chose to negotiate under ESA where development levels are more balanced. However, this could lead to the emergence of tensions. Zimbabwe has to choose one bloc since no country can belong to two customs unions (Bossuyt, Keijzer, Medinilla and Tollenaere, 2016).

Kondo (2012) posits that economic integration with the EU comes at the expense of real progress towards regional integration in the ACP. Countries in the ACP are in the process of consolidating regional custom unions with the aim to boost intra-regional trade. Regional markets are key to increasing productive capacity and stimulating infrastructure development. Unfortunately, the EPA process has been slowing down progress towards regional integration by fostering tensions between LDCs (which already receive non-reciprocal market access to the EU on EBAs and hence do not stand to gain from signing an EPA) and non-LDCs (which stand to lose preferential market access if they do not sign an EPA) and imposing different market access arrangements on countries in the same region, meaning that consolidating their customs union is impossible while they are faced with controlling their borders for EU imports/exports (Bartels and Goodison, 2011).

### **Contentious Issues Under EPAs**

All African countries negotiating an EPA are locked in unhealthy post-colonial dependence on Europe for development aid, fiscal support and markets, a development that has hindered Africa's competitiveness at the national, regional and international markets. A Director in the Ministry of Macro-Economic Planning and Investment Promotion supported this assertion by indicating that:

*The underlying matter is that the EPAs are being negotiated by two groups (EU and ACP) who have a wide gap of economic and political development. Therefore EPAs remain biased in the interest of the developed EU at the expense of the developing ACP group which effectively curtails economic development of the latter.*

The Chief Executive Officer of ZimTrade noted that;

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*The EU has been increasingly using its economic and political power to force its own vision of EPAs onto the ACP. Further, the EU is hiding highly sensitive and potentially dangerous trade liberalisation under the pretence of development rhetoric.*

From the beginning of the negotiations, the EU and ACP countries did not share the same vision of what future EPAs may contain, especially in the areas of trade liberalisation. The argument put forward by the EU is that they facilitate Foreign Direct Investment (FDI) in developing countries which translates to economic growth. However, the past proves that to ACP states, that FDI has not yielded intended results from the EU but rather negatively crushed the infant industries within the developing economies (Action Aid, 2012). ACP states feel that the standstill clause should be removed from the EPA texts in order to allow for maximum use of policy space for development purposes.

Another matter that has been of contention is The Most Favoured Nation (MFN) clause. Schloemann (2010, p.10) explains the following:

*The conclusion of an EPA; should any ACP country or grouping conclude a Free Trade Agreement with any developed country or any other major trading economy, including the newly emerging economies such as China, India, Russia and Brazil, then any more favourable treatment provided to that developed country or grouping must also be extended to the EU and vice versa.*

Kamidza (2017, p.270) exposed the hypocrisy of the EU's strategy of 'divide and conquer' in the EPA process. The EU is currently the main sponsor of all sub-regional economic integration schemes and yet promoted individual interim EPA tariff liberalisation schedules and commitments that are at variance with those obtained regionally. Another contentious issue is the standstill clause which stipulates that after the entry into force of the EPAs, the parties may not introduce new tariffs, or may raise existing tariffs, and once eliminated, tariffs may not be re-imposed (Schloemann, 2010).

As a result of the wide range of contentious issues clouding the EPAs, by August 2016, only one EPA region, the Caribbean had a full regional EPA in force, as it was the only region to conclude a comprehensive deal by the initial deadline of December 2007. Three other regions-SADC, West Africa and the EAC-have concluded regional EPAs, but the likelihood of signature is in doubt in West Africa and the EAC. There is little hope of regional EPAs materialising in the remaining regions of Central Africa, ESA and the Pacific (Bossuyt, Keijzer, Medinilla and Tollenaere, 2016). LDCs in these configurations have opted to trade under EBA, while the non-LDCs have signed and ratified individual bilateral EPAs.

## **CONCLUSION**

Reciprocal trade liberalisation which is at the heart of proposed EPAs between the EU and ACP countries inflict substantial damage on emerging ACP industrial sectors and close off the policy space governments need to ensure long-term national development. Most ACP countries formalised relations with the EU through economic cooperation. The EU also assisted former colonies through development trade which had conditions with negative impact on developing countries' economic growth. As a result, countries run the risk of remaining commodity exporters with limited employment benefits and generating little revenue instead of moving up the value chain and diversifying their economies (Kondo, 2012)

A high level of transparency in the negotiations will reduce mistrust and increase the quality of inputs by all stakeholders. Using trade negotiations to achieve a development objective is rather new. The innovative character of EPAs might be one of the reasons for some of the mistrust and suspicion we have experienced in the past three years. Our response to this is a high degree of transparency both towards the ACP partners and all interested stakeholders (EU, 2017).

Regional integration has been one of the fundamental arguments by the EU to influence ACP countries to agree to sign EPAs. However, ACP states have a different concept of regional integration from that which the EU is recommending by means of EPAs. EU's ideal of regional integration is one based on trade liberalisation, while for ACP it is about production and infrastructure, as well as harmonisation of trade and other shared policies. Consequently, EPAs have been partially effective in fostering regional integration in the ACP (Chakanya, 2011).

Moreover, overlapping memberships of multiple regional economic communities have the effect of spreading resources too thinly, complicating the overall continental integration process, and putting strain on governments' abilities to manage diverse agenda. Kondo (2012) posits that economic integration with the EU comes at the expense of real progress towards regional integration in the ACP. Countries in the ACP are in the process of consolidating regional custom unions with the aim to boost intra-regional trade. Regional markets are key to increasing productive capacity and stimulating infrastructure development.

Developing countries must be allowed to protect and promote infant industries in order to develop their economies and eradicate poverty. The EU and ACP states need to have a common vision and understanding in the EPAs contents for them to negotiate speedily and meaningfully on the EPAs. As EPAs seems to be a neo-colonial strategy which widens the cracks of ACP integration, ACP states can from a radical perspective delink with the EU in such economic arrangements and deepen their focus on intra-regional cooperation until the EU or the ACP states propose and design EPAs that suite and meet their developmental levels (Bossuyt, Keijzer, Medinilla and Tollenaere, 2016).

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## **KEY TERMS AND DEFINITIONS**

**Agreement:** A negotiated and typically legally binding arrangement between parties as to a course of action.

**Dependency:** The state of being dependent.

**Development:** A discourse (a set of ideas) that actually shapes and frames reality and power relations.

**Economic Nationalism:** A set of practices to create, bolster and protect national economies in the context of world markets.

**Globalization:** Integration of economic activities across borders, so that nations become interdependent.

**Negotiation:** A discussion aimed at reaching an agreement.

**Neo-Liberalism:** A modified form of liberalism tending to favor free-market capitalism.

**Partnership:** An agreement in which two or more individuals share the profits and liabilities of a business venture.

**Paternalism:** The interference of a state or an individual with another person against their will, and defended or motivated by a claim that the person interfered with will be better-off or protected from harm.

# Chapter 9

## The Impact of Macroeconomic Indicators on Unemployment Rate: Western Balkan Countries

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### ABSTRACT

*The aim of this chapter is to study the impact of the selected macroeconomic indicators on unemployment rate in the region of Western Balkan countries and, more specifically, Albania, Serbia, Macedonia, Montenegro, Bosnia-Herzegovina, and Kosovo. This research is based on the time period 2000 to 2017 and includes five countries and the econometric model used in here is panel data. Data are retrieved from official and trustable sources such as World Bank and International Monetary Fund (IMF). The methodology used is the vector autoregressive model (VAR), unit root test, Hausman test, Granger causality test. All the macroeconomic variables, inflation, interest rates, GDP, and FDI are found to have a significant impact on unemployment rate of this group of countries. The novelty of this study remains the fact that this analysis is performed for the Western Balkan countries as a group. The results can serve and can be taken into consideration when applying similar econometric analysis in the future researches or implementing new policies that influences the macroeconomic factors.*

### INTRODUCTION

The Western Balkans is a geopolitical term coined by the governing bodies of the European Union in the early 2000s and referring to those countries in south-eastern Europe that were not EU members or candidates at the time but could aspire to join the bloc (Dabrowski and Myachenkova, 2018). At the very beginning the Western Balkan region was composed of Albania, Bosnia and Herzegovina, Croatia,

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Kosovo, Macedonia, Montenegro, Serbia and Croatia. Since 2013 Croatia is part of European Union. As all the countries or the regions, the Western Balkans (WB) have their ups and downs. In the 1990s, the Western Balkans suffered from different conflicts, which negatively impacted the political, economic and social environment in this region. Meanwhile, the prospect of EU accession and the global boom in 2000s made possible some emerged reforms within the institutions and pushed the economy to recover. These positive steps were seen as promotor of economic growth of the whole region. But again, the financial crisis of 2007 has its negative impact even in this region.

One specific to this region is that the Western Balkan countries have huge similarities in the culture, social norms, languages, background and historical past. As so, these countries are considered as group highly affecting each other and becoming like this as a single zone. The study of this region is crucial to understand the gaps and ambiguities showing up. If the WB countries are considered a “common zone”, the steps toward a prosperous economy and a better future would be much easier since they do influence each other and, somehow, they consider the countries of the region their competitor. In the last years all the countries except Albania have seen much faster growth of exports than of GDP. And what is crucial, the exports toward EU have increased faster than the rest of the region. Another indicator supporting the non-economic nationalism of the WB countries is that apart from Albania and Serbia, all the other countries use euro or have fixed exchange regime based on the euro. According to Gligorov, in 2017, the intra-ethnic political competition and growing exports in Western Balkan countries have been supportive of democracy and free trade and have kept in check nationalism and protectionism respectively.

Labor market in the selected region has high unemployment rate. Unemployment is an important issue which affects society politically and economically. A large number of authors have been writing through years about the problems that labor market presents, emphasizing unemployment. Western Balkan economies have a considerable number of similarities among them in terms of labor market conditions and developments. Their remarkable challenge is high unemployment rate.

Unemployment rate is defined as the proportion of the nation’s non-institutionalized population sixteen years and older that is out of work, actively looking for a job, and available for work (Frumkin, 1998). If the number of people who are forced to register for work to receive particular benefits but express unwillingness to work is large, then the unemployment rate will increase even though the number of persons actually seeking work may remain relatively constant (Miller, 1983). There are several reasons of high unemployment, mentioning the most important one, the economic crisis that affects the whole economy. Albania and Kosovo, in 2009 which was the recession period, were the only Western Balkan countries that could maintain positive growth.

People are unemployed because of different reasons, and these reasons divide unemployment into six main categories (Mankiw, 2003). The first one is frictional unemployment, which is a short-run unemployment that comes from the condition of searching for a new job. The second type is structural unemployment, which is a persistent unemployment that happens when wages in labor markets do not balance supply and demand. The third and most often type of unemployment is cyclical unemployment, which is related with the ups and downs of the economy. The fourth type of unemployment is the seasonal one, which is related to seasonal nature of the product or service. The fifth type of unemployment is the voluntary one, which includes that group of people who choose not to work for different reasons. The last but not least type of unemployment is the hidden one, which does not appear in government statistics, due to the way the statistics are collected (Mankiw, 2003).

Factors affecting unemployment rate are macroeconomic indicators. These indicators are economic statistics which are released periodically by government agencies and private organizations. They pro-

vide insight and information into the economic performance of a particular country or region. Of all the economic indicators, the four most important ones in relation with unemployment rate are inflation, gross domestic product (GDP), interest rate and foreign direct investment. Gross domestic product shares a negative relationship with unemployment rate. Usually, 1% decrease in GDP results in an increase of 1.3% to 1.5% in unemployment (Zuckerman, 2004). The impact of inflation on unemployment rate is widely touched. They have an inverse relationship according to Philips' curve. As one increases, the other must decrease (Philips, 1958). By analyzing the relationship between interest rate and unemployment, it can be noted that an increase in interest rate, increases unemployment. Foreign direct investment shows an important relationship with unemployment. As FDI increases, unemployment decreases (Mucuk, 2013).

The objectives of this study are as below:

1. To analyze the unemployment rate in Western Balkan Countries, its changes through time over these countries (Albania, Kosovo, Macedonia, Montenegro, Serbia and Bosnia Herzegovina).
2. To examine the impact of the selected macroeconomic indicators on unemployment rate using econometric analysis.

The topic of unemployment is a common issue for the Western Balkan Countries and its challenge to reduce high rates of unemployment is an ongoing process. The whole economy is affected by the unemployment rates and it is of a high interest to examine the impact that each of the selected macroeconomic indicators has on the unemployment rate. The most dominant motivator on studying unemployment rate is to find out how to reduce it by using particular policies and to maintain economic stability.

Studying unemployment rate issue is of a high importance because every country in the world faces unemployment. It plays a critical role in the development of economies. So as to reduce the constraints which are created by high unemployment rates is important to conduct analysis and research in order to identify how the macroeconomic variables impact on unemployment and what are the best methods to reduce it. An econometric model will be conducted in order to understand the significance of each selected variable on unemployment.

## **BACKGROUND**

### **Western Balkan Countries Before 2000s**

Balkan is the southeastern part of Europe. Geographically, economically, politically and culturally it stands in-between Europe and Asia. Nowadays, western Balkan countries are formed by Albania, Montenegro, Macedonia, Serbia, Kosovo, Bosnia Herzegovina and Croatia. Kosovo declared its independence in 2007, while Croatia entered officially EU in 2013. Kosovo in terms of history has been mainly part of Serbia; therefore, its historical economic analysis consists with Serbia. Croatia is not part nowadays of western Balkan countries, in terms of economy, therefore its economic history it's not directly relevant to the topic.

These countries applied communism as a political and economic system during the years 1945-1990. Except Albania, all western Balkan was united as Yugoslavia (FRY). During this period unemployment was not an issue since work was mandatory and non-optional. Therefore, everything was controlled centrally by the state who organized all the labor force in the needed positions. Nevertheless, this period



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should not be underestimated since its main focus of labor force was on industrial facilities which were one of the main reasons of the extreme increase of unemployment after 1990 (Economics, 2018).

Western Balkan has always faced complex and mix issues regarding politics and economy. After 1990 there was a change in the political and economic system. Communism was replaced with democracy and capitalism. This led to a massive change, freedom of choice and massive fled of labor force to more developed countries. Most of the industries failed and the unemployment increased drastically in a short period. A change in employment rate occurred with the GDP raise after 1999, still in different times in respective countries. This is mainly because in the first year of recovery there is an increase of productivity rather than creation of new job opportunities. According to European standards of employment, western Balkans is characterized with high unemployment rates. Labor force has went through a massive change of the system which is now is controlled by the private sector. During the time of recovery, the state sector employment covered from 40 percent of the employment rate in Montenegro and Serbia, to 30 percent in Albania and Former Yugoslav Republic of Macedonia. The rest 60 to 70 percent of the employment rate was provided by the private sector.

Even after the recovery years, unemployment rate remained high in western Balkans as a consequence from the past decisions. The highest unemployment rates after the 2000 were in Bosnia Herzegovina, Kosovo and Former Yugoslav Republic of Macedonia 54, 45 and 32 percent respectively. Also in Serbia, Montenegro and Albania a rise of unemployment occurred because of the economic reforms at the beginning of the second millennium.

### **Western Balkans Countries After 2000s**

Ganić, in 2019, states that the level of employment has stagnated well below the EU average. In particular, the high rate of long-term unemployment and the high rate of youth unemployment have affected all countries of the region. In comparison, the unemployment rate measured by long-term unemployment in percentage of the active labour force is much higher in the Western Balkan countries than in Romania (3%), Bulgaria (5.6%) and Croatia (10.2%). The highest long-term unemployment in percentage of the active labour force was recorded in Bosnia and Herzegovina (22.8% in 2015) and Macedonia (21.3% in 2015) followed Montenegro (13.6% in 2015) and Serbia and Albania (11.3% in 2015). (Ganić, 2019).

Considering the economy of Albania there is an increase in economy in recent years. Albania has continued with a steady economic growth also through economic crises. Before the global crisis, Albania had a constant growth of 6%, while after 2008 growth declined and unemployment went from 12.5 to 17.6% in 2014 (World Data, 2015).

The differences in the rate of growth of individual countries of the Western Balkans can be also explained by political and administrative constraints including incomplete political democracy, weak institutional capacity to formulate and implement the economic reform programmes and constraints on implementing structural reforms (Ganić, 2019).

Agriculture remains the leading focus of labor force in Albania. In 2015 agriculture was responsible for almost 21% of GDP and 43% of the employment rate (World Data, 2015).

Bosnia Herzegovina had a decrease of unemployment until 2008. In the second part of 2008, economy started to decline as a consequence of global crisis. In the case of Bosnia Herzegovina, politics and structural issues were also a major influence of this decline. After 2008 Bosnia Herzegovina required help from the International Monetary Fund (IMF). Bosnia Herzegovina is a federal country formed by the republic of Srpska and Federation of Bosnia and Herzegovina. The continuous debates and conflicts

influenced to increase the impact of global financial crisis upon Bosnia Herzegovina after 2008. Both regions applied different economic reforms and this led to low inflation in Bosnia Herzegovina. Unemployment rates stand highest of the western Balkans, 44.6% (World Data, 2015).

Macedonia has made great economic progress but has failed to attract foreign investment and therefore developed a gray market which is not reflected in official stats. This gray market covers between 20% and 45% of the GDP. Unemployment rates have been constantly over 30% in Macedonia. The existence of such gray market provides a large error tolerance in unemployment rate of Macedonia. Macedonia experienced the first economic growth after the global crisis in 2012 and its inflation stands stable at 2.8% (IMF, 2015).

In Montenegro, the state section remains a huge part of job placing, but it is slowly passing to a market system. Tourism and refinery of metals are two crucial sectors for the increase of the economy. The global crisis had a big negative impact for Montenegro, mainly in the decline of metal export and real estate. Montenegro had a tax increase of 2% in 2013 and its inflation stands at 4%. The unemployment rate in Montenegro is 19.1% (IMF, 2015).

Serbia faced many economic issues in 2008, due to global financial crisis and internal factors. The internal factors were mainly because the economy was mainly based on consumption, debts and import. These issues resulted in economic decline, high unemployment rates and unstable inflation. Reforms to stabilize these factors were made. These reforms were successful, and Serbia had a big increase of Foreign Direct Invest, which influenced to increasing economy growth to 30%. This foreign impact was the largest in western Balkans. This impact was a consequence of monetary policies and reforms. Due to these there was an increase in exports and investment and Serbia has nowadays a positive economic growth.

## **GDP and Unemployment Through Okun's Law Theory**

Arthur Melvin Okun was a Yale professor who proposed an economic theory based on GDP and unemployment. The relation between economic prosper and unemployment rate is exploited by many researchers. One of the most important is the Okun's law theory. Okun states that GDP and unemployment have a proportional negative relationship between them. The theory supports the economic concept that if unemployment rate falls with 1%, GDP increases with 3% (Okun, 1962). This creates a direct relationship of output and labor force. Therefore, according to Okun's law, western Balkan countries through their transition years were more productive in the existing labor force rather than new labor opportunities. This fact also correlated with the dependence with foreign direct investment influenced in slow GDP increase. Okun's law has also limitations and situations where its non-functionality is proven by many researchers.

This hypothesis is empirical, and it should be true also in its opposite direction. That means that if GDP growth slows down then there should be an increase in unemployment rate. This relation between these two economic fields are rather statistical than pure economic theory. (Sögner, 2001). There is no economic theory which explains the relationship between GDP and unemployment rate, therefore Okun's law can be used as a measuring start point of the relation between these variables. The simple manner in which this theory is put makes its understanding easier. Okun stated that unemployment is influenced also from the misuse or non-usage of resources in sectors of the system. He claims that there should be an optimum equilibrium between capital, labor and technology (Okun, 1962).

The flaws in Okun's theory were made obvious firstly in 1970s where the empirical rule was no longer held true. Okun even suggested his own reasoning for short term issues focusing on capital, labor and technology, but nowadays most of the researches focus on labor force, technological innovations

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and working time. According to Prachowny, these three variables influence in GDP growth (Prachowny, 2001). Also, the basic concept of the Okun's theory is put in doubt by many researches who claim that for variables other than 3, the theory fails to provide correct information. Knotek claimed in 2007 that increase in unemployment rate is not always the case with the slowing down of the economy (Knotek, 2007).

The relation between unemployment rate and GDP has varied through time and along the business cycles. Okun's law theory can be a valuable tool for economists, always taking into consideration its instability.

## **Inflation and Unemployment Through Phillips Curve Theory**

Phillips claimed that inflation and unemployment are stable, and they have a negative relationship between them. The theory claims that through economic prosper comes inflation, this provides more job opportunities and therefore less unemployment. According to Phillips change in unemployment rate influences on inflation and has a predictable effect (Phillips, 1958).

According to these concepts, in 1960s it was believed that any economic stimulus would increase demand and start having predictable effects. Job demand increases, unemployment rate would fall, and the job providers would increase wage because of less talent on unemployed opportunities. After these effects, the wage would increase and also the prices would go up. This closed loop of economy would end with the consumer recycling the money and the economy would prosper. Another point of economic belief was that the system faced unemployment or inflation, never both at the same time. Therefore, the existence of one issue would dictate the macroeconomic objectives of the future, without influencing the other. In 1958, Phillips put these assumptions into question with his theory that unemployment and inflation were related with each other.

Policymakers used the Phillip's curve theory also according to major macroeconomic interests. For example, more inflation leads to less unemployment and the vice versa. This economic concept influenced many countries where a goal for the inflation was set and therefore a "pause-start" strategy was implemented.

However, in 1970s, Phillips curve was put in doubt because there were high levels of inflation and unemployment where coexisting at the same time. In these years, stagflation arose, and the predictable balance of inflation and unemployment was proven empirically wrong. Stagflation happens when there is stagnant economic prosperity, leading to high unemployment rate and inflation. This occurrence directly refers negatively to the Phillip's curve theory. Demand is one of the most influential variables that change the flow of economy. During stagnant times, demand falls, since there are no job opportunities and prices fall to sell at consumers. As a result, Phillip's curve was no longer applicable in economic systems since it was not stable. The relationship between inflation and unemployment was broken, since any number of inflation was possible for any unemployment rate.

Wage and unemployment are directly related since wages adjust to ensure a much employment as possible. This claim leads that prices and wages are flexible toward each other. Economy will always look to provide maximum employment, but wage adjusts slowly at employment changes in order to keep the employment present opportunities at maximum, according to the Phillips curve theory.

Wages do not move quickly through time, they are rather stable and increase or decrease slowly, this also to provide the maximum working labor force and never use less than its best present potential. Phillips curve relationship is provided through a proportion of employment level and wage change. There is

a positive relation between wage and employment. That means that increase in employment would lead to increase in wage. A positive curve between wage and employment level results that wage is higher when more hours are put into labor force. This proportion changes through time if the employment level is not at its full capacity. These changes will influence in unemployment rate and therefore also in wages.

## **Keynesian Theory**

John Maynard Keynes was an English economist who changed the perception of certain crucial economic variables. With the release of his book in 1936 “The Theory of Employment, Interest and Money” he contributed to a better understating of the processes in the economic system.

His first revelation consisted of the claim that economic balance is achieved by aggregate demand (Keynes, 1936). Aggregate demand is the total amount of goods produced by the economic system and their total exchange by the consumers at different prices. Keynes claimed that more services and goods are directly related to an increase in demand in the system. In 1929, through global crisis and extremely high inflation, classical economic thinkers suggested that the economy should be left to resolve its own issues independently since it is a closed cycle. According to Keynes, interventions in such moments of crisis were crucial and unrecoverable damage would occur in the long term economical self-recovery. The consumer as one of the economic pillars needed to be protected as soon as possible.

The solution provided by the classical theorists were that wages needed to be cut. Through this reform, businesses could employ more people and there would be an increase in labor force (Skidelsky, 1986). Keynes rejected strongly this solution through the idea that capitalism was based upon the consumer, goods need to be produced and then sold. If the wages were to be cut this would bring less capital for the consumer and therefore the prices would fall, afterwards companies would not earn as much as needed to make good profit and labor force would decrease in order to gain profit. Therefore, this would lead to a greater issue and still high unemployment (Keynes, 1936).

Keynes believed in the closed loop of capitalism, but still claimed that through crisis governmental interference was positive. If the government would interfere by spending on goods or services, the prices would fall and therefore become available for the consumer demand. On the other side the companies would gain their profit and hire more labor force. A good example is the creation of agricultural jobs by Roosevelt, which gave the farmers a chance for a wage and added consumer power into the market, resulting in consumer spending. Companies through hiring more employees, wages would increase, and consumer spending capital would increase. At this point we have a closed loop of increased aggregate demand which stands in the basics of economic prosperity.

Keynes whole domino process relies on trust that the companies “reward” the system with new employment. The curve of aggregate goods of Keynes provide little information in order to be reconstructed therefore his claims are taken as his theory. In long term Keynes includes interest rates in his theory as they determine the intended investment. In short term expectation, Keynes theory determines the consumer goods demand and the amount of selling from the companies (Sayre, 2009).

Therefore, Keynes provided an auto critical view of a system which he supported. His aggregate demand theory is the principal contribution to economic theory and the aggregate supply curve can be determined and conceived through Keynes’s claims and his idea representation.

## EMPIRICAL ANALYSIS

### Data and Methodology

This study analyzes a quantitative study. The impact of macroeconomic indicators on unemployment rate is explored by econometric models and methods. The countries included in this study are: Albania, Bosnia and Herzegovina, Macedonia, Serbia and Montenegro. The limitation of data led to the decision to exclude Kosovo from the econometric model.

The time period studied starts from 2000-2017 and the data for these years are provided yearly. Several sources are taken into consideration regarding the finding for the data required for the study, mentioning official sources like Global Economy, World Bank and International Monetary Fund (IMF).

Variables used in this study are as follows:

1. Unemployment: is defined as the growth rate of total unemployment as percentage of labor force
2. Interest Rate: reflects nominal interest rate minus the inflation rate
3. GDP: refers to the annual percentage of GDP growth
4. Inflation: reflects the percentage change of a price index over time
5. FDI: reflects the percentage change of investment over time

In this study will perform a Unit Root Test, the vector auto-regression model (VAR), Hausman test and Granger Causality test in order to analyze the impact of macroeconomic variables on unemployment rate in the Western Balkan Countries. We will use Hausman test in order to find out which effect model to use, random or fixed. The VAR model is used to analyze the relationship that exists between explanatory and dependent variable and vice versa. The decision to use a VAR model comes because of unit root test, concluding that the studied variables are stationary, and we can proceed with VAR model. A panel data is a combination of both cross-section dimension and time series dimension. Choosing panel data for the study is a key point because panel data are very challenging. The most important reason is that panel data provide a more accurate inference of model parameters.

The research model basing on existing literature is as following:

$$\text{Log (unemployment\_rate)} = -1.31-0.67\text{interest\_rate}-1.25\text{inflation}-1.51\text{gdp}-1.24\text{fdi} \quad (1)$$

The above research model shows the initial regression of explanatory variables on unemployment. As we have mentioned above, our model uses a panel least squares method. The expected signs of the coefficients of the variables have been satisfied except the sign of the interest rate. We expected interest rate to have a positive impact on unemployment because as the interest rate increases, the unemployment increases too. Overall the model is significant, emphasizing that inflation and FDI are significant at 5% significance level. The interpretation of R-squared would be that 12.8% of the variation in log (unemployment rate) is explained by our model.

### Vector Autoregressive Model (VAR)

Econometric models are complex and unique at the same time. Before explaining VAR model, it is important to note the AR model which involves one predicted variable. In an AR model the dependent

*Table 1. Econometric model*

Dependent Variable: LOG(UNEMPLOYMENT_RATE)				
Method: Panel Least Squares				
Sample: 2000 2017				
Total panel (balanced) observations: 90				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTEREST_RATE	-0.671710	0.654884	-1.025693	0.3079
INFLATION	-1.252433	0.531299	-2.357305	0.0207
GDP	-1.518719	1.195862	-1.269978	0.2076
FDI	-1.245996	0.553818	-2.249829	0.0270
C	-1.316975	0.097099	-13.56322	0.0000
R-squared	0.128250	Mean dependent var		-1.562826
Adjusted R-squared	0.087226	S.D. dependent var		0.326747
S.E. of regression	0.312171	Akaike info criterion		0.563421
Sum squared resid	8.283312	Schwarz criterion		0.702300
Log likelihood	-20.35396	Hannan-Quinn criter.		0.619425
F-statistic	3.126255	Durbin-Watson stat		0.372659
Prob(F-statistic)	0.018891			

Source: Author's work

variable depends only on legs of itself. On the other hand, a VAR model has more than one dependent variable including more than one equation. In the VAR model each equation uses its independent variables lags of all the variables we have chosen to study.

Sims was the first econometrician that used the Vector Autoregressive model (Sims, 1980). Sims claimed that VAR models would be appropriate to be used only when the variables are proved to be stationary without time trend.

## **VAR Equations**

As mentioned before VAR equations have more than one dependent variable where each dependent variable has its own equation. The equations respective for the macroeconomic variables to be studied in this research are as above; noting that “t” is time. Each equation contains 4 lags of all the chosen variables in the study.

Ordinary Least Squares method is helpful in estimating and testing the stationary of the macroeconomic variables. The significance of the coefficients is carried out by the examination of the p-value or t-statistics. Why using Vector Autoregressive model? The reasons to use VAR are because it is an easy model which provides a well-structured framework in testing further Granger Causality test. Hypothetically, the independent variables in the VAR model might be able to influence the dependent variable, but there is no possibility the vice-versa situation, in which the dependent variable influences the explanatory variables. Like most of the models also VAR has its drawbacks and flaws noting that the theoretical part of VAR is missing, meaning that VAR is not supported by any economic theory, apart from the theory that leads to choose the variables for testing VAR.

## Granger Causality Tests

Granger in 1969 defined the causality relationship based on two principles (Granger, 1969):

- The cause happens prior to its effect.
- The cause has unique information about the future values of its effect
- If event X happens before event Y, then it is possible that X is causing Y.

This means that actions and situations happened in the past can cause actions and situations to happen in the present. However, future events cannot cause at any chance past events. The basic idea that stands behind Granger Causality test is that a variable  $x$  Granger does cause a variable  $y$ , in case past values of  $x$  contribute in explaining  $y$ .

## EMPIRICAL RESULTS

In this part of the study is included the empirical analysis for Western Balkan countries regarding the selected macroeconomic variables for this paper. To analyze which of the variables has significant impact on the unemployment rate and to study the impact of unemployment rate on the macroeconomic variables.

In this section the macroeconomic variables of this study are presented in graphs. For each variable, a graph is provided regarding the five countries that are included in this study.

Figure 1 shows clearly that within five countries, Montenegro is the country with the most stable unemployment rate for the period of study. Macedonia has the highest unemployment rate reaching a peak in 2004. From 2000 to 2005 Serbia seems to be stable, then it faces an increasing trend regarding the crisis in 2008. Albania's unemployment rate is stable and does not vary too much.

*Figure 1. Unemployment*  
Source: Author's work

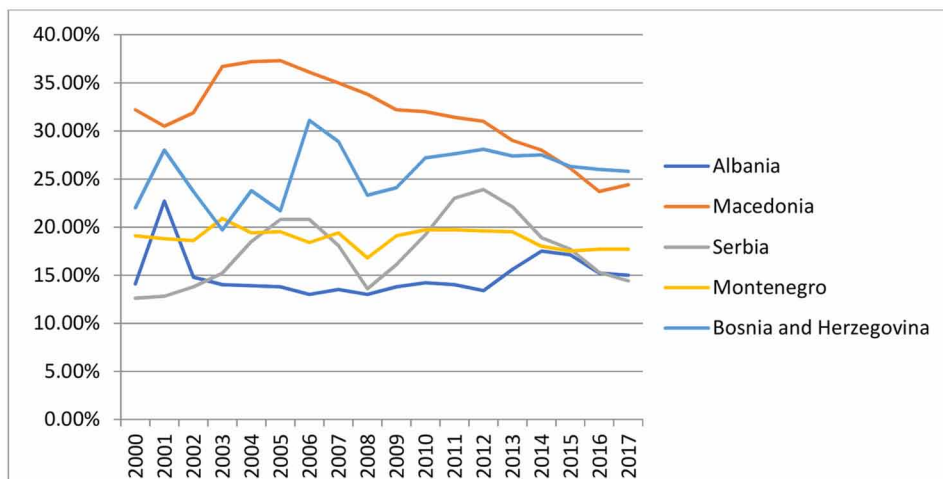
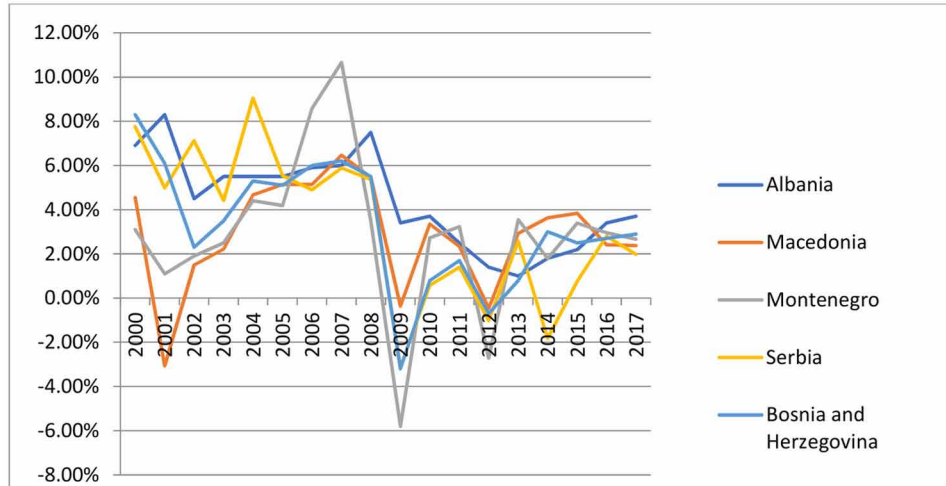


Figure 2. GDP of Western Balkan Countries

Source: Author's work



In Figure 2 it can be seen the ups and downs in each country. The GDP growth seems to fluctuate a lot because of the financial crisis that happened in 2009. Except Albania which is able to maintain a positive position regarding economic growth, the other Western Balkan countries face the recession in 2009. Analyzing the GDP growth, it can be observed that Montenegro has a variation from 2000 to 2017 of GDP growth at a high percentage. The minimum GDP growth rate is faced by Montenegro in 2009 that is -6%. Moreover, the economic growth of the other countries seems to fluctuate a lot over this period. Lastly, only Albania's growth rate stays more stable from year to year.

Figure 3 shows the inflation rate in percentage through time period 2000-2017. It can be seen that Serbia has reached the highest inflation rate in 2001. Albania seems to have a stable inflation rate through years. Macedonia and Bosnia Herzegovina have a stable variation of inflation rate too.

As it can be seen from Figure 4, Montenegro is the country with the most fluctuated foreign direct investment. It reaches its highest investment rate in 2009. Serbia is the country with the most ups and downs of FDI through years. Regarding Albania and Bosnia Herzegovina, it can be noted that these two countries are stable and do not vary too much over time.

Interest rate is computed as the difference of the nominal interest rate and inflation rate. In Figure 5, it is shown that all countries that are taken into study do have a low rate of interest with exception of Serbia, which has a steep increase of interest rate in 2002 and then it remains stable with little ups and downs from 2002 to 2017. The other countries seem to be stable over time with low positive interest rates.

## Hausman Test

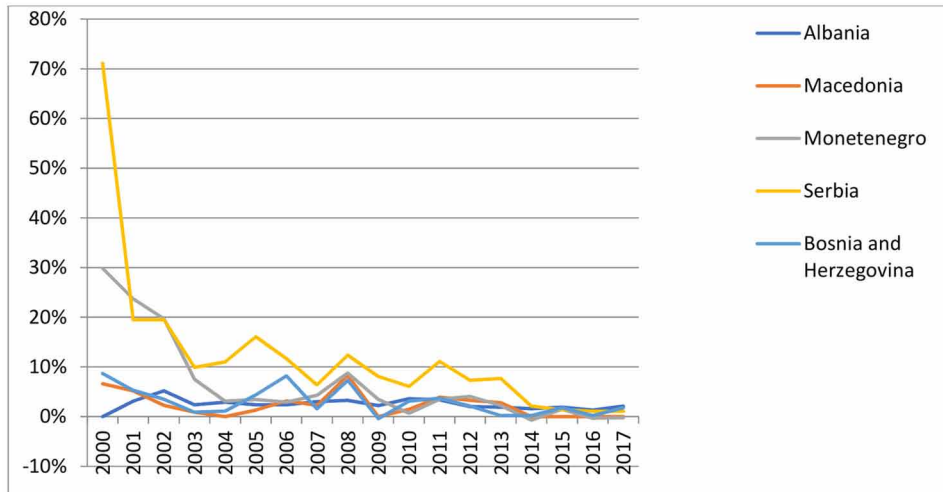
Durbin-Wu-Hausman test is a specification test that evaluates the consistency of an estimator when compared to an alternative, less efficient estimator which is already known to be consistent. It helps one evaluate if a statistical model corresponds to the data (Durbin, 1954).



**The Impact of Macroeconomic Indicators on Unemployment Rate**

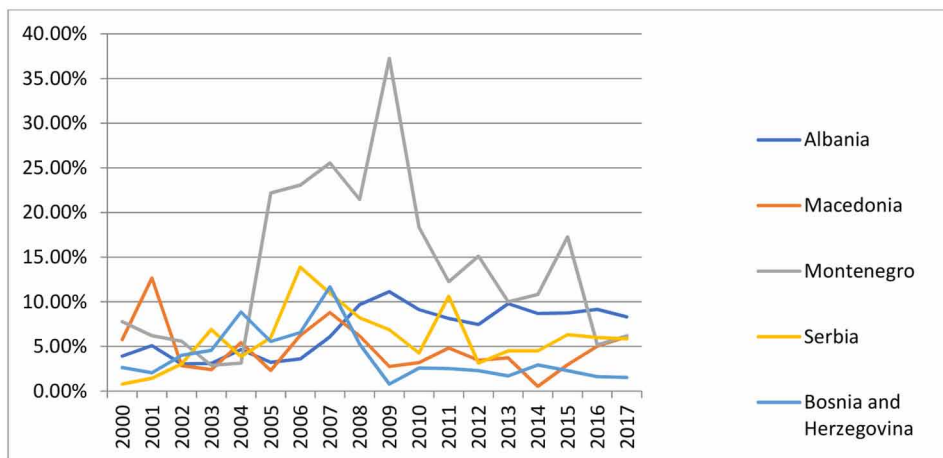
*Figure 3. Inflation of Western Balkan Countries*

Source: Author's work



*Figure 4. FDI of Western Balkan Countries*

Source: Author's work



Null hypothesis is random effect model and the alternative hypothesis is fixed effect model. The probability of the Hausman test is 0.06. Considering 1% significance level, we reject the null hypothesis. A fixed model effect is the desired model for our econometric model. Below it will be given a more efficient model using fixed effect model.

In the above table, it can be noticed that all variables except interest rate are now significant at 5% significance level comparing to the previous model. Interest rate is significant at 1% significance level. The probability of F-statistic is higher than 0.05 so the overall model is significant.

## The Impact of Macroeconomic Indicators on Unemployment Rate

Figure 5. Interest Rate of Western Balkan Countries

Source: Author's work

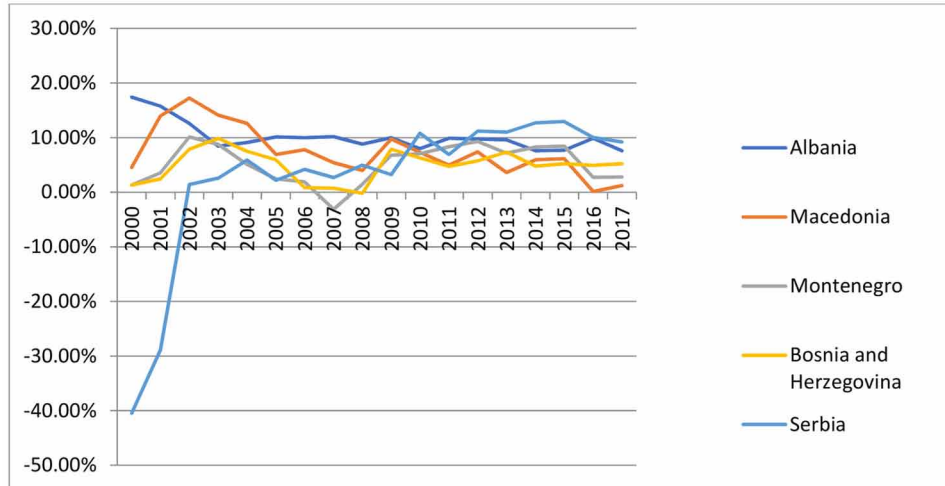


Table 2. Hausman Test

Correlated Random Effects - Hausman Test			
Test period random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Period random	9.001147	4	0.0611

Source: Author's work

Table 3. Fixed Period Econometric Model

Dependent Variable: LOG(UNEMPLOYMENT_RATE)				
Method: Panel Least Squares				
Sample: 2000 2017				
Total panel (balanced) observations: 90				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTEREST_RATE	-1.325870	0.774007	-1.712995	0.0913
INFLATION	-2.065786	0.705345	-2.928759	0.0046
GDP	-5.636925	2.028337	-2.779087	0.0070
FDI	-1.712745	0.635874	-2.693531	0.0089
C	-1.063883	0.132862	-8.007456	0.0000

Source: Author's work

## OLS Assumptions

The linear regression model is “linear in parameters.” Linearity is proved by Ramsey RESET test. The null hypothesis that the econometric model is linear in parameters. The probability is higher than 0.05 so we fail to reject null hypothesis and conclude that our model is linear in parameters.

- There is a random sampling of observations.
- The conditional mean is zero.
- There is no multicollinearity. Multicollinearity is studied by the correlation matrix which shows how the variables are related with each-other.
- There is homoscedasticity and no autocorrelation. Since the model includes logarithmic format then we can expect that the model does not suffer from heteroscedasticity and does not have a serial correlation.

Error terms should be normally distributed. Normality distribution test is observed for this assumption as above. So, probability is higher than any significance level that we could use so we fail to reject the null hypothesis and conclude that the model is normally distributed.

## Unit Root Test

The Unit Root test for stationary of the data is represented and analyzed in this section of the study. Unit Root test is computed and showed at the below table. The table constitutes of the results of the stationary test of the data computed by ADF and PP tests.

The results taken from the Eviews program show that all the selected macroeconomic variables for study are stationary in their levels.

*Table 4. Ramsey RESET Test*

Specification: LOG(UNEMPLOYMENT_RATE) INTEREST_RATE INFLATION GDP FDI C				
Omitted Variables: Squares of fitted values				
	Value	df	Probability	
t-statistic	1.217464	84	0.2268	

SOURCE: Author’s work

*Table 5. Heteroskedasticity Test*

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	2.165947	Prob. F(4,85)	0.0797
Obs*R-squared	8.324893	Prob. Chi-Square(4)	0.0804

Source: Author’s work

## The Impact of Macroeconomic Indicators on Unemployment Rate

Table 6. Unit Root Test

Macroeconomic Variables	ADF	PP
Unemployment	0.0057*	0.0149*
Inflation	0.0043*	0.0000*
GDP	0.0431*	0.0092*
FDI	0.0181*	0.0406*
Interest rate	0.0000	0.0000

\* Indicates significant at 5% significance level

Source: Author's work

### VAR Model Results

As it has been stated above, the objective of this study is to examine the impact of macroeconomic indicators on unemployment of Western Balkan countries. Based on this objective, the following analysis will be made.

This table shows the impact of log (unemployment) on the selected macroeconomic indicators for this study. It is clear that unemployment has impact on GDP. This effect is statistically significant and negative for this sample of countries. It is statistically significant at 5% level. This impact means that if unemployment increases, the GDP will decrease.

Table 7. VAR Analysis Results regarding Unemployment Rate

	LOG(UNEMPLOYMENT_ RATE)	INTEREST_ RATE	INFLATION	GDP	FDI
LOG(UNEMPLOYMENT_ RATE(-1))	0.665069	-0.022202	0.010699	-0.055448	0.029601
	(0.13846)	(0.02473)	(0.02850)	(0.02083)	(0.04723)
	[ 4.80345]	[-0.89762]	[ 0.37546]	[ -2.66156]	[ 0.62680]
LOG(UNEMPLOYMENT_ RATE(-2))	0.186899	0.001596	0.024103	-0.031098	0.046502
	(0.17417)	(0.03111)	(0.03584)	(0.02621)	(0.05941)
	[ 1.07311]	[ 0.05128]	[ 0.67244]	[-1.18667]	[ 0.78278]
LOG(UNEMPLOYMENT_ RATE(-3))	0.010264	0.026375	-0.041921	-0.021982	-0.074131
	(0.17785)	(0.03177)	(0.03660)	(0.02676)	(0.06066)
	[ 0.05771]	[ 0.83012]	[-1.14528]	[-0.82144]	[-1.22200]
LOG(UNEMPLOYMENT_ RATE(-4))	0.068121	-0.022533	0.003779	0.002655	-0.022631
	(0.14198)	(0.02536)	(0.02922)	(0.02136)	(0.04843)
	[ 0.47980]	[-0.88838]	[ 0.12934]	[ 0.12427]	[-0.46733]

Source: Author's work

## The Impact of Macroeconomic Indicators on Unemployment Rate

Table 8. VAR Analysis Results regarding Interest Rate

	INTEREST_RATE	LOG(UNEMPLOYMENT_RATE)	INFLATION	GDP	FDI
INTEREST_RATE(-1)	0.527652	0.065931	0.085310	0.009209	-0.237490
	(0.14149)	(0.79199)	(0.16300)	(0.11917)	(0.27014)
	[ 3.72937]	[ 0.08325]	[ 0.52339]	[ 0.07728]	[-0.87914]
INTEREST_RATE(-2)	0.291267	0.087955	-0.104185	0.121641	-0.565277
	(0.15526)	(0.86908)	(0.17886)	(0.13077)	(0.29643)
	[ 1.87602]	[ 0.10120]	[-0.58249]	[ 0.93022]	[-1.90694]
INTEREST_RATE(-3)	-0.193274	0.381660	0.075754	0.058070	0.645480
	(0.11967)	(0.66985)	(0.13786)	(0.10079)	(0.22848)
	[-1.61511]	[ 0.56977]	[ 0.54950]	[ 0.57615]	[ 2.82514]
INTEREST_RATE(-4)	0.049949	0.25774	-0.137914	0.012324	0.127468
	(0.07697)	(0.43088)	(0.08868)	(0.06483)	(0.14697)
	[ 0.64890]	[2.59819]	[-1.55523]	[ 0.19009]	[ 0.86732]

Source: Author's work

The results of the table above show that for this sample of countries, from all the macroeconomic indicators only interest rate has a significant impact on unemployment. This effect is statistically significant at 5% significance level on unemployment rate. It means that if interest rate increases, fewer loans are required from the companies and fewer investments are made. This brings to higher unemployment rate.

Table 9. VAR Analysis Results regarding Inflation Rate

	INFLATION	LOG(UNEMPLOYMENT_RATE)	INTEREST_RATE	GDP	FDI
INFLATION(-1)	0.276444	-1.477127	-0.273825	-0.164004	-0.210414
	(0.13752)	(0.66819)	(0.11937)	(0.10054)	(0.22791)
	[ 2.01025]	[ -2.21064]	[ -2.29393]	[-1.63124]	[-0.92323]
INFLATION(-2)	0.170640	-0.871165	-0.041800	0.374189	-0.488661
	(0.15784)	(0.76691)	(0.13701)	(0.11539)	(0.26159)
	[ 1.08112]	[-1.13594]	[-0.30510]	[ 1.24269]	[-1.86807]
INFLATION(-3)	0.095903	-0.693195	-0.009808	-0.176175	0.271234
	(0.13607)	(0.66114)	(0.11811)	(0.09948)	(0.22551)
	[ 0.70482]	[-1.04848]	[-0.08304]	[-1.77096]	[ 1.20277]
INFLATION(-4)	-0.057820	0.390947	-0.089240	0.189552	0.394282
	(0.09639)	(0.46837)	(0.08367)	(0.07047)	(0.15976)
	[-0.59983]	[ 0.83469]	[-1.06652]	[ 2.68983]	[ 1.46801]

Source: Author's work

## ***The Impact of Macroeconomic Indicators on Unemployment Rate***

In order to widen the analysis of the studied macroeconomic variables, this table shows which macroeconomic indicators are affected by Inflation.

Inflation has a significant impact on unemployment rate. This effect is statistically significant at 5% level. It has a negative impact unemployment rate because as inflation increases, unemployment rate decreases. Also, inflation has a significant impact on GDP. This effect is statistically significant and positive for this sample of countries. It is statistically significant at 5% level. This means higher inflation brings higher GDP. Moreover, inflation rate has a significant negative impact on interest rate. It is statistically significant at 5% level. This means that as inflation rate increases, interest rate decreases.

### **Granger Causality Test Results**

Granger causality analysis has been performed to observe the causal relationship among the variables. The results of Granger causality are represented in the table.

*Table 10. Granger Causality Test Results*

Pairwise Granger Causality Tests			
Sample: 2000 2017			
Lags: 2			
Null Hypothesis:	Obs	F-Statistic	Prob.
INTEREST_RATE does not Granger Cause UNEMPLOYMENT_RATE	80	0.51392	0.0102
UNEMPLOYMENT_RATE does not Granger Cause INTEREST_RATE		0.91432	0.4052
INFLATION does not Granger Cause UNEMPLOYMENT_RATE	80	0.13740	0.8718
UNEMPLOYMENT_RATE does not Granger Cause INFLATION		0.34622	0.7085
GDP does not Granger Cause UNEMPLOYMENT_RATE	80	1.67179	0.1948
UNEMPLOYMENT_RATE does not Granger Cause GDP		0.47879	0.0324
FDI does not Granger Cause UNEMPLOYMENT_RATE	80	0.23940	0.7877
UNEMPLOYMENT_RATE does not Granger Cause FDI		1.12162	0.3312
INFLATION does not Granger Cause INTEREST_RATE	80	7.53073	0.0010
INTEREST_RATE does not Granger Cause INFLATION		0.81529	0.4464
GDP does not Granger Cause INTEREST_RATE	80	3.78178	0.0272
INTEREST_RATE does not Granger Cause GDP		0.01556	0.9846
FDI does not Granger Cause INTEREST_RATE	80	0.98698	0.3775
INTEREST_RATE does not Granger Cause FDI		0.65279	0.5235
GDP does not Granger Cause INFLATION	80	4.45612	0.0148
INFLATION does not Granger Cause GDP		8.45738	0.0005
FDI does not Granger Cause INFLATION	80	0.41146	0.6642
INFLATION does not Granger Cause FDI		0.22895	0.7959
FDI does not Granger Cause GDP	80	5.17222	0.0079
GDP does not Granger Cause FDI		3.49795	0.0353

Source: Author's work

## ***The Impact of Macroeconomic Indicators on Unemployment Rate***

For the null hypothesis that “interest rate does not Granger Cause unemployment” the p-value is equal to 0.012. We reject this hypothesis at 5% significance level. So it means that interest does Granger Cause unemployment. In the other words, interest rate has an impact on unemployment.

On the other hand, for the null hypotheses that “unemployment does not Granger Cause GDP” the p-value is 0.0062. We reject the null hypotheses at 5% significance level. This means that unemployment does Granger Cause GDP and has an impact on GDP.

Also, for the null hypotheses that “inflation does not Granger Cause interest rate” the p-value is 0.001. We reject this hypothesis at 5% significance level. This means that inflation does Granger Cause interest rate and has an impact on it.

Moreover, analyzing the null hypothesis that “interest rate does not Granger Cause GDP” we fail to reject the hypothesis at 5% significance level with a p-value of 0.98. This means that interest rate does not Granger Cause GDP and does not have an impact on it.

It can be implicated that the results in VAR model correspond with the interpreted results in Granger Causality test.

## **SOLUTIONS AND RECOMMENDATIONS**

This study derives implications for policy makers of the studied region, Western Balkan. These implications include using different policies in order to decrease unemployment rate. The unemployment is a common challenge for the Western Balkan countries and the government faces losses whenever the rate of unemployment is high. This research also includes implications for future scholars. It is a contribution in extending and enriching the existing literature and results on unemployment in Western Balkan countries.

Limitations are part of every research. The limitations of this study are listed as below:

1. Lack of data about Kosovo which is part of the Western Balkan countries, but it could not cover the time period selected for study 2000-2017.
2. Lack of sample size, meaning that data that were selected for the study are given yearly. If the data could have been available quarterly or monthly, the results would have been more precise
3. The macroeconomic variables chosen for this study do not cover all the variables that may affect unemployment rate to exactly explain the unemployment rate in Western Balkan countries.

In order to overcome the problem of unemployment, crucial policy decisions will need to be made to improve the competitiveness of the economy. It is important to facilitate and encourage a faster rate of technological development in the Western Balkans and at the same time to be competent in the export activities which support sustainable economic growth. Additionally, it is important to have educational systems matching the labor market as best as possible. This for sure will drive to a significant increase in employability, a significant support to GDP and a better life of the region.

## **FUTURE RESEARCH DIRECTIONS**

The analyses made in this study suggest that several and more expanded studies can be conducted in the future. Researches of this framework for all developing countries in Europe using the same variables, including a larger sample size could be successfully implied in the future.

## **CONCLUSION**

The countries in the Western Balkan region have among the highest unemployment rates in Europe (Bartlett and Uvalić, 2019). The negative repercussions of high youth unemployment cannot be understated. Perhaps the biggest mistake of the economic model of the Western Balkans is a chronic problem of underutilisation of human resources and the underutilisation of training capacity (Ganić, 2019).

The aim of this study is to study the impact that the selected macroeconomic indicators have on unemployment rate in the region of Western Balkan. We computed several tests in order to satisfy the expectations. The results in Unit Root test showed that the variables are stationary. Having stationary variables allows us to continue in computing a VAR model for the sample of countries. The results from the Vector Autoregressive model represented that from all of the selected macroeconomic variables to be studied, only interest rate showed to have a significant impact on unemployment. Unemployment can be decreased considering the monetary policy that each country implied because the central bank of each country defines the interest rate. Since it is shown that is statistically significant on unemployment, it is an important tool to be used in order to reduce unemployment rate. The reduction on interest rate will consequently motivate more investments bringing more production and a higher demand of companies for workers.

On the other hand, it is of a high importance to mention that VAR model also identifies the relationship of dependent variable on explanatory variables. In our model, as it is expected, unemployment rate basing on VAR model implied that it has a significant and negative impact on GDP. When unemployment increases, it is meaningful to note that the GDP of a country decreases and vice-versa situation.

In the extension of the VAR model it is clearly seen that inflation has a significant and negative impact on unemployment rate. So, when inflation increases, more money tends to move up and down, pushes unemployment rate to decrease, which is a good sign for each country. Also, the increase in inflation rate increases GDP by making the countries better off.

Regarding the Granger Causality tests results, it is clear that interest rate Granger cause unemployment rate. In the other words, interest rate has an impact on unemployment. Moreover, unemployment does Granger Cause GDP meaning that a decrease or an increase in unemployment rate tends to increase or decrease GDP. GDP is also impacted by the fluctuations in interest rate, because interest rate does Granger Cause GDP. Apparently, it can be agreed that the results computed by the VAR model meet the results derived from the Granger Causality test.

Even though in 2016, all Western Balkan countries except Kosovo were classified according to the World Bank Atlas method as upper middle-income countries, the region suffers from very high youth unemployment rates. This points to the inefficiency of labour market institutions in Western Balkan countries, one of the legacies of employee self-management in the former Yugoslavia (Roaf et al, 2014).



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## KEY TERMS AND DEFINITIONS

**Foreign Direct Investment (FDI):** An investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets, including establishing ownership or controlling interest in a foreign company.

**Granger Causality Model:** A way to investigate causality between two variables in a time series. The method is a probabilistic account of causality; it uses empirical data sets to find patterns of correlation.

**Gross Domestic Product (GDP):** The monetary value of all the finished goods and services produced within a country's borders in a specific time period. Though GDP is usually calculated on an annual basis, it can be calculated on a quarterly basis as well.

**Inflation:** The rate at which the general level of prices for goods and services is rising and, consequently, the purchasing power of currency is falling. Central banks attempt to limit inflation—and avoid deflation—in order to keep the economy running smoothly.

**Interest Rate:** The amount charged, expressed as a percentage of principal, by a lender to a borrower for the use of assets. Interest rates are typically noted on an annual basis, known as the annual percentage rate (APR). The assets borrowed could include cash, consumer goods, and large assets such as a vehicle or building.

**Unemployment Rate:** The share of the labor force that is jobless, expressed as a percentage. It is a lagging indicator, meaning that it generally rises or falls in the wake of changing economic conditions, rather than anticipating them. When the economy is in poor shape and jobs are scarce, the unemployment rate can be expected to rise. When the economy is growing at a healthy rate and jobs are relatively plentiful, it can be expected to fall.

**Vector Autoregression (VAR):** A stochastic process model used to capture the linear interdependencies among multiple time series.

## The Impact of Macroeconomic Indicators on Unemployment Rate

### APPENDIX

Table 11. Row Data Used

Year	Unemployment rate	GDP	Inflation	FDI	Interest rate
2000	13.50%	6.90%	0%	3.94%	17.42%
2001	22.70%	8.30%	3.10%	5.10%	15.79%
2002	13.40%	4.50%	5.20%	3.04%	12.59%
2003	12.70%	5.50%	2.40%	3.10%	8.43%
2004	12.60%	5.50%	2.90%	4.67%	9.10%
2005	12.50%	5.50%	2.40%	3.22%	10.10%
2006	12.40%	5.90%	2.40%	3.62%	9.97%
2007	13.50%	6%	3%	6.10%	10.16%
2008	13.00%	7.50%	3.30%	9.68%	8.82%
2009	13.80%	3.40%	2.20%	11.14%	10.00%
2010	14.20%	3.70%	3.60%	9.14%	7.97%
2011	14.00%	2.50%	3.40%	8.14%	9.89%
2012	13.90%	1.40%	2%	7.47%	9.73%
2013	15.60%	1%	1.90%	9.81%	9.58%
2014	16.10%	1.80%	1.60%	8.69%	7.59%
2015	17.30%	2.20%	1.90%	8.74%	7.68%
2016	15.20%	3.40%	1.30%	9.17%	9.89%
2017	15.00%	3.70%	2.10%	8.30%	7.60%
2000	19.10%	3.10%	29.86%	7.80%	1.32%
2001	18.80%	1.10%	23.73%	6.20%	3.56%
2002	18.60%	1.90%	19.70%	5.60%	10.12%
2003	20.90%	2.50%	7.50%	2.89%	8.78%
2004	19.40%	4.40%	3.10%	3.15%	5.12%
2005	19.50%	4.19%	3.45%	22.18%	2.45%
2006	18.40%	8.57%	2.90%	23.07%	1.92%
2007	19.40%	10.66%	4.30%	25.55%	-3.11%
2008	16.80%	3.49%	8.80%	21.45%	1.46%
2009	19.10%	-5.80%	3.50%	37.25%	6.79%
2010	19.70%	2.73%	0.70%	18.32%	7.05%
2011	19.70%	3.23%	3.50%	12.26%	8.30%
2012	19.60%	-2.72%	4.10%	15.13%	9.30%
2013	19.50%	3.55%	2.20%	10.00%	7.17%
2014	18%	1.78%	-0.70%	10.83%	8.29%
2015	17.50%	3.39%	1.50%	17.27%	8.43%

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**The Impact of Macroeconomic Indicators on Unemployment Rate**

*Table 11. Continued*

<b>Year</b>	<b>Unemployment rate</b>	<b>GDP</b>	<b>Inflation</b>	<b>FDI</b>	<b>Interest rate</b>
2016	17.70%	2.95%	-0.30%	5.18%	2.73%
2017	17.70%	2.67%	-0.20%	6.20%	2.80%
2000	32.20%	4.55%	6.60%	5.77%	4.51%
2001	30.50%	-3.07%	5.20%	12.66%	13.97%
2002	31.90%	1.49%	2.30%	2.84%	17.25%
2003	36.70%	2.22%	0.90%	2.41%	14.11%
2004	37.20%	4.67%	0.00%	5.44%	12.62%
2005	37.30%	5.14%	1.30%	2.32%	6.89%
2006	36.10%	5.14%	3.20%	6.23%	7.78%
2007	33.90%	6.47%	2.30%	8.80%	5.39%
2008	33.80%	5.47%	8.30%	6.17%	3.97%
2009	32.20%	-0.36%	0.00%	2.76%	9.74%
2010	32.00%	3.36%	1.50%	3.20%	7.29%
2011	31.40%	2.34%	3.90%	4.84%	4.96%
2012	31.00%	-0.46%	3.30%	3.47%	7.41%
2013	29.00%	2.93%	2.80%	3.72%	3.63%
2014	28.00%	3.63%	0.00%	0.54%	5.93%
2015	28.30%	3.84%	0.00%	2.95%	6.11%
2016	23.70%	2.41%	0.00%	5.04%	0.13%
2017	24.40%	2.38%	0.00%	6.10%	1.20%
2000	12.60%	7.76%	71.10%	0.79%	-40.47%
2001	12.80%	4.99%	19.50%	1.45%	-28.90%
2002	13.80%	7.12%	19.50%	3.04%	1.41%
2003	15.20%	4.42%	9.90%	6.92%	2.56%
2004	18.50%	9.05%	11.00%	3.86%	5.90%
2005	20.80%	5.54%	16.10%	6.01%	2.18%
2006	20.80%	4.90%	11.70%	13.90%	4.19%
2007	18.10%	5.89%	6.40%	10.98%	2.69%
2008	13.60%	5.37%	12.40%	8.23%	4.98%
2009	16.10%	-3.12%	8.10%	6.87%	3.21%
2010	19.20%	0.58%	6.10%	4.29%	10.79%
2011	23.00%	1.40%	11.10%	10.61%	6.90%
2012	23.90%	-1.02%	7.30%	3.13%	11.20%
2013	22.10%	2.57%	7.70%	4.52%	11.00%
2014	18.90%	-1.83%	2.10%	4.52%	12.68%
2015	17.70%	0.76%	1.40%	6.31%	12.94%
2016	15.30%	2.80%	1.10%	6.01%	10.05%

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## ***The Impact of Macroeconomic Indicators on Unemployment Rate***

*Table 11. Continued*

<b>Year</b>	<b>Unemployment rate</b>	<b>GDP</b>	<b>Inflation</b>	<b>FDI</b>	<b>Interest rate</b>
2017	14.40%	1.98%	1.10%	5.87%	9.20%
2000	25.20%	8.30%	8.70%	2.65%	1.32%
2001	27.60%	6.09%	5.30%	2.06%	2.45%
2002	24.60%	2.30%	3.50%	4.03%	7.88%
2003	26.00%	3.50%	0.90%	4.56%	9.87%
2004	28.30%	5.30%	1.10%	8.88%	7.51%
2005	26.00%	5.10%	4.40%	5.56%	5.94%
2006	31.80%	6.00%	8.20%	6.57%	0.83%
2007	29.70%	6.20%	1.60%	11.68%	0.72%
2008	23.90%	5.50%	7.30%	5.26%	-0.20%
2009	24.10%	-3.20%	-0.40%	0.79%	7.90%
2010	27.20%	0.80%	3.10%	2.58%	6.29%
2011	27.60%	1.70%	3.70%	2.53%	4.70%
2012	28.10%	-0.70%	2.10%	2.28%	5.75%
2013	27.40%	0.80%	0.20%	1.72%	7.35%
2014	27.50%	3.00%	0.20%	2.94%	4.78%
2015	44.60%	2.50%	1.80%	2.29%	5.21%
2016	26.00%	2.70%	0.20%	1.61%	4.90%
2017	25.80%	2.90%	1.80%	1.52%	5.20%

(Data Source: World Bank and International Monetary Fund)

# Chapter 10

## USA Economic Nationalism and the Second-Hand Clothes Industry in Sub-Saharan Africa

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### ABSTRACT

*This chapter examines the effects of USA economic nationalism in the second-hand clothing (SHC) industry within Sub-Sahara Africa (SSA). The SHC industry creates an estimated 355,000 jobs in the EAC, which predictably generates incomes of US\$230 million that supports an estimated 1.4 million people. The chapter looks at attempts by Kenya, Ghana, Nigeria, Zambia, and Rwanda, among other Sub-Saharan to curtail SHC to protect their infant or struggling textile industry through subtle economic nationalism policies. It then examines the repercussions of having Rwanda implementing the ban from US market. The study inspects why the Trump-led administration feels that the SHC industry is important to the US. Undeniably, the chapter will put forward a case for banning of SHC and why it is gaining notoriety in the Sub-Saharan Africa region. The chapter finally advises what managers ought to do in the wake of economic nationalism and American only policy in Africa.*

### INTRODUCTION

Chitrakorn (2017) observed that several East African nations moved to curb used clothing imports from the US to support the growth of the local textile industry. This came hot on the heels of a summit of the East African Community Heads of State. The summit, keen on promoting vertically integrated industries in the textile and leather sector, directed the partner states to procure their textile and footwear requirements from within the region where quality and supply capacities are available competitively. They did this with the aim of phasing out the importation of used textile and footwear within three years (2019).

However, this may come at a cost given that USA views such actions as hurting American interest in view of billions of dollars the US is likely to lose. Hansen (2004) believes that the popular media routinely sensationalizes Second Hand Clothing (SHC) imports as destroying garment and textile manufacturing

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in the countries that receive them. The American First Policy however, coupled with tariffs levelled against other products, especially from China, have been viewed as pure Economic Nationalism by other countries. This is why President Trump does not take lightly any retaliation from the said countries that adopt protectionism tendencies against USA products. In fact Evans (2018) explains that while “America First” is Donald Trump’s favorite slogan, a version of “economic nationalism” owes its popularity to the failures of global neoliberal capitalism. It is in line with this that Baughn and Yaprak (1996) propose that economic nationalism is the adoption of an “us first” in the in-group versus out-group distinction relating to companies, products, jobs, and workers. They theorized that the craving to keep economic activities under domestic control encourages those who can play a role in curtailing the influence of foreign business in the domestic economy, to be bold and aggressive.

Evans (2018) explains that “Economic nationalism” has a venerable history and can be traced from Alexander Hamilton to Friedrich List, to their twentieth-century successors in Latin America, Africa and Asia. Many officials in governments across the world have always tried to protect their economies from external shock and financial aggression. This has always been done through protectionism tendencies and economic nationalism. Consequently, Pryke, (2012) specifies that in a way, economic nationalism mean closing off an economy to external influences can be beneficial to growth and fiscal progress and be defined as a mixture of trade protectionism and economic planning.

In recent years the business climate around the world has been relaxed to encourage inter country trading and Foreign Direct Invest (F.D.I). Without a doubt the philosophy of economic nationalism has a definite concentration on safeguarding of the national economic autonomy. The emphasis is then the concept of protecting the domestic economy from the influence of foreign firms or products. Consequently, economic nationalism gives credence primarily to economic practices (selling, advertising, consumption etc.) as key markers of nationhood (Castello & Mihelj, 2017). Although in some quarters, economic nationalism is misinterpreted as anti-globalization and isolation, which can be self-defeating for a nation in the hyper-connected world economy. Such a view is not only detrimental but obstructive. It therefore serves some credence in this discourse to give economic nationalism a proper definition:

*Economic nationalism is a set of policies that emphasize domestic control of the economy, labour, and capital formation, even if this requires the imposition of tariffs and other restrictions on the movement of labor, goods and capital. Labeş & Cuza (2001).*

“As a set of state practices, policies and strategies, often in concert with private capital and politically supported generally by organized labor to protect and promote national economic interests such as improving wages and incomes, fostering national competitiveness, promoting national champions. (D’Costa, 2012).

Okur (2007) swiftly clarifies that in Economic nationalism, national and corporate interests tend to converge as one point. For instance, when a company wants to sell abroad ‘critical’ products and technologies, although their trade within the territorial boundaries of nation state no scrutiny is involved, outside the nation’s borders such moves invite state involvement. For example, he observes, when Boeing applies a new technology to its planes it only observes legality and rules within the American market. On the other hand, if Boeing tries to transfer the same technology to a Chinese market, it becomes subject to approval of security institutions of state. Such acts of domination led to Wei and Liu (2001) to proclaim that economic nationalism is a result of and a response to the age of imperialism, modernization, and

globalization, propelled by economic activities and competitions across national borders, leading to the consciousness and actions to protect national economic interests.

## **Motivations of Economic Nationalism**

The political basis for economic nationalism finds its justification in the conduct of many foreign firms in different host countries (Akhter, 2007). Han, (1988) postulated the operant belief is that increasing international trade may jeopardize the survival and growth of some domestic firms and vitiate the pursuit of domestic economic well-being. Akhter, (2007) explains that the economic basis for economic nationalism ultimately rests on the desire to protect domestic business interests. Labeş and Cuza (2001) then insist that an economic nationalist nation will generally support any move to make use of domestic production instead of imported goods and services to meet domestic consumption. Economic nationalism is used a response to the fear of losing control of domestic businesses to foreign firms (Miller, 1990; Reich, 1991). The economic nationalism notion acts as both a balance to, and an opponent of the concept of globalization, in which all nations are regarded to be economically interdependent (Labeş & Cuza 2001).

Carreyrou et al. (2004) admits that governments can also oppose takeover bids of domestic firms. The French government, opposed Switzerland's Novartis bid for Aventis, a French drug maker, on grounds of national interest and the acts of France's enforcing a merger between Suez SA and Gaz de France SA to prevent a takeover of Suez by an Italian firm Enel SpA. Spain also blocked a bid by the German energy giant E.ON. These are clear examples of such trends in the economic nationalism (Akhter 2007). Similar collective strategies exist in Germany. For example, the Deutsche Bank group intervened on behalf of the Germany economy to buy Mercedes-Benz's shares when Arab investors threatened to take it over (Opati 2017). Beck (1996) then calls for the rise of sub-politics, a new frame of reference for politics both beyond and underneath the political institutions of nation-states, involving individual participation that bypasses traditional channels of representation and the borders of states.

Labeş and Cuza (2001) indicate that in many cases, economic nationalists oppose globalization or at least question the benefits of unrestricted free trade. Baughn and Yaprak (1996) argue that economic nationalism is frequently confused with other associated, but conceptually different terms such as nationalism, patriotism, ethnocentrism, and consumer ethnocentrism. They are compelled to admit that economic nationalism does not go beyond expounding on the "economic practices and policy measures perceived as nationalist."

Okur (2007) puts forward a case of the Russian and Chinese, instrumentalization of corporate power in the service of state's geopolitical needs taking a more direct form. For instance, the Russian state-owned natural gas company Gasprom, effectively took advantage of Ukraine, Belarus and Georgia's energy dependency by raising gas prices during political crises. In China on the other hand, despite its gigantic corporations operating the world over, it still created a state-owned investment agency (Okur 2007) to champion the states interests across the globe.

One of the ways protectionism and imperialism's system are perpetuated is by forcing cultural and political institutions to adopt the language and practices of the market as indicated by Castello and Mihelj (2017). Such processes lead governments to behave as corporate actors who use the national brand to sell goods and services in order to boost the national economy. Akhter (2007) discloses that when such expectations and beliefs stumble on the knowledge that domestic resources, industries, and jobs cannot be protected, then they rely on the involvement of the domestic government and businesses and the public to safeguard their interest. Okur (2007) gives an example: in the U.S., the most visible



examples of economic nationalism in the form of protectionism on grounds of security are the congressional opposition to the takeover bid of Chinese Petroleum Company CNOOC by Union Oil Company of California (Unocal). Similarly, the refusal to sell port management businesses in six major U.S. seaports to DP World, a company based in the United Arab Emirates is another example.

## **The Second-Hand Clothing Industry**

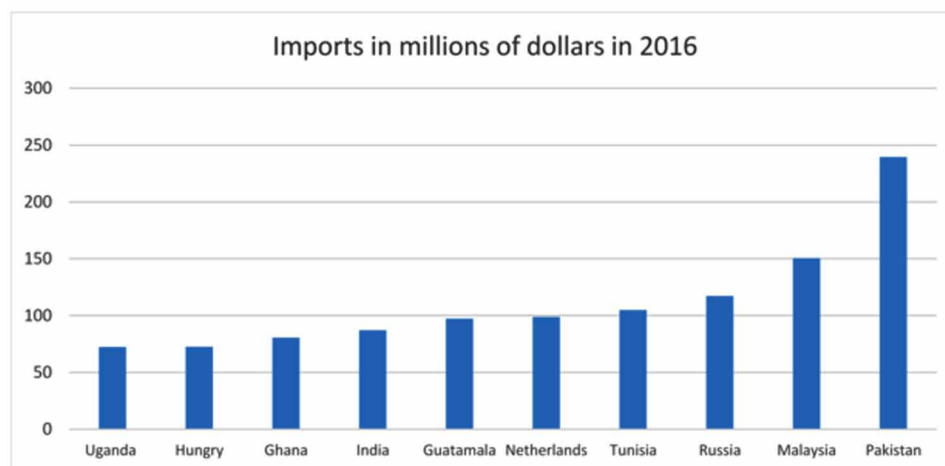
Chitrakorn (2017) indicates that millions of people around the world donate clothes annually with the understanding that these clothes will be freely given to the needy. This however, is mainly a thinly veiled truth. Going by statistics, the SHC (second hand clothes) is a big business with massive employment records within the exporter, importer, and charity industries. Gittleson (2018) confirms this by the data he sanctions; the imports of the worldwide SHC stood at 1.1 Billion US dollars in 2016 while the value of top ten exporters stood at 2.7 Billion US dollars according to the United Nation.

The US is the largest exporter of used clothes with statistics indicating that in 2016, the country exported 575.5 Million US Dollars' worth of SHC. Nevertheless, most of these clothes are resold in second hand stores abroad and mostly they find their way in developing countries such as in Africa, and Asians countries (See Figures 1 & 2). Most of the donors do not understand that SHC is a multi-million dollar industry. They are ignorant of the facts that their clothes do not benefit the needy, but they are sold in local markets, in the developing world with 70 percent of these global donations ending up in Africa (Cline, 2012).

Katende-Magezi (2017) then determines that consumers in the developed world have found themselves with more clothing than they need, with a purchase going out of style in a matter of weeks. Since they can readily afford to buy new clothes, they get rid of outgrown, unfashionable or worn out garments and discard them as waste, or dispose of them for recycling or donate them to charities (Cline 2012).

*Figure 1. Value of exports of second hand clothes in millions of US dollars in 2016*  
*Source BBC (2018).*

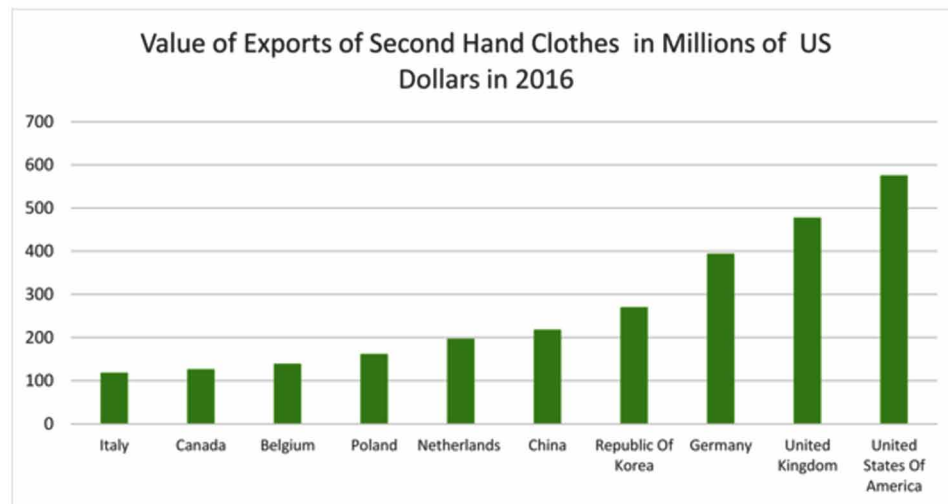
**Figure 1; Value of Exports of Second Hand Clothes in Millions of US Dollars in 2016**



**Source BBC (2018).**

Figure 2. Value of exports of second hand clothes in millions of US dollars in 2016  
Source BBC (2018).

**Figure 2; Value of Exports of Second Hand Clothes in Millions of US Dollars in 2016**



Source BBC (2018).

It is Baden and Barber (2005) who stipulate that the SHC trade tends to represent less than 0.5 per cent of total value small proportion of the total global trade in clothing but the within the Sub Saharan Africa these are figures gigantic. It is irrefutable that clothing consumption all over the world has increased over the years principally due to the fast-changing fashion trends and the existence of cheaper clothes with reduced quality (Katende-Magezi 2017). SHC still remains a dominant feature of the clothing market (more than 30 per cent of the total value of imports and much more than 50 per cent in volume terms (Baden & Barber 2005)).

### Value Chain of Second-Hand Clothes

Second-hand clothing (SHC) mainly emanate from donors in the West who give them out for charity. The clothes, which start out as donations, are then commercialized by particular companies and legally sent to their export destinations as formal trade from one country to another. Cline (2012) postulates that undoubtedly the overwhelmingly supply and demand of these SHC from developed countries creates the need to transfer the clothes and shoes, as donations, to developing countries.

The journey begins when clothes are discarded, not being sellable in charity shops, such as Salvation Army or Oxfam. In the USA for example, one large company sorts used clothes in more than 400 different categories (Rivoli, 2005). These are then packed into 45-55kg bales of the same kind. The bales are next loaded into containers and shipped overseas (Brooks, 2012). It is subsequent that commercial companies abroad take over the distribution as they sort them into different sets for export (Katende-Magezi 2017). Others are sold to textile merchants, who sort, grade and export the garments, converting what began as donations into tradable goods (Chittrakorn 2017).

This sorting process involves first dividing the clothes into rags, clothing, and fibre, and then these are further classified according to the type of product (Katende-Magezi 2017). Currently, only 20 percent of the clothing donated to charities actually gets sold there, according to the Council of Textile Recycling. The rest goes into landfills — despite the fact that most textiles aren't biodegradable, which means they can sit around for more than 200 years.

## **American vs. Textile Industry Protectionism**

Petersen, Schoof, and Yalcin (2017) posit that one of the core messages in Donald Trump's election campaign was the isolation of domestic markets from competition abroad. After his inauguration in January 2017, he followed up his campaign promises with action. Notably, one of his first acts in office was to issue an executive order to suspend the Trans-Pacific Partnership (TPP). This move threatened to tear up the North American Free Trade Agreement (NAFTA). Trump later sought also to renegotiate the US-South Korea free trade deal. For Trump, the goal of his protectionist measures is to secure jobs and income in the United States and to reduce the high current account deficit in the United States (Petersen, Schoof, and Yalcin 2017).

The Second Hand Clothes market has become a very important one to the USA economy despite its perceived status to be less of a trade. This trade has an intrinsic worth of \$147 million (the value of used clothing and footwear market (via both direct exports from the USA as well as indirect exports via third-country markets) and it employs an estimated 40,000 working class Americans, with an additional 150,000 indirect jobs in the charity sector. Given that the Sub Saharan Africa is a strategic location for USA to conduct its commercial and military activities the apprehension about increasing the SHC taxes is bound to irritate the USA, given that the trade has grown more than ten-fold since the early 1990s (United Nations 2008).

The USA has an unquestionably long-standing trade deficit in textiles and apparel, with an exception of SHC. The total value of these exports in 2006 was \$28 million and by 2012 had risen to \$64 million, with these exports surpassing U.S. imports of worn clothing and other worn textile articles by \$27 million in 2006 and by \$63 million in 2012 (Research Education and Economics Information System REEIS – United States Department of Agriculture USDA). As a matter of fact, the United States is the world's largest exporter in terms of volume and value.

The US has been a leading producer of used clothing exports but interestingly low-income countries are both the main source of U.S. textile and apparel imports and the main markets for U.S. exports of worn clothing and other worn textile articles (REEIS–USDA n.d.). Thus, the move by East African states to ban SHC tread on the risk of being blacklisted by President Donald Trump given his stand on Economic Nationalism and America First policy. The US government could respond to such a stance by withdrawing of African Growth and Opportunity Act [AGOA] initiative for the East African Community countries. In fact Chittrakorn (2017), hypothesizes that the US may eventually withdraw, suspend or limit AGOA to these countries if they implement the proposed tariffs before it expires in 2025 — all of which would have a significant impact on the EAC. US lobby groups strongly object to the EAC's import ban and proposed tax increases. They maintain that the 40,000 American jobs would be at risk should the ban enter into force. Further, AGOA, already signed by several African countries, stipulates, among others, that African countries must eliminate barriers to US trade and investment (Kuwonu 2018). With a combined 36.1% of the global share, the United States, the United Kingdom and Germany were the top three used clothes exporters in 2015. Kuwonu (2018) reveals that The United Arab Emirates (7.3%),

Pakistan (5.0%) and India (4.4%) were the top importers, while Kenya, a distant 12th in global ranking, was sub-Saharan Africa's top destination with 2.2% (US\$95 million) of global import

Another compelling reason why the US identifies Second Hand Clothes market in East Africa as an important one, is the elimination of textile waste in the USA. Supremely the USA uses SHC to avoid textile-waste diversion from the landfills located in many rural areas – a backbone to agriculture and rural life in the United States. The landfills are costly to operate, mostly with tax dollars, and are quickly filled to capacity.

Watson, et al (2016) explain that in annual Nordic exports of 75,000 tonnes of used textiles are estimated to give an annual net saving of 193,000 tonnes carbon dioxide (CO<sup>2</sup>). This is an equivalent of greenhouse gases and 72 million cubic metres of water use, and a host of other environmental benefits. This goes to show that dumped used clothes have a devastating impact on the environment over time. Chitrakorn, (2017) explains that, of much surprise is that the average American throws away 70 pounds of textile waste every year, according to the Council for Textile Recycling, so diverting used clothing away from landfills and giving it a new life may seem like a good idea for the American economy. The findings of (Watson, et al., 2016) explains that the benefits arise because the impacts caused by the transportation and processing of used textiles were found to be small in comparison to the savings caused by offsetting new textile production.

In the US alone landfills come about because textile waste is of gigantic quantity. For instance, 13.1 million tons of textile waste was generated in the United States in 2011, of which 31% was recovered for export or reprocessing (REEIS – USDA n.d). This is despite conservative estimates for the degree to which sales of used textiles offset production of new textiles. As such, the benefits as Watson, et al (2016), continue to explain are far higher than would have been achieved if the textiles had remained in Western countries. In this case then, the most likely fate would be incineration; domestic markets currently don't exist to reuse or recycle 75,000 tonnes of additional used textiles.

These textiles ideally are supposed to be kept from landfills, partially because many today are made of non-biodegradable materials. Used textile goods that are too worn or stained for further use in their original form can be reprocessed by textile recycling companies for uses such as wipers and insulation. Used textile goods still useable in their original form have ready markets in low-income countries and some developed countries. In the U.S. curb side pickup of used textile goods is far less common than that of glass, plastic, and paper; however, some localities have partnered with Goodwill Industries to minimize textile waste going to landfills by facilitating consumer recycling of textiles in collection bins placed in convenience centres (RE EIS – USDA n.d).

## **CHINESE FACTOR**

The Chinese have made a foray into the Horn of Africa, by a four-pronged approach, which is also strengthened by the Belt and Road Initiative [BRI] (CRU Policy Brief 2018). The textile industry is no exception given that the Chinese are targeting each and every sector to penetrate Africa. Launched in 2013, BRI involves underwriting billions of dollars of infrastructure investment in countries along the ancient Silk Road, linking it with countries in Europe, Asia and Africa (CRU Policy Brief 2018). Ideally, the Global business has been dominated by the America-centered liberal world order but in recent times, the re-emergence of China has been a cause for concern especially for the USA (Graaff & Bastiaan, 2018).

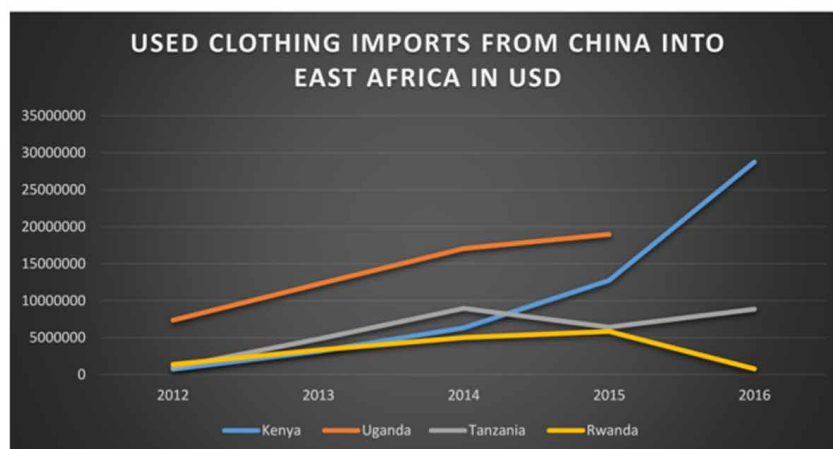
China is seen as a potential lever to upset the America dominance in the market. Schweller and Pu (2011) find it conceivable that China will come to act as what has been called a ‘spoiler’ of the system, seeking to overthrow the rules-based liberal world order. With the rise of Trump protectionism and perceived Western countries bullying of African countries, African nations who have little power to retaliate, align themselves with China. The impact of competition from China in third-country markets on poverty and livelihoods is very substantial (McCormick & Morris 2010). In this light, Layne (2016) argues that while some realists view American decline as inevitable and advocate accommodation to China’s rising power, most argue that the United States should and will resist this challenge by pursuing a ‘containment’ strategy, leading to a new Cold War or even open military conflict (Mearsheimer, 2010). Some of this is positive, insofar as reduced prices of clothing imports enhances the consumption power of consumers (McCormick & Morris 2010).

Trump’s protectionism is inspired not only by economic and ‘national security’ reasons, which may be allowed for by WTO regulations, but also by considerations to enforce good conduct of trading partners in order to ‘make America great again’ which are obviously illegal according to WTO rules (Associated Press 2018). The concerns are whether Chinese foray into the African Market will affect the USA dominance into the region. China’s entry into Africa has also some significant negative impacts. With minimal backward linkages into textiles, the major conduit for income-dispersal in the clothing industry has been through direct employment (McCormick & Morris 2010). The growth of Chinese clothing, both new and imported has been on the rise (the following diagram can explain the trend).

The economic reason comes in third. Chitrakorn (2017) claims that the SHC industry secures 40,000 jobs and any encouragement to ban it puts these jobs in jeopardy. As such, the US Trade Representative (USTR) has threatened to impose trade sanctions on African nations and launched a review of AGOA, a trade agreement that allows tariff-free access for thousands of goods from 38 African nations to the US.

*Figure 3. Clothing imports from China into East Africa in USD*  
Source BBC (2018).

**Figure 3; Clothing Imports from China into East Africa in USD**



Source BBC (2018).

With increase in clothes imports from China, Trump’s hostility towards Rwanda can be seen as a way of the US using proxy wars to keep in check Chinese dominance in East Africa. There has been a surge of new, cheaper Chinese clothes and an avalanche of Chinese SHC. It is easy to admit that in the past several years, China has become exceptionally active in Africa, with a stream of high-level visits, large commitments of loan capital, extensive investment, and a general currying of African favour. China’s surge into the continent cannot be underestimated. The following data explains China’s inroad in East Africa in SHC for over the span of five years.

Some see China as a strategic threat, seeking to “lock up” access to vital natural resources such as oil, minerals and timber, and to undermine traditional Western influence. Others reject the idea of a strategic threat, but acknowledge China as a formidable competitor for both political influence and commercial advantage. What is perhaps most striking is that while China has a fairly clear and comprehensive strategy for Africa, with significant implications for U.S. interests, the U.S. does not have a similarly comprehensive response.

### **Overview of Sub-Saharan Second-Hand Clothes Market**

Masquelier (2013) indicates that almost anywhere in Africa, young people use SHC in creative outfits inspired by international performers and media. Contesting at least temporarily, prevailing dress norms Africa’s clothing markets show considerable regional variation. Chitrakorn (2017), however, observes that in the Muslim-dominated North Africa, SHC constitutes a smaller portion of total garment imports than in Sub-Saharan Africa [SSA]. Chitrakorn continues to point out that the dress conventions differ in Africa not only in terms of religious norms but also by gender, age, class, and region/ethnicity. Christians in Africa tend to be more fashion conscious than Muslims while the young urban more explicit in fashion consciousness than the rural fold and the old. These factors consequently, taken together, inform the cultural norms of dress practice, influencing what garments which people will wear, and when (Chitrakorn, 2017).

Kuwonu (2018) specifies that Second Hand Clothing (SHC) known in local language as *mitumba* (“bundles”) in Kenya, *obroni wawu* (“dead white men’s clothes”) in Ghana and *salaula* (“select by rummaging”) in Zambia, over years have been imported as used clothing from USA. In Rwanda Chitrakorn (2017) explains the clothes are christened “chagua,” It is thus evident that most African languages have a word for the piles of discarded garments that end up for sale across the African continent depicting an attitude in which SHC are looked at . However, to think that SHCs are associated with the poor in Africa is misleading. Hansen (2014) confirms that nowadays used clothing has lost some of its association with

*Table 1. Used clothing imports from China into East Africa in USD*

<b>Used Clothing Imports From China Into East Africa in USD</b>					
	2012	2013	2014	2015	2016
Kenya	723513	3164040	6350692	12754976	28757351
Uganda	7367290	12246206	17068501	18972539	
Tanzania	949833	4821660	8970871	6439968	8865814
Rwanda	1404255	3350048	5017114	5866475	800572

Source BBC (2018).

thrift and charity and attracted fashion-conscious consumers looking for vintage or specific period dress, in quest for distinct garments to complement existing outfits or clothing that make them stand out against the uniformity of brand name apparel in the sub-Saharan market. Kuwonu (2018) points out that in Africa these clothes have been frequently blamed for the low-level of domestic apparel manufacturing in Africa.

Chitrakorn (2017) nonetheless explicates that the trade deficit for many African countries is already stark. Imports from Rwanda, Tanzania and Uganda to the US totalled \$43 million in 2016, while US exports to the same countries amounted to \$281 million, according to figures from the USTR. Currently, more than 66,000 jobs in Kenya are linked to AGOA, which earned the country 35.2 billion Kenyan Shillings (about \$341 million) in textiles and apparel exports in 2016 (ibid).

Velia et al., (2006) point about having few major importers of used clothing does not seem to explain the section about importing disproportionate high volumes of SHC imports. Ghana, Benin, Tanzania, Kenya and Uganda each absorbed between 2% and 4% of world exports and combined, 62% of SSA's imports of used clothing between 1999 and 2003. Concerns are rife that used clothing in good condition, which enter the supply chain as a donation, undercut new clothes produced locally. To this point, the governments of the East African Community (EAC) — the regional organization that comprises of Kenya, Rwanda, South Sudan, Tanzania, Burundi and Uganda — want to outlaw all second hand clothing imports by 2019, in a bid to boost domestic manufacturing (Chitrakorn 2017).

Baden and Barber, (2005) perceive that SHC has clear consumer benefits in countries with low purchasing power, and for poorer consumers, though in many sub-Saharan African countries it seems that almost all socio-economic groups are choosing to buy SHC. Rivoli (2014) reports that than more than 30 countries worldwide effectively banned the importation of used clothing, with Botswana and Malawi having outright prohibitions and Ethiopia and Morocco having impenetrable bureaucratic walls. Watson et al (2016) notes that Malawi as a country found that 1% of the imported textiles imported from Europe ought to be rejected. These rejects, however, are used for clothing repairs or cut into industry wipes within the country.

Therefore Malawians progressively reduce prices for clothing in the shops over the space over a one or two-week period until a fresh load arrives. This move is aimed at maximizing sales, ensuring that there are minimal non-sold goods. Unsold goods will again be used for repairs for example by roadside seamstresses in the main cities (Watson, et al (2016).

Crowe (2014), agrees that in Kenya discussions vary as to whether second hand clothes undermine Kenya's own garment makers as some industrialists purport. This is because it is perceived that Africa's infant industries rely heavily on foreign trade in view of its limited local and regional markets. Intra-African trade accounts for far below 20% of total African foreign trade (Kohnert 2018). Crowe (2014) then reveals that Kenya imports about 100,000 tons of second hand clothes a year, providing the government revenues from customs duties and creating tens of thousands of jobs. It also offers quality clothes to Kenyans, many of whom earn less in a month what a pair of new Ralph Lauren khakis costs in the West.

Kuwonu (2018) revisits the Uganda altercation with US. He points out that the Ugandan government took a decisive position to protect its local textile industries and would not bow to pressure, locally or internationally, to remove the taxes on used clothes. In fact, in 2016, Uganda increased an environment levy on used clothes from 15% to 20%, (Kuwonu 2018).

The West Africa region draws a peculiarity when it comes to distinct regional dress styles. They tend to pick products of long-standing textile crafts in weaving, dyeing, and printing. This practice co-exists with dress styles introduced during the colonial period and after (Chitrakorn, 2017). Ghana strives to

*Table 2. Second hand clothing imports value (000) USD –EAC region*

Second-Hand Clothing Import Value (000) USD - EAC Region				
Year	Kenya	Tanzania	Uganda	Rwanda
1997	11,402	18151	19467	7190
1998	34,003	30270	20458	6295
1999	31814	26682	20570	7954
2000	30836	34783	17927	
2001	39595	32790	21908	7029
2002	28949	34051	24448	7816
2003	26119	30217	23260	9455
2004	31817	31806	27066	9641
2005	27979	26090	26161	8065
2006	38341	27595	24530	103859
2007	47283	32870	25576	11264
2008	51938	36267	31555	21340
2009	58256	38712	30574	12978
2010	82096	48826	37811	12474
2011	76144	57455	44012	15827
2012	97699	62914	51559	20921
2013	95244	61652	61400	20027
2014	98410	74603	70105	23534
2015	101077	62730	66879	27151
2016	124644	61809		17605

Source BBC (2018).

have a national identity through clothing, and this has been the drive to mobilize campaign for local clothing and textile consumption.

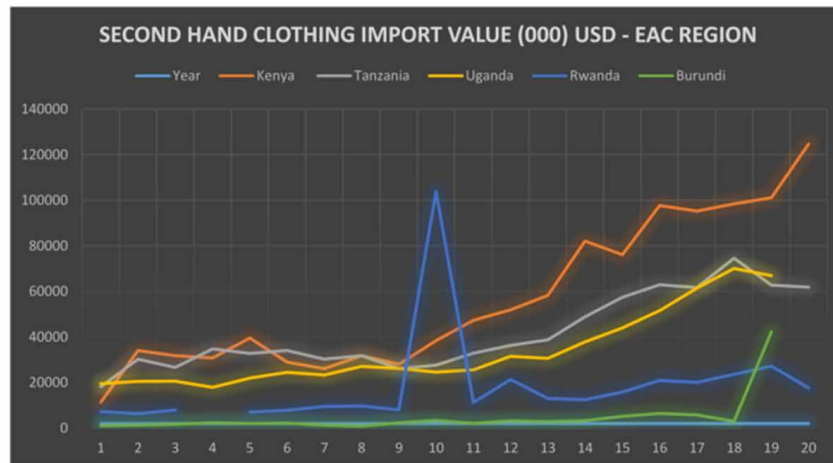
Wahabu (2017), argues that whether Ghana’s nationalist policy is as a result of the resentment of globalization or a product of the anti-globalists or a culmination of local interest protectionism, it is a point we have to belabour. In Nigeria and Senegal, and much more of Western African countries second hand clothing has entered a specific niche. Despite having people from different socioeconomic groups, it’s not just the very poor that purchase imported SHC and use it for everyday wear. For special occasions, Senegalese and Nigerians commonly follow long-standing regional style conventions, dressing with pride in locally produced cloth in “African” styles not a domain of imported SHC (Chitrakorn, 2017).

Watson et al (2016) give an impression that locally in Nigeria used textiles are on the list of products that are absolutely forbidden according to the Nigerian Custom Service. This came into force when the federal government imposed a textile import ban in 2010 to protect local industries. However challenges of enforcing it are enormous with the listed items being smuggled in, badly impacting the nation’s economy. Nigeria’s faces these challenges from neighbouring countries Benin and Togo being notorious for the volumes of imported worn textiles. Watson, et al (2016) lament that the factories the Nigerian ban was designed to protect have either become moribund or have completely shut down, rendering thousands jobless.



Figure 4. Second hand clothing import value (000) USD-EAC region  
Source BBC (2018).

Figure 4 ; Second Hand Clothing Import Value (000) USD-EAC Region



Source BBC (2018).

Ghana sought to maintain its drive for local clothes not through direct economic nationalism but through driving a policy that is meant to induce the local purchase. To end this, Ghana adopted the slogan “buy Ghana, build Ghana”, culminating in the country adopting the Made-in-Ghana Policy (MIG) in 2016. The move was meant to spur a demand-driven policy to increase the patronage of indigenous goods and services and increase without upsetting imports by encouraging the locals to patronize local goods and services. This strategy was also grounded on ‘moral persuasion and encouragement’ than a forceful one to its citizens to support Ghana’s economy.

Wahabu (2017) observed that for years the country had adopted a neo liberal approach towards the economy. Its neoliberal policy practice has for now been challenged by Ghanaian elites who insist on promoting campaigns to favour national products over foreign ones. However Baden and Barber, (2005) indicate that over 90 per cent of Ghanaians purchase SHC as affordability is the main reason why people buy these goods. The buy Ghana campaigns has seen the adoption of the ‘National Friday Wear programme’ launched by ex-president John Agyekum Kufour (2000-2008), as part of efforts to spur the needed interest in Ghanaians to patronise locally produced goods, most especially African prints. Asiedu, (2013) describes the motion ‘wear indigenous prints’ as that will preserve ‘our identity’. Ironically Fashion and consumer preferences also seem to be shifting away from traditional, ‘African’-style to more ‘Western’-style clothing.

Down South Chitrakorn (2017) explains that Zambia SHC market brings a different dimension. He explains that given such textile hardly existed in the pre-colonial period but is prevalent today due to economic reasons. Today people from across the socioeconomic spectrum except the top are dressing in the imported used clothing. However, Watson, et al (2016) explain that Zambia’s neighbour Zimbabwe passed a high tax tariff regime for used textiles that effectively acts as a ban. Consequently, problems with illegal import are reported and there is an on-going discussion about the possibility for deregulation.

Klopper (2000) revisits the story of how South Africa chose a different path as they adopted invented dress traditions. President Nelson Mandela's Indonesian-inspired brightly patterned shirts, worn without tie and jacket, quickly became part of local fashion as "Mandela shirts" which were adopted in the neighbouring countries as well. Grabski (2010) explains that imported second hand clothing in South Africa plays an active role in this process by providing stylistic components that are incorporated into new tailor-made designs.

## **Rwanda vs. USA**

In Rwanda, the stand towards SHC has brought about a trade altercation with USA. Rwanda blames used clothing – which mainly comes from the US – for undermining the development of its local textile industry consequently in 2016, Kigali raised tariffs on the importation of second-hand clothes, disrupting a multi-million dollar industry and setting it on a collision course with the United States (Capital News, 2018).

Tara (2018) reminds us that the Rwandan textile market is bogged down by decades of mismanagement, instability, the market liberalization of the 1980s and the subsequent global competition with cheap Chinese imports and overstocking African markets with used clothing from overseas bringing African local textile industry to its knees.

Crabtree (2018) reports that it was prudent that Rwanda increases duties by 20 cents to \$2.50 per kilogram to counter the surge of local SHC from USA and the like. To add insult to injury, Kuwonu (2018) explains that in 2018 Rwanda started taxing imported used clothes at \$4 per kg—it will be \$5 per kg given that in 2016 the tax was \$0.20 per kg. In response, a U.S. trade group filed a complaint, claiming that the new tariffs violate the terms of the African Growth and Opportunity Act, which requires participating countries to reduce trade barriers for U.S. goods (Harris 2018).

Crabtree (2018) divulges that the U.S. issued a 60-day notice period for Rwanda to reduce its tariff on imported used clothing — or face the consequences. Upon expiry of the notice, the USA retaliated by suspending the application of duty-free treatment for all apparel products from Rwanda. Although Rwanda stands suspended from duty-free benefits that came under the AGOA, it is eligible to receive non-apparel benefits available under the measure (Capital News, 2018). If it spreads to the other East African Nations, USA may have to review the AGOA pact with Rwanda, Tanzania and Uganda who have shown the vigour of implementing the ban (Kuwonu 2018). The other East African States rescinded their ban of SHC from USA but Rwanda did not making her to be seen as a lone ranger in her bid to promote local textile by banning SHC from USA. Consequently 2016 its imports of used clothing dropped by a third (Capital News, 2018).

Pundits have expressed fears that eventually the U.S, under President Trump may retaliate by filing a petition to reconsider the general EAC Partner States' AGOA eligibility should the EAC take an explicit decision to ban used clothing imports or de facto limit imports via non-tariff barriers. However, Petersen, Schoof, and Yalcin (2017) warn that the Trump protectionist policy would cause great economic damage to the US should these countries adopt protectionist policies. The suspended SHC accounted for around three percent of Rwandan exports to the US in 2017, valued at \$1.5 million (Capital News, 2018).

Harris (2018) avers that the Trump administration cannot claim to be protecting a vital American industry. The complaints by the used-clothing association— that Rwandan tariffs would have a negative impact on up to 40,000 U.S. jobs— are unsubstantiated. Rwanda, a country of approximately 12.5 million people, imported \$17 million in used clothing in 2016, according to the U.S. Agency for International Development (Harris (2018)). Though the US maintained that the 40,000 U.S. jobs would be negatively impacted, as well as tens of thousands of jobs in the East African countries themselves, should an embargo be put in place (Crabtree 2018).

Kenya, Tanzania and Uganda have since backed away from the tax hikes following a U.S. threat to limit the benefits accrued from their membership of the AGOA — the U.S.’ main trade legislation for Africa which permits duty-free U.S. imports on 6,500 goods (Crabtree 2018). Kohnert (2018) explains that The Pan-African Free Trade Agreement (CFTA) that was recently negotiated on a special AU summit in Kigali (Rwanda, 21 March 2018) by 44 African states is not likely to change this situation in the foreseeable future. However, it is prudent for managers to examine the preliminary impact of such agreements on their organizations and how they need to align themselves to derive benefits from such.

Banning used clothes is not enough to build Rwanda’s domestic textile and apparel industry, especially given competition from cheap Chinese imports of ready-made clothing Harris (2018) interjects. Reactions in the U.S. have varied. Bloomberg Economics’ estimates that USA economic nationalism tendencies may cost 0.5% of global GDP by 2020 or to put it into perspective, that is about \$470 billion — roughly the size of Thailand’s output (Bloomberg Economics 2018).

The mass influx of cheap hand-me-downs from Western countries has had a negative impact on local apparel industries and production in low-income countries. Countries eager to sustain local textile manufacturing industries are trying to ban used clothes imports, but exporters are pushing back, arguing that any such ban violates international trade agreements (Kuwonu 2018). Consequently, the impact of SHC is not just about the degree of job loss, but the nature of the jobs, which have gone (McCormick & Morris 2010). It is then not clear whether in the absence of SHC in Sub Saharan African countries can improve the local textile/garment production or increase employment through such economic nationalism tendencies. Of particular concern is the dumping of cotton on international markets. This already has a negative impact on 10–15 million small farmers in the region (Oxfam International (2002, 2004).

While initial data suggest a limited direct impact of SHC trade on informal sector production, as this is the largest informal employment sector in many African countries — these impacts need to be closely analysed and monitored over the long term. However, it remains to be seen if Africa can create or revive local manufacturing industries —, which collectively could double from \$500 billion in 2016 to \$930 billion by 2025, while spending by African consumers and businesses could reach \$5.6 trillion over the next decade, according to McKinsey & Co.

## **Implication to Managers**

Economic nationalism can co-exist with globalization because economic nationalistic policies can be used to manage the globalization processes to an organization’s own advantage. Moreover, globalization can be leveraged as a means to serve the developmental needs of a country using economic nationalistic policies to have access to foreign capital, expertise and markets leading to export-oriented domestic industries. Managers need to understand how to tap into the policies that give them full advantage to push their business forward. The aptitude to conduct realistic and effective scenario planning and stress

testing will be indispensable for any international business planners in the light of growing hostile global economic nationalism.

As global business activities are becoming more integrated, the rise in economic nationalism can prove highly disruptive to multinationals' value chain and marketing activities. It is therefore essential for managers to follow through and identify political candidates with potential hurtful promises and prepare thoroughly for any eventualities in case of an election. Economic nationalism can be misinterpreted as anti-globalization and isolation, which can be self-defeating for a nation in the hyper-connected world economy. However, companies and business entities that find themselves caught between the web of the confrontation between countries need to identify gaps that can be used to their advantage.

The complexity of economic nationalism lies in preserving self-interest and promoting international economic partnerships. It can thus be used to promote the industries in a nation to grow and expand beyond its national borders to become global. Economic nationalism can be associated with context-specific economic policies including support for economic liberalization and globalization where free minds with entrepreneurial skills and agility thrive. Certainly it is likely that SHC can displace new clothing imports to third world countries, particularly from Asia and especially China, - a source of cheap new products. If such trends of protectionism continues to gain momentum, managers in export/import business, need to evaluate strategy to counter aggressive or over protective protectionism mechanism.

Parts of Sub-Saharan African countries along with governments in other parts of the world inhibit imports of used textiles via bans, restrictions or prohibitively high taxes. Such restrictions may be a sticking plaster rather than a real solution to the decline in local industries. For instance the ban in South Africa has not stemmed the decline in the domestic industry. Imports of new clothes to South Africa per capita are ten times higher in value than total imports of new and used to the other mentioned countries and growing rapidly. Bans and restrictions on used textiles can also have negative side effects. Subsequently trade can shift to illegal pathways leading to an associated loss of revenue in the form of import duties. They can also damage what many governments have appreciated as an important poverty-reducing activity; it is relatively easy to start-up as a market trader in second-hand clothing and the sector in Sub-Saharan Africa.

The impact on domestic textile industries could instead be reduced by focusing on production for the export market, by specializing in particular types of textiles and by investing in modern equipment and processes to allow the industry to compete on global markets. This will require significant investments that, in developing countries, may need to be attracted from elsewhere. Corporate leaders must then contemplate how to reassess existing activities and examine new opportunities in light of the rapidly changing global business climate with rise of Economic nationalism, i

Managers in all sectors must place renewed emphasis on strategic planning and forward-looking risk management—at all phases of the trade and investment process. Being 'reactive' is no longer sufficient. Corporate managers must consider how to re-evaluate existing activities and analyse new opportunities in light of the rapidly changing global investment climate. The best way to address these risks is to establish risk management procedures that ask the right questions and establish effective methods for managing risk—before it becomes an issue. The ability to conduct realistic and effective scenario planning and stress testing are essential for any international business.

## **USA Economic Nationalism and the Second-Hand Clothes Industry in Sub-Saharan Africa**

The rising political waves with undertones of Economic nationalism simply imply an increase of the risk of expropriation of foreign-owned assets and it portends tough business environment in some countries. Cases of expropriation have been reported Argentina and Russia offer a good confirmation of host nations growing appetite to forcibly taking extraordinary stakes in existing local businesses. The best way to address these risks is to establish risk management procedures that ask the right questions and establish effective methods for managing risk before issues materialize.

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# Chapter 11

## Economic Nationalism and Foreign Domestic Investment (FDI)

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### **ABSTRACT**

*Nationalism is not closing the door to other nations. On the contrary, sometimes it exhibits as crazy expansion. For example, during the Second World War, both Adolf Hitler and Emperor of Japan claimed that they are helping their citizens. However, that is not the truth. Both German and Japanese people suffered something that they wouldn't have suffered without this war. Meanwhile, nationalism is one reason that the other countries keep fighting the war. By observing the relationship among nationalism, government policies and intervention, and FDI, this chapter attempts to offer an understanding of how FDI is impacted by the nationalism and government policies and intervention by providing two cases: the Brexit of the UK and the "American First" of the USA.*

### **INTRODUCTION**

#### **FDI (Foreign Direct Investment)**

The OECD (Organisation for Economic Co-operation and Development) offers definitions of FDI. In term of the BD4 (OECD Benchmark Definition of Foreign Direct Investment: 4<sup>th</sup> Edition, 2008), FDI is an investment made from a foreign economy acquiring a constant interest, such as managerial power in the targeted corporations and entrance to a certain market, which otherwise inaccessible to the investors. The country of origin of the firm is the home country and the foreign country is the host country. In essential, FDI builds an economic bridge linking home countries and host countries. From a host country perspective, direct investment in any form by a foreign MNE is the inward direct investment and this is the outward direct investment for the home country. It can enhance the corporation and national economic development, competitive capability for the countries, and technology improvement.

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Therefore FDI is different from the international trade. However, it was born from the international trade. Motivations of FDI originate from avoiding uncertainties because markets are not perfect as well. The market imperfections give both country-specific and company-specific advantages. Thus MNEs (Multinational Enterprises) located in different countries invest in other countries to seek their country-specific advantage and avoid risks from their home countries (Dunning, 1988; Dunning, 2001). John Dunning (1998 & 2000) proposes four basic motivations for corporations to involve in FDI. (1) Corporations chasing specific natural resources, low labor cost, or technological, managerial, or organizational technology, are *resource* seeking motivated. (2) Corporations tending to enter a new or large market are *market* seeking motivated. (3) Corporations diversifying risk or enhancing the economic scope and scale are *efficiency* seeking motivated. (4) Corporations trying to hold the position of competitiveness, in the long run, are *strategic-asset* seeking motivation. Therefore, through FDI, corporations which invest in foreign countries explore new markets, channels, save on production facilities and access the new technology and newer ways of conducting business. In addition, companies which receive the FDI can gain new managerial skill, high wages. In sum, FDI is a way to avoid risk in corporation's domestic country. It can be pushed out or pulled in some countries for different motivations.

## **Economic Nationalism**

Nationalism is “loyalty and devotion to a nation”, a definition that recalls the idea of “imagined communities” proposed by Anderson (1983). However, while we talk about economics, especially international economics, “a nation” is as an economy – territorially defined - which interacts with other national economies, for trade, investments, technological transfer, etc. Therefore, essentially, in a globalized world economy, economic nationalism is often self-contradictory; but, it does exist, and cannot be ignored.

Nationalism can manifest itself in different forms. It not only closes the door to the other nations (autarchic policies) but also exhibits as crazy expansion, sometimes, combining autarchy and imperialism. For example, during the Second World War, both Adolf Hitler, Benito Mussolini and Emperor of Japan claimed that they were helping their citizens. However, all German, Italian and Japanese people suffered something that they would not have suffered without this war. These people could have lived in a peaceful environment, so as the victims. We may infer from this disaster that a rigid nationalism could not help any society, even though it seems like can at the very beginning, eventually it will bring more damage than benefit.

Economic nationalism presents similar contradictions as political nationalism. Economic nationalism never disappears. While the economic development decreases, the economic nationalism increases. When economy depressing, citizens who are instigated by politicians, start blaming the foreign countries, for example accusing immigrants of stealing jobs (Ali, 2017; Iliescu, 2017).

## **GOVERNMENTS INTERVENE IN INTERNATIONAL BUSINESS AND FDI**

According to Wild & Wild (2014), governments have a long history intervening in the international business. There are three main reasons: culture, politics, and economics, for governments to limit free trade.

Culturally, governments intervene in international business to protect national identity when the government believes the cultural imperialism are harmful, and because trade and culture impact each other. Politically, governments restrict international business to protect jobs, preserve national security,

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gain influence, and respond to unfair trade. Economically, governments are protecting infant industries and pursue strategic trade policy through intervening international business (Wild & Wild, 2014).

Governments restrict international business by setting tariff, quotas, embargoes, local content requirements, administrative delays, and currency controls. On the other hands, governments provide trade promotions, such as the subsidiary, export financing, FTZ (Foreign Trade Zones), and special government agencies to enhance the international business (Wild & Wild, 2014). In addition, by joining WTO, Free Trade Union, Customs Union and etc., negotiating and signing trade agreements with other countries, governments enhance the capability of international business and globalization of their countries.

Flowing with the international business, FDI has been observed impacting on host country's modernization, urbanization, reformation, globalization, and government policies for years (Held & McGrew, 2002; Wang, 2010; Kalafsky, 2012). Clark (1998) reviewed historical researches on urbanization and pointed out that economic growth in developing countries located in Asia and Africa, is a response to the capitalism. Capitalism transmits with FDI from capitalist countries to non-capitalist countries. The deeper involving in international business, the faster the economic development in host countries, especially in the developing countries. With an open market, capital flow and international trade are two most powerful engines driving the national economic development (Dunning, 2002; Pizarro, Wei, & Banerjee, 2003; Zhao, Chan & Sit, 2003). On the other hand, being eager for the economic development, host countries keep adjusting their policies to attract FDI and this adjustment pushes their reformation gradually and eventually. The future of developing countries highly relied on the infrastructure of communication and transportation, FDI policies, and regionalization (Sit & Yang, 1997).

In addition, FDI acquires different comparative advantages in different host countries. Therefore, host countries' governments adjust policies to provide different advantages, attracting FDI. For example, 20 years ago, FDI flowed into China seeking low labor cost. Recent years, FDI has entered China for a large market. Thus, 20 years ago, the Chinese government provided policies to attract low skilled manufactory FDI, such as textile MNEs, which polluted river and earth. Nowadays, the Chinese government abandoned old policies and adopted new policies, which attracted high-technology FDI, such as electronic MNEs.

On the other hand, nationalism is also impacting FDI. Countries with high-technology, such as the U.S.A., started holding this competitive advantage within the country rather than outsourcing or offshoring to other countries because of the consideration generated from the US government of other countries may steal these high-technologies.

However, the international trading war between the U.S.A. and China exhibits that international business is not one-way. Both countries have their nationalism and they both have some competitive advantages in certain areas. Therefore, winning in one industry accompanying by losing in another industry. For instance, the U.S.A. is winning in the high-tech industry while losing in the agriculture. For example, on March 8, 2018, the President of the U.S.A., Trump started imposing tariffs on steel imports, and later, other Chinese goods. Simultaneously, China hits back in the same amount of American goods. Both claim that they are doing the best for their country (Cheng, 2018). However, a lot of companies will suffer a huge loss, employees will lose their jobs and customers will eventually pay for everything. Moreover, this action impacts not only these two countries but the whole world. European, Mexican and Canadian companies already complain that they are hurting because of the new steel tariff. In addition, more and more countries will be impacted since they are also in the supply chain of these two giant countries. Therefore, sooner or later, all the countries will be involved in this economic nationalism.

Therefore, governments intervene IFDI (Inward FDI) to protect culture, domestic companies, and jobs, control balance of payments, and obtain resources and benefits. They can achieve these targets by creating and adjusting orders, regulations, and laws that foreign companies must follow when they make an actual investment in the host countries. On the other hand, governments also intervene OFDI (Outward FDI) to prohibit technologies and jobs of the home countries lost with OFDI. Governments can limit OFDI by punishing the corporations with export tariffs or extra taxes (Wild & Wild, 2014).

In the following chapters, the author will go over the WTO, EU, G7, and NAFTA to exhibit the functions of these unions and groups. Thereby exhibit why governments join or quit unions later.

## **WTO (World Trade Organization)**

Officially commenced on 1 January 1995 under the Marrakesh Agreement, The WTO (World Trade Organization), signed by 124 nations on 15 April 1994, is the successor of the GATT (General Agreement on Tariffs and Trade). It is the only global international organization dealing with the rules of trade among countries, which maintains the trade fairness and freedom internationally. The priority of it is to benefit all its members through open international trade. It provides trading rules and WTO agreements, which essentially are principles constructing a multilateral trading system. Agreements signed by its member nations who participate in international trade are the core of the WTO.

The WTO has 164 members since 29 July 2016 representing 98 percent of world trade, and more than 20 countries are seeking to join the WTO. Any government seeks to accede to the WTO has to agree with the WTO rules by adjusting its economic and trade policies and process negotiations.

The WTO enhances negotiation of agreements and cooperation of these members' governments and eventually guarantees the international trade by penalizing the offending members. The WTO's member governments make all major decisions. Every two years, the ministers of member's countries meet, or their delegates or ambassadors meet in Geneva regularly to process the decision-making. The decisions are made by the Ministerial Conference of the WTO, which normally holds every two years. The organization of the WTO can be distinguished into three groups: General Council, Goods Council, and Services Council. The General Council, meeting regularly, is the highest-level decision-making body who carry out the function of the WTO in Geneva. Delegates or ambassadors from members' countries representative in it. It also works as the Dispute Settlement Body and as the Trade Policy Review Body, but under different rules.

The Dispute Settlement Body of the WTO was active whenever one member nation's government files a complaint against another nation's government. The rulings of WTO will be followed by any member nation's government because any offender who refuses to follow the WTO guideline will be punished by financial penalties or trade sections (Wild & Wild, 2014). Countries join the WTO to seek bigger marketing and fair trade.

## **EU (European Union)**

The EU is a political and economic union with free trade, constituted by 28 European countries, which is the next generation of the EEC (European Economic Community). The EEC was built after the Second World War in 1958 by Belgium, Germany, Italy, France, Luxembourg, and the Netherlands. Initially, the EEC only pursues raising economic cooperation. In 1993, the EU replaced the EEC.

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Nowadays, the EU is not only a single, internal market, but also a political union, which focuses on promoting peace, well-being of its citizens, and its values; maintaining price stability, rich culture, climate, environment, and linguistic diversity; offering a highly competitive market economy with full employment; enhancing science and technology advance; eliminating discrimination; offering freedom, justice and security without internal borders; and providing an economic, social, political and geographic cohesion amongst members.

The membership application is open to all European countries if they would respect and promote the democratic values of the EU. According to the “enlargement policy” of the EU, once an applicant country meets the conditions for accession, it can become an EU member. By joining the EU, member countries will attain three key criteria: political stability, a functioning market economy, and the ability to take on the obligations of membership.

The values shared by all the EU members integrate the EU countries into a solid society with tolerance, inclusion, justice, and non-discrimination prevail. These values are human dignity, freedom, democracy, equality, human rights, and rule of law.

The EU’s foreign and security policy allowing the EU members works as one in world affairs. A single market and a single currency (Euro) are both main economic engines for the EU, which provide free move of people, money, goods, and services. All the EU citizens can move freely among the EU members’ countries. They are treated in exactly the same way as a domestic citizen in working, studying and retiring. They have the equal rights of employment, social security, and taxation just as the original citizens in any EU country they move to.

According to the European Union (2018), the EU is the largest trade block in the world until 2018. It is the world’s biggest exporter of manufactured goods and services, and the biggest import market for over 100 countries in 2018.

## **G7 (Group of Seven)**

On Sunday, 25 March 1973, George Shultz (an U.S. Secretary of the Treasury), Helmut Schmidt (Finance Ministers from West Germany), Valéry Giscard d’Estaing (President of France), and Anthony Barber (Chancellor of the UK’s Exchequer) had a meeting in the library on the ground floor of the White House, Washington, D.C., which has been known as the original Group of Four or “Library group”. Later the same year, at the World Bank-IMF meetings, Japan was invited to join the group and G5 was built (Farnsworth, 1977; Shultz, 1993; Bayne, 2000).

According to the Federal Government of Germany, because of the first oil shock, the following financial crisis and collapse of the Bretton Woods fixed exchange rate system, a group of six advanced industrialized economies: the U.S.A., UK, France, Italy, Germany, and Japan, founded an informal grouping G6, in 1975, discussing the global economy and international business policy. In 1976, Canada joined the G6, thereby, the G7 was founded. G7 opened direct talks with the EU in 1977 at the 3<sup>rd</sup> G7 summit (London), to which the President of the European Commission was invited to attend. Since 1981, the EU has participated in the G7 as a none-numerated member. Russia joined the G7 in 1998, and the group has contemporarily formed G8 until 2014, the year Russia was suspended from participating the group because it violated the sovereignty and territorial integrity of Ukraine (Laub & McBride, 2017).

In term of the G7/8 Ministerial Meetings and Documents (2014), the group holds annually summit discussing economic policies since 1975, to which the heads of government attended. The duty of hosting the year’s summit belongs to the member country which holds the G7 presidency. Every 7 years, a

member country hosts a summit in general following the order of France, United States, United Kingdom, Germany, Japan, Italy and Canada (Hajnal, 2007; Feldman, 2008). Preparing the summit, the host country arranges several preparatory meetings. Sherpas, the personal representative of the G7 leaders, who are important governors, attend these preparatory meetings to discuss potential agenda items and communicate directly with each other throughout the year (G7 Summit, 2018).

In addition, finance ministers of member countries have met at least semi-annually, up to 4 times a year at stand-alone meetings since 1987.

According to the *G7/8 Ministerial Meetings and Documents* (2014), the main purpose of G7 was extended to national security and foreign policy in 80s last century. In the 90s, it focused on energy, environment, and employment. In the first decade of this century, it focused on education, development, crime, gender equality, and agriculture.

## **NAFTA (North American Free Trade Agreement)**

Signed in 1992 by the U.S.A., Canada, and Mexico, NAFTA was established on January 1st, 1994, aiming to build a free-trade zone. According to the NAFTA Secretariat, the primary purpose of Free Trade Agreements (FTAs) is to provide opportunities for helping economic growth among the member countries. It focuses on promoting competition fairness, eliminating trade barriers, such as tariffs, quotas, and duties, offering business and investment opportunities, protecting intellectual property rights, and disputing settlement procedures. It also has rules of origin, customs procedures, agriculture and sanitary and phytosanitary measures, and government procurement. According to the *Office of the United States Trade Representative*, after the establishment of the NAFTA, tariffs were eliminated progressively and all duties and quantitative restrictions, with the exception of those on a limited number of agricultural products traded with Canada, were eliminated by 2008.

In term of the *NAFTA Secretariat*, the Alternative Dispute Resolution (ADR) is the main method member countries applied to settle any dispute beyond the traditional litigation and the courtroom in business today. The ADR is a system resolving arguments amongst the NAFTA countries which will unavoidably be generated from participating in international business.

## **CASES**

In this part, the author offers two cases from the UK and USA to explain how the globalization and nationalism impacts governments' policies and eventually impacts the FDI. In addition, the author provides observations from MNEs to show how firms react to these governments' policies regarding FDI.

### **UK: Brexit**

According to Hunt and Wheeler (2018), Brexit is a word merging Britain and exit, which means the UK leaving the EU. UK joined the EU in 1973 (Anderson & Reichert, 1995), while voted to exit from it in 2016 (Hunt & Wheeler, 2018). As an EU member, British can move, resident, and work in any EU member country freely, and Vice versa (Moyer & Josling, 2002). On the other hand, the EU immigration and refugee crisis are both huge burdens to the British society (Ross, 2016).

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On Jun 23, 2016, The Brexit referendum was initiated, which also known as the United Kingdom European Union membership referendum. More than 30 million people participated account for 71.8% people who are qualified to vote. Both England and Wales supported the Brexit, while Northern Ireland and Scotland both voted for a stay. Eventually, 51.9% of the electorate voted to leave the EU (Hunt and Wheeler, 2018).

Shaw, Smith, and Scully (2017) collected themes of the campaign for voting. Four main motivations for leaving are: (1) EU is failing the UK, (2) UK sent money to the EU without any control over, (3) the UK is strong enough to be successful, and (4) UK does not have significant decision power in the EU. On the other hand, at least five main motivations support remain: (1) EU reform has some benefit for the UK, (2) The EU is not bad, (3) isolation of the UK is not pure positive, (4) benefits of the free movement, and (5) several risks will go up.

In term of the European Commission (2018), on March 29, 2017, the UK government appealed an “article 50 of the treaty on the European Union”, by which the eventual Brexit is due on March 30, 2019, at 00:00h CET (Central European Time). Then the UK will be a third country to the EU.

In addition, the UK would not hold the membership of either the European Single Market or the ECU (European Union Customs Union) after leaving the EU. It would abolish the European Communities Act 1972, which signed by the UK in 1972 to join the EEC (European Economic Community), the EAEC (European Atomic Energy Community), and the ECSC (European Coal and Steel Community) (Mctague, 2017; Wilkinson, 2017).

The impact of the Brexit for FDI will be shown in the future as a long-term consequence. First of all, it isolates the UK as an independent market, with its own currency. Thereby, the risk of this market is isolated from the EU, both economically and politically, as well. It provides investors a second choice to the European region with possibly lower risks than the EU members. On the other hands, the attractiveness of the UK may decrease with the Brexit, because it does not belong to the EU anymore. For the investors who want to access the whole EU market, UK is out of the table.

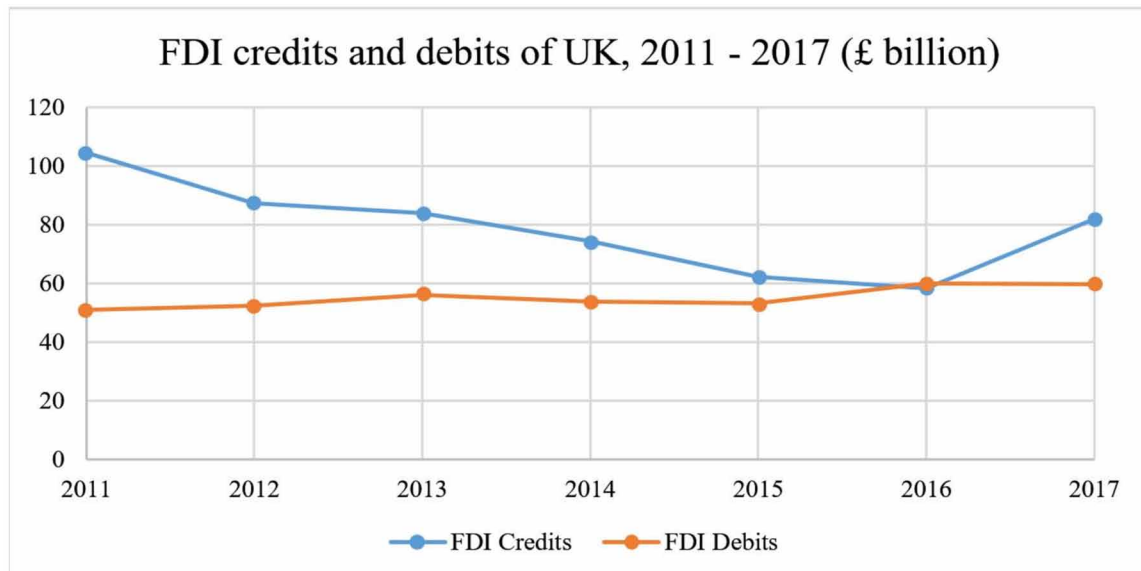
In addition, UK can get rid of the regulations, limitations, and burdens from the EU, which means UK has more choices of attracting other investors, rather than EU members, such as Americans, Indian, Chinese and Russian. UK has a special relationship with the USA than other EU members through culture and history. However, under the control of the EU, the UK cannot overwrite the authority of it, and that is limiting the attractiveness of UK to the USA. For example, EU and USA are negotiating regarding tariffs and duties. However, the UK may not be impacted when it leaves the EU eventually.

Furthermore, EU as a whole has its concern regarding the Chinese BRI (Belt and Road Initiative). BRI attempts to build a regional international relationship through China to Europe, which will provide huge FDI opportunity for all. Some EU members hold positive perspectives of the BRI, while others hold the negative perspective of it. The UK is linked by the maritime Silk Road directly and through the tunnel, it is linked to the Silk Road from France. Once UK leaves the EU eventually, it can decide its own policy regarding the BRI and the FDI flows with it.

In Figure 1, we can see the year 2016 is a breakpoint. The FDI credits (inflow) first turned into upward since the year 2011. After the Brexit decision, this upward trend keeps going. According to the Office for National Statistics (2018), the FDI credits rose from £58.4 billion by 2016 to £81.9 billion in 2017, while the value of FDI debits (outflow) nearly remained stable in 2017. It slightly dropped £0.2 billion to £59.8 billion in 2017. In other words, we may infer that even though it seems to show the nationalism, the Brexit makes the UK more attractive to foreign investors.

Figure 1. UK foreign direct investment (FDI) credits and debits, 2011 to 2017

Source: Office for National Statistics, UK. <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/ukforeigndirectinvestmenttrendsandanalysis/july2018>



## U.S.A.: America First

According to Rubino (2017), the 45<sup>th</sup> U.S. President Donald Trump was not the first U.S. President using the slogan “America First”. The first U.S. President who used this slogan was the 28<sup>th</sup> U.S. President Woodrow Wilson. In 1916, he proposed it to show the neutral attitude toward the WWI, which means to keep the U.S.A. away from the war (Causey, 2017). After the WWI, this slogan transformed into non-intervention and nationalism political policies (Rubino, 2017). The non-intervention policy is a foreign policy that prevents the U.S. government allying with any other countries in case of being drawn into unnecessary wars that not directly related to the territorial self-defense of the U.S.A. (Boaz, 1998).

President Donald Trump colored this slogan with a stronger nationalist coat, by which he switched the politically non-intervened policy to an economically nationalist policy. This new “America First” policy focuses on keeping American economic interest, benefit and consideration first, which contains hiring American workers first and purchasing American goods first (Bravo & Bryce, 2018). On March 16, 2017, President Trump proposed a federal budget for the fiscal year 2018, named “America First: A Budget Blueprint to Make America Great Again” to the 115<sup>th</sup> Congress (Taylor, 2017; Rampton & Cowan, 2017). On April 18, 2017, he signed the “Buy American and Hire American Executive Order”. This policy tends to provide more job opportunities and to increase income level for Americans. In addition, this policy enforces immigration laws and limits hiring opportunity for foreigners to the most-skilled or highest-paid labors (Buy American, Hire American: Putting American Workers First, 2018)

This “America First” policy expanded to nationalism as “America Only” by increasing tariffs on foreign goods and fighting trade war with trading partners. Even though President Trump stated these tariffs are a protection of the national security (Mayeda & Epstein, 2018), it seems a little bit overdoing and provoking retaliation from the involved countries.



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In addition, quitting the WTO is another proposal of President Trump, which is believed will disarray international trading further (Swan, 2018). According to Swan (2018), there are two main reasons for President Trump to withdraw from the WTO, the “Most Favored Nation” and the “bound tariff rates”. The former prohibits the capability of member’s countries avoiding favoritism from charging different tariffs from different countries, and the latter prohibits the capability of member’s countries from charging too high tariffs by setting a tariff ceiling.

According to Bach (2018), withdrawing the WTO gives the President of the U.S.A. more power adjusting tariffs and participating in international negotiations. In other words, the freedom of international trade will be weakened if the U.S.A. quits the WTO. Meanwhile, the nationalist expansion will have less limitation.

On March 8, 2018, President Trump, signed the orders to impose 25 percent duty on steel and 10 percent on aluminum imported from every country except the NAFTA (North American Free Trade Agreement) members: Canada and Mexico, Australia, Argentina, Brazil, South Korea and the EU, temporarily (Horsley, 2018; Harding, 2018). Neither Japan, India nor China was waived from the duty. China has imposed tariffs on steel and aluminum up to \$60 billion. Simultaneously, the Chinese government imposed a new duty on the same value of American goods (Petroff, Iyengar & Mullen, 2018; Glenn & Perry, 2018). On May 18, India informed the WTO’s Goods Council that it starts suspending concessions on goods imported from the U.S.A., responding to the US “Section 232 Tariffs On Steel and Aluminum” (Vicki, 2018). In addition, it will impose extra duties on American goods up to \$165.56 million. Both China and India filed an official complaint against the new American tariffs on steel and aluminum to the WTO, joining the Japan, Russia, and Turkey (Swanson & Tankersley, 2018; Vicki, 2018).

Moreover, on Apr 04, 2018, the U.S.A. planned to impose 25% tariffs on high-tech products from semiconductors to lithium batteries made in China up to \$50 billion, which will cover 1,300 tariff lines (Wei & Kubota, 2018). The USTR (United States Trade Representative) stated that “This level is appropriate both in light of the estimated harm to the U.S. economy, and to obtain the elimination of China’s harmful acts, policies, and practices” (Mayeda, Han, & Hamlin, 2018). In addition, the USTR pointed out that it is targeting the Chinese products which are “benefit from Chinese industrial policies, including Made in China 2025”.

On May 30, 2018, Wilbur Ross, an American Commerce Secretary, announced that, according to a trade law which protects national security, the U.S.A. imposed new tariffs 25 percent on steel and 10 percent on aluminum imported from EU, Canada and Mexico since June 1, 2018. “Every country’s primary obligation is to protect its own citizens and their livelihood,” he claimed in Paris (Bravo & Bryce, 2018). Meanwhile, the EU also imposes tariffs on imported US goods, which contain agriculture, clothing, steel, motor vehicle, and so on (Noguchi, 2018). Furthermore, Canada and the EU both filed WTO complaints against the US “Section 232 Tariffs on Steel and Aluminum”, followed by Mexico (Elis, 2018).

In addition, on May 23, 2018, President Trump called an investigation of whether imported autos are a national security threat to the U.S.A. (Swanson, 2018). If so, he will impose new auto tariffs up to 25 percentage (Lynch & Paletta, 2018) on cars, trucks, and auto parts import (Korte, 2018).

Moreover, During the G7 Summit, President Trump “betrayed” American alliances again by insisting promote tariffs and duties on these countries. In sum, we can see that the new “America First” policy proposed an implemented by President Trump is increasing the political and economic risks for all other countries, even for the ones not involved directly. They will suffer as well because of they belong to the supply chain. In addition, the alliances of the U.S.A. were attacked either. The EU and NAFTA members

are charging the new tariffs just as the non-alliance countries, such as Russia, China, and India. And some of them may be impacted more in the future because of the planning car tariffs.

What behind these tariffs and duties adjustment is, President Trump said in the video he signed the Tariffs on Steel and Aluminum Imports at Fox 10 Phoenix on March 8, 2018, “we will not place any new tax on product made in the U.S.A., so there is no tax of a product just made in the U.S.A. You don’t want to pay tax, bring your plant to the U.S.A., there is no tax” (FOX 10 Phoenix, 2018). In other words, President Trump is trying to attract or we should say “force” the FDI flows go to the U.S.A. by imposing tariffs to the products made in foreign countries and sold in the U.S.A. to an unaffordable level.

However, the price of goods made in the USA is too high to be afforded, that is the one main reason why American corporations’ FDI flows go out at the beginning. At the same time, the U.S. government is trying to prohibit certain foreign country’s FDI in acquiring American high-technology corporations. At some point, it would protect certain high-technology. On the other hand, just as Shan and Song (1997) argue in their research, sooner or later, all the high-technology nowadays will be eliminated and replaced by a new one. That’s way lots of scientists, economists and companies’ owners do not support trump’s policy.

Eventually, threatening to withdraw from the NAFTA for months, on Jun 05, 2018, the White House economic adviser, Larry Kudlow, announced that President Trump switched his strategy to negotiate a trade with Canada and Mexico separately, instead of quitting the NAFTA (Dopp, Wingrove, & Leonard, 2018). The main reasons for this decision are unless stop doing international business, or essentially, the USA needs some cooperator, especially in North America. Mexico supplies lower price products to it, and Canada is the closest developed market where the GDP ranks the tenth among the world in 2018, according to the Statistics Times (<http://statisticstimes.com/economy/projected-world-GDP-ranking.php>).

In other words, nationalism from one country always triggers nationalism from other countries, politically and economically. For example, when President Trump promoted tariffs and duties on other countries’ goods, these countries hit back by promoting tariffs and duties on American goods.

On the other hand, there is a soft way to deal with the American forbidden business. For example, the Customs Tariff Commission under China’s announced car tariff-reducing decision, which claimed that the car import duties would be diminished from 20-25% to 15% since July 1<sup>st</sup> 2018, on May 22, 2018 (Shane, 2018). Tesla’ head of worldwide sales, Robin Ren, announced on June 5, 2018, that Tesla will build its first overseas “Gigafactory” in Shanghai, China, producing auto parts, batteries, solar panels, and electric cars. This plan was seen as a response to the Chinese government tariff-reducing announcement (Alvarez, 2018; Kolodny, 2018; Ren, 2018). In as much as the U.S. government does not allow the Chinese FDI acquiring American high-technology in the U.S.A., the Chinese government seems to acquire foreign high-technology in China by offering more opportunity to attract FDI from other countries. The cost is the competition in the certain industry will increase. However, as long as China is doing international business with other countries, the competition never stops. According to Alvarez (2018), after the Chinese government announced a car import duties deduction, the entire Model X 75D inventory was sold out in 24 hours in a Shanghai Tesla gallery.

Furthermore, on June 15, 2018, China responded to new tariffs and duties to the USA, again. President Trump imposed \$50 billion Chinese goods in two steps, the first is on \$34 billion of 818 product lines starting on July 6, 2018, and the second is on \$16 billion 284 products starting later. The Chinese government then responded by abandoning the previous car tariffs diminishing plan and imposing new

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tariffs and duties on \$50 billion American goods as well. It will impose 25 percent tariffs on \$34 billion, 545 categories of American goods on July 6, 2018, at first, then an additional \$16 billion list will follow up (Donnan & Hancock, 2018).

Tesla's FDI choice makes it avoid the trade war between its homeland and the "enemy" of its homeland. More American automakers may follow it in the future. In sum, an appropriate FDI can be a lifesaver for some corporations during a certain period. In addition, the tight FDI policies may prohibit some M&A at some point in the domestic market, but may also push FDI out from the domestic market. The increasing tariffs and duties policies may force FDI to come in the domestic market while decreasing the export because of the other countries' retaliatory tariffs and duties policies.

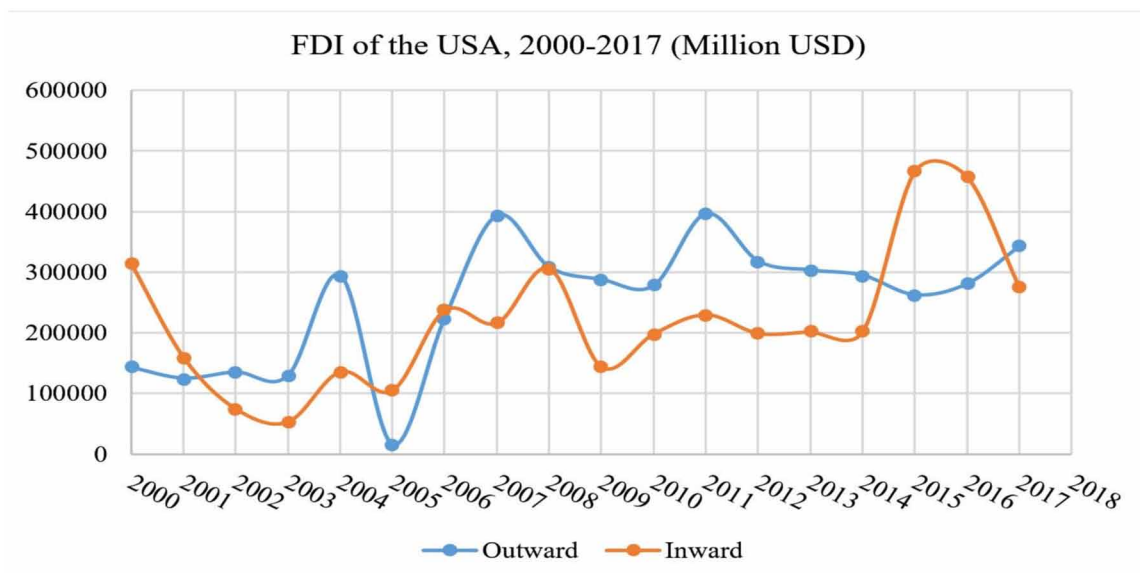
The presidency of Donald Trump began at noon EST on January 20, 2017. In one year, the inward FDI decreased from 457,126 million USD in 2016 to 275,381 million USD in 2017, while the outward FDI increase from 280,682 million USD in 2016 to 342,269 million USD in 2017 (see Figure 2). In other words, more investment went out while less investment came into the country since Donald Trump became the President of the "American Frist" and nationalist expansion policy.

## CONCLUSION

The last but not the least, through the three cases we can see the FDI is either pulled in or pushed out by the government policy. Operating corporations are challenging for all firms from all countries. It is not enough following the regulations and laws, but also knowing and respecting the domestic culture, beliefs, history, and religions.

Figure 2. FDI of the USA, 2000-2017

Source: UNCTAD



In addition, the limiting power of international union and agreements are disappearing. Nationalism is replacing globalization and international cooperation. FDI was treated as escaping from the investors' homeland, rather than exploring the new marketing. The idea of against goes up, while the consideration of co-operating goes down. Nowadays, the political issues raise sharply from different regions, Europe, America, and Asia. A new challenge for the corporations and investors is to make a better choice, which is the last thing corporations would love to do. Choosing means losing revenues. However, not choosing means losing more in some case.

On the other hand, the government intervention or protection is necessary at some point. Because of the FDI, jobs and wealth left. Hundreds and thousands of domestic residents cannot find jobs. The economic growth slows down. Many believe that without the government intervention, the economic growth will be negative eventually. The most curious concern of this situation is all the countries are thinking the same, and we are living in the international century. Therefore, Nationalism from one country triggers nationalism in other countries. In the short term, the nationalist policy may stimulate or force some FDI flowing into the certain country. In the long term, Sooner or later, a trade war will hurt all of us because the opportunity of aggregate international business is shrinking. No one will be the winner. At some point, we will have to stop, sit down, negotiate, and shake hands again.

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# Chapter 12

## Economic Nationalism and Corporate Social Responsibility

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### ABSTRACT

*This chapter addresses conceptual relationships between corporate social responsibility (CSR) and a set of related phenomena typically labeled as economic nationalism, economic patriotism, economic protectionism, populism, and antiglobalization. The research question addressed is whether this set of related phenomena redefines or at least affects CSR in significant ways that practitioners and scholars should include in the conception of CSR and, if so, how theoretically. Such investigation is affected by two essential circumstances. First, CSR remains a topic of continuing theoretical controversy: specific “responsibility” of any business anywhere is not a resolved matter. Second, economic nationalism and related phenomena—which appear to be rising in importance—are opposed to the economic, political, and social globalization effects following the 1995 founding of the World Trade Organization (WTO). The chapter seeks to refine CSR for varying conditions as shaped by economic nationalism, economic patriotism, economic protectionism, populism, and antiglobalization.*

### INTRODUCTION

This chapter investigates the implications of increasing economic nationalism for corporate social responsibility (CSR) theories and practices. Economic nationalism, one approach to international economic relationships, emphasizes that state policies and home-country businesses should promote national self-interest relative to international cooperation if occurring at national cost. Countries differ in economic nationalism or increased economic nationalism, which facilitates a comparative perspective. Economic nationalism is a continuum from relatively low, especially in open economies in Switzerland and the Nordic countries, to relatively high in countries like the United States, China, and Russia.

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The main ideas and findings of the chapter are as follows. Economic nationalism is part of a rising tide of related phenomena, including economic patriotism, economic protectionism, populism, and antiglobalization (Nelson, 2017). These phenomena are part of the broad context for the economic nationalism discussed in this chapter. CSR theorizing and practices can adjust to increasing variation in economic nationalism conditions. Viewing economic nationalism as a set of state-level policies, an empirical question is whether CSR of specific businesses are responding to variable country conditions. CSR implications may differ considerably based on privately-owned domestic businesses and privately-owned multinational enterprises (MNEs), both distinct from state-owned enterprises (SOEs) operating domestically or increasingly internationally. The chapter draws on empirical data and case instances to validate these arguments.

Economic nationalism involves varieties of three kinds discussed in this chapter. One variation is the increasing international aggressiveness of China and Russia (an oil producer), as each is a one-party authoritarian regime of different types (Associated Press, 2018b). Iran (also an oil producer) and North Korea, both pursuing nuclear weapons and regional dominance, are special situations of international aggressiveness. A second variety is a negative reaction to globalization in some advanced economies, most notably to date the U.S. and the UK, which is in the process of Brexit from the European Union (EU). A third variety (of different types) involves developing countries, including Brazil, India, South Africa, and Saudi Arabia (an oil producer).

The objectives of the chapter are as follows:

- The chapter aims to provide a conceptual discussion of the basic ideas concerning CSR in relation to economic nationalism. Other related phenomena (i.e., economic patriotism, economic protectionism, populism, and antiglobalization) are the broad context for economic nationalism.
- The chapter offers working definitions of this set of phenomena.
- The chapter places economic nationalism within the setting of international economic relationships established through the World Trade Organization (WTO). It gives attention to disputes occurring between the U.S. and the North American Free Trade Agreement (NAFTA), as well as between the UK and the EU.
- Beyond the conceptual discussion and working definitions, another objective is to note company examples and empirical evidence concerning SOEs illustrating the crucial issues.
- The final objective is to propose refinements of CSR for accommodating economic nationalism as a real-world consideration. The author suggests that CSR theorizing must address the likelihood of alternative models for business-society relationships considering the shift from a WTO-oriented freer trade and investment setting to a more hostile environment for international economic relations. This shift occurs in conjunction with a resurgence of aggressive nations, including China, Iran, North Korea, and Russia.

The chapter proceeds as follows. The background section provides working definitions of the basic terms, together with a review of related literature. The third section addresses refining the CSR conception considering problems in the WTO approach and the emerging UN human rights regime. The fourth section considers solutions and recommendations for these issues. The fifth section addresses future research trends. The conclusion reviews the essential points of the chapter.

## **BACKGROUND**

The “Key Terms and Definitions” section provides brief formal definitions of essential terms. This section combines an explanation of working definitions of basic terms in relationship with review of related literature.

Economic nationalism is the preference that foreign trade and exchange activities are beneficial to one’s country. Economic patriotism supports domestic producers and stakeholders in preference to foreign producers. Consumers may prefer materials made in their home country vs. imported from the outside. Economic protectionism is the use of tariff and nontariff trade barriers to deter import in favor of domestic production and employment. While there may be a desire to promote exports, an increase in exports is more likely to result from a reduction of trade barriers. Rodrik (2018a) accepted economic populism and opposed political populism. The essence of economic populism is a pronationalistic negative reaction to adverse impacts of globalization and importation. There is also an element of political antielitism centered on criticism of Washington, DC, EU cross-national institutions, and anti-immigration. Antiglobalization is a sentiment that national problems are at least partly, if not entirely, due to the adverse effects of economic globalization, increased importation, and increased immigration.

Economic nationalism is the preference to benefit from international economic relationships as opposed to helping other countries, especially at some national cost. The introduction notes three fundamentally different kinds of economic nationalism. One type is an aggressive assertion of diplomatic and military power against the established international order, such as the North Atlantic Treaty Organization (NATO), which is dealing with a resurgence of Russia (Deni, 2017). China and Russia reflect this kind of economic nationalism, which also occurs with Iran and North Korea seeking to become nuclear powers. A second kind is a negative reaction in some advanced economies, most notably to date the U.S. and the UK, which is in the process of Brexit from the EU. More broadly, economic nationalism in advanced economies occurs in Germany and Japan. A third kind happens in developing countries, such as Brazil and South Africa. For example, there may be increasing resource nationalism in sub-Saharan Africa aimed at domestic control of energy and mining resources. Andreasson (2015) illustrates this situation for Mozambique, Nigeria, and South Africa.

Nationalism in an economic setting involves the specific configurations of domestic considerations in each country (McNamara, 2017). Economic patriotism is a preference, particularly by consumers and producers, for local vs. foreign goods and services. For example, the three Baltic republics (Estonia, Latvia, and Lithuania) have called on Walmart (a U.S. firm) to stop selling Soviet-themed apparel from a third-party company (Amazon also sells such apparel) because the Soviet Union invaded and annexed the three countries and attacked Finland during the early stages of World War II (Dapkus, 2018). Canadian consumers, which is relevant to current controversies concerning the renegotiation of NAFTA, may show a preference for 100% Canadian milk dairy products (Forbes-Brown, Micheels, & Hobbs, 2015).

Economic protectionism is the adoption of any tariff or nontariff barrier to imports of goods, services, capital, resources, and labor. Such protectionism tends to rise as a feature of nationalism and patriotism. A detailed discussion occurs in the chapter’s main section on refining CSR in relationship to the WTO trading regime and the UN human rights regime. However, a significant feature of protectionism deals with labor mobility. Such protectionism is not likely to decline even with increased free trade in goods, services, capital, and nonlabor resources. The reason is that labor mobility is bound with immigration issues and domestic labor conditions.

*disconnect between trade rules and development needs is nowhere greater than in the area of international labor mobility. Thanks to the efforts of the United States and other rich countries, barriers to trade in goods, financial services, and investment flows have now been brought down to historic lows. But the one market where poor nations have something in abundance to sell ... has remained untouched by this liberalizing trend. Rules on cross-border labor flows are determined almost always unilaterally (rather than multilaterally as in other areas of economic exchange) and remain highly restrictive. Even a small relaxation of these rules would produce huge gains for the world economy, and for poor nations in particular. (Rodrik, 2002, para. 14)*

Populism, closely associated with antiglobalization, has become increasingly significant in the U.S. and some countries of the EU, which is under stress from Brexit and difficulties with immigration, the return of Russian aggressiveness in Eastern Europe, and financial problems in Greece, Italy, Portugal, and Spain. Populism is one of the drivers of increasing nationalism, patriotism, and protectionism. According to Inglehart and Norris (2016), economic insecurity and cultural backlash are competing views related to the increased support for populism. Economic insecurity is partly related to labor mobility issues as discussed in the previous paragraph. Cultural backlash is a reaction to changing values. Based on data from the 2014 Chapel Hill Expert Survey (CHES), Inglehart and Norris (2016) ideologically positioned 268 political parties in 31 European nations. Those authors draw on European Social Survey data (2002-2014) at the individual level to study the relationship of economic insecurity and cultural values in voting for populist parties (as identified in the ideological positioning). They found that these data support cultural backlash over economic uncertainty as explanatory. Pastor and Veronesi (2018) examined the effect of perceived inequality between voters and high-consumption elites on populism. They argued that voters elect populists who promise to end globalization, and redistribution has a limited effect on this backlash phenomenon. Higher inequality, higher financial development, and current account deficits correlate with populism. Pastor and Veronesi (2018) found that 2016 voters for Brexit and Trump reflected this same explanation. Algan, Beasley, Cohen, and Foucault (2018, para. 1) studied the 2017 French presidential election in which Macron won. Voters on the traditional left-right axis were associated with ideology about redistribution. Thus, socioeconomic variables, including income and social status, were important. In contrast, voters on the new diagonal defined by open vs. closed society views were associated with individual and subjective variables. Low well-being predicted antisystem views; low interpersonal trust predicted right-wing populism.

Embedded in these related views is the problem of reconciling globalization, democracy, and national sovereignty. Rodrik characterized the issue as a paradox in which two dimensions but not all three aspects are compatible (see Lester, 2011). For Rodrik, this characterization led to a critique of national sovereignty in favor of global democracy (in some form). In effect, he argued against nationalism without arguing against patriotism. He permitted some degree of protectionism.

A fundamental tension exists between national sovereignty and interdependency. Bagwell and Staiger (2004) defined national sovereignty in a benchmark world without international agreements. That is, there is merely national sovereignty. Isolation and bilateral or multilateral arrangements do not exist. The next step in their argument was to consider the effects of specific international agreements, which involve detailed design considerations, on national sovereignty. The design issue looks at how to minimize or eliminate tensions between sovereignty and internationalism. There is likely to be a balancing of the two dimensions. This problem emerged in practical terms in the decision of the Czech Republic to join the EU, considering sovereignty vs. internationalism.

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*The [2007] Treaty of Lisbon requires a new definition of national sovereignty. It is no longer enough for a state to just promote policies at home or speak to its individual national interests. They must also actively participate in the international community where coordination between individual states is paramount. In this interstate dialog, nations must be clear in defining the border between where their national interests should be defended and what common interests and rights should be agreed upon and lent to the European Union. (White, 2009, para. 1)*

## **REFINING CORPORATE SOCIAL RESPONSIBILITY**

The main section of the chapter concerns the implications of a rising tide of economic nationalism, patriotism, protectionism, populism, and antiglobalization for CSR conceptualization. This section comprises four subsections. The first discusses the WTO approach to international economic relations. The second addresses problems within and for the WTO approach by rising economic nationalism, patriotism, protection, populism, and antiglobalization. The third presents the UN business and human rights framework. The fourth and final subsection examines the specific implications for CSR conceptions, illustrated by a comparison of different country models of economic nationalism and some empirical data concerning SOEs.

### **The WTO Approach**

The WTO, headquartered at Geneva, Switzerland, dates from January 1, 1995, following the 1986-94 Uruguay round of trade reduction negotiations and succeeding the previous General Agreement on Tariffs and Trade (GATT) of 1947. WTO in 2018 had 164 members accounting for 98% of world trade (WTO, 2018a). China joined the WTO in 2001. The general purposes of the WTO are to promote economic growth and development through multilateral trade barrier reductions and to settle international trade disputes.

The WTO, however, arguably goes well beyond these general purposes by drawing on WTO statements. WTO replaces trade domination by the U.S., EU, Japan, and Canada (WTO, 2018d, para. 5). One point to note is that the named major advanced economies formally agreed to the WTO terms. However, such an agreement does not prevent any of the parties, including the U.S., from withdrawing or threatening to withdraw from the WTO arrangements or to lobby for modifications in those arrangements to secure greater national benefits. Whether such actions are economically rational (concerning national economic interest) may be entirely different from political considerations related to a rising tide of nationalism, patriotism, protectionism, populism, and antiglobalization. China, Russia, Iran, Brazil, India, and South Africa may have entirely different purposes in WTO membership (Hopewell, 2015).

Additionally, the WTO tilts in the direction of assisting economic development as distinct from promoting free trade and shifting trade negotiations or dispute settlements toward a political process anchored on strengthening the role of developing countries. Among “10 things the WTO can do” are “help countries develop” and “give the weak a stronger voice” (WTO, 2018b). Thus “... the WTO agreements are full of provisions that take into account the interests of developing countries” (WTO, 2018c, para. 2). This approach deliberately strengthens bargaining power, or at least the bargaining voice, of developing countries. The WTO approach explicitly substitutes global negotiated rules and dispute resolution for economic dominance by the largest advanced economies (U.S., EU, Japan, and Canada).

*One important point about the WTO is the practice of reaching decisions by consensus. Every country has to be convinced before agreement can be reached. Compromise is key: whatever is proposed has to be refined until it is acceptable to everyone or more precisely until it is objectionable to no one. Consensus means there are no dissenters. (WTO, 2018d, para. 7)*

*Small countries would be weaker without the WTO. Differences in bargaining power are narrowed by agreed rules, consensus decision-making and coalition building. (WTO, 2018d, para. 1)*

*Coalitions give developing countries a stronger voice in negotiations. The resulting agreements mean that all countries, including the most powerful, have to play by the rules. The rule of law replaces might-makes-right. (WTO, 2018d, para. 2)*

The trade negotiation process has arguably shifted toward preferential trade agreements (PTAs) on a bilateral basis (Baccini & Dür, 2015; Lechner, 2016; Limão, 2016). Neglecting other considerations, even on this narrow basis, the future of the WTO as an effective multilateral trade barrier reduction approach is in question (Baldwin, 2016; Goldstein, 2017). Arguably the WTO does not adequately promote international trade (Rose, 2003).

## **Problems Generated Within and for the WTO Approach**

The political economy of the WTO separates into distinct economic and political spheres. From an economic perspective, both economic protectionism and tariff or trade wars are economically irrational for global welfare. Griswold (2018) argued that everyone loses. Hence, one can characterize economic nationalism broadly as nonsense. The reader should see Anderson (2017) on the broad consensus of economists concerning the advantages of free trade and the disadvantages of protectionism and trade wars. What some term “neoliberalism”—defined broadly as a preference for markets and against governments—is also subject to criticism in turn as bad economics (Rodrik, 2017). Siddiqui (2016) pointed to adverse effects of WTO liberalization on developing countries, especially on food self-reliance with an impact on rural employment.

*In particular, SDT conflicts with the GATT’s two key principles of reciprocity and nondiscrimination, compromising the efficiency of the multilateral trading system. Still, if SDT provisions help those who most need help, sacrificing economic efficiency may be justifiable. (Omelas, 2016, abstract)*

Fundamentally, however, difficulties with the WTO trade regime are political rather than economic. The economic perspective emphasizes rational choice, whereas the political view is about human behavior. International trade relations are a problem in game theory interactions among real actors.

*Game theory holds out the promise of transforming the core of economic theory from a science of rational choice into a science of human interaction. (Devereaux & Wagner, 2018, para. 1)*

A central difficulty within the WTO approach is an obvious imbalance of economic and military power among trading partners. The risk in WTO arrangements is a resulting rent-seeking by members. Rodrik argued that countries are entitled to defend national institutions.

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*Countries have the right to protect their own social arrangements, regulations, and institutions. ... That's more important than squeezing out the last bit of purported efficiency gains from trade. (Rodrik, cited in Kuttner, 2017, para. 10)*

Rodrik (2018c) also argued that the WTO must accommodate alternative economic models, such as China's approach. However, such accommodation presumably should extend to the changing views of the U.S., as well as the EU and the UK. The theory underlying economic globalization is that free trade generates greater aggregate welfare gains than protectionism (or any modern variant of the protectionist mercantilism preceding free trade). The theoretical case for global free trade is a strong one. However, the WTO is not automatically a pro-free trade body. Instead, efforts oriented to sustainable development may give preferential treatment to developing countries at the expense of already developed countries. Such preferential treatment may be acceptable if, for instance, the EU agrees. Such preferential treatment may be unacceptable if, for instance, the U.S. dissents. The U.S., EU, and China are the world's largest economies. Free trade theory dictates that various trade barriers be zero, not higher, for trading partners of the U.S. or EU to their disadvantage. The WTO may not promote free trade (see Rose, 2003). They should act to defend the interests of developing countries relative to advanced countries. Although the purpose is worthy, the approach may not be. The global economy is not a barrier-free world market. Rent-seeking is an effort to increase one's share of existing wealth without any associated attempt to improve the overall stock of wealth (Krueger, 1974; Tullock, 1967).

The WTO approach improves global welfare at an aggregate level, rather than necessarily for every country. The WTO approach arguably assumes that specific trade agreements and trade dispute resolutions automatically improve the national welfares of the participating countries. This assumption is not necessarily valid. It is important to emphasize the distinction between Pareto welfare improvement and Kaldor-Hicks hypothetical compensation. In Pareto improvement, there is no offsetting loss to a gain. One party improves welfare while all other parties hold welfare constant. No country is harmed; and at least one country gains. The real problem in dynamically changing global conditions is Kaldor-Hicks hypothetical compensation. In Kaldor-Hicks improvement, there can be an offsetting loss. One party enhances welfare while at least one other party suffers a loss in welfare. In principle, the winner gains enough to be able to compensate the loser while enjoying a net benefit. The compensation is hypothetical because it rarely occurs. The interests of consumers, employees, domestic firms, and MNCs may conflict across countries and within countries, reflecting realities in which no compensation is provided for losses. The perception that some countries are gaining at the expense of the United States arguably underlies the Trump Administration's theory of trade negotiations.

The WTO Director-General Roberto Azevedo, a Brazilian diplomat who succeeded Pascal Lamy of France, has warned publicly that a U.S. withdrawal from WTO would result in chaos for the global economy, the U.S., and U.S. companies (Donnan, 2018). Azevedo stated that "The United States is being treated exactly the same way as every other WTO member" (Donnan, 2018, p. B2). He noted that the U.S. both files and receives more WTO dispute cases because it is the largest economy. The U.S. has won more than 90% of filed cases and lost most cases in which it was the target (Donnan, 2018). However, this procedural interpretation, which emphasizes "fairness," does not address the problem of economic nationalism and the relative economic power of the U.S. (or the EU) directly. U.S. withdrawal might be less damaging to the U.S. than to other WTO members (Robinson & Thierfelder, 2018).

A study of judicial appointments to the Appellate Body of the WTO over a 15-year period reports that the process is “deeply politicized,” which has increased over time (Elsig & Pollack 2014). Based on the outcomes of previous Appellate Body decisions, countries have become more interested in the candidates to influence future results in their favor. If so, Appellate Body proceedings are biased.

This general problem also occurs at the regional level. The EU is under strain, illustrated by Brexit and the unsuccessful effort for Catalonian independence from Spain (an EU member). The U.S. effort to change NAFTA, in effect January 1, 1994, with Canada and Mexico, illustrates the problem. The Trump administration announced an intention to withdraw from NAFTA unless redesigned to U.S. preferences. There are internal disagreements within the U.S. concerning the benefits of NAFTA and the merits of withdrawal from NAFTA. The Trump administration threatened to withdraw unless there were acceptable concessions from Canada and Mexico. U.S. withdrawal would presumably leave bilateral arrangements (Canada-U.S., Mexico-U.S., and Canada-Mexico). Simson (2018) stated a standard of three-way mutual satisfaction:

*Regardless of the choices made to improve or replace NAFTA, trade pacts must be mutually satisfactory to survive the test of time. It's all about a long-term win-win vs. what looks in the short run like a better deal. (Simson, 2018)*

Canada is concerned with protecting its culture (affected for instance by media), agriculture (especially dairy farming), and softwood lumbering (Bird, Vance, & Woolstencroft, 2010). Canada also wants to preserve independent dispute resolution procedures (Knowledge@Wharton, 2018). A three-way mutual satisfaction standard, advocated by Simson, ignores relative power. Whatever the aggregate benefits for the NAFTA region (Canada, Mexico, and U.S. combined), the situation rests unavoidably on the satisfaction of one country rather than three countries. The U.S. can withdraw, regardless of domestic costs, if it chooses to do so. Canada and Mexico would withdraw (voluntarily) only by ignoring their domestic costs. The U.S. had reportedly reached a deal with Mexico, thus presumably placing increased pressure on Canada (Rampton & Mason, 2018). The agreement, at the end of August 2018, was to be finalized with Canada before December 1, when the new Mexican government would take office (Wingrove & Sink, 2018). The agreement with Mexico is with the outgoing government. As of early September 2018, the incoming government—a different party—was not publicly committed to the new agreement (Osborne, 2018). The Trump administration’s approach was to threaten economic ruin for Canada in the absence of an agreement (Wingrove & Sink, 2018). However, the U.S. may have considerably more leverage concerning Mexico (Knowledge@Wharton, 2018).

In the final analysis and at the last possible moment, Canada joined the new USMCA agreement (Rappeport, 2018). The incoming Mexican government signaled its support of USMCA in preference to continuing NAFTA (Malkin, 2018). One might critique the new USMCA as not much of an improvement (Tomlinson, 2018). However, there have been some changes politically significant for the U.S. The Trump administration also signed a revised free trade agreement with South Korea (Tankersley, 2018). These new agreements may bring pressure on China, depending on what the EU does concerning U.S. and China relationships (Associated Press, 2018c; Fifield, 2018). Although the EU has criticized the conflict-oriented approach of the U.S. (Wiseman, 2018), the EU favors reform of the WTO (Politi & Ewing, 2018). The basic issue is whether collaboration or threat leads other countries to agree to changes adverse to their interests (Wiseman, 2018).



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Putnam (1988) placed domestic politics and international politics into a proposed logic of two-level games. The two spheres may be fully independent. However, each game is separate. Legally mandated minimum wage in service industries may be X in one country and 2X in another country. This difference may not materially affect costs and prices for any goods or services traded between the two countries. The two spheres may be interdependent in a system of “reciprocal influence” (Putnam, 1988, p. 459). If countries subsidize aircraft manufacturers (for example, Airbus in Europe, Boeing in the U.S., Bombardier in Canada, or Embraer in Brazil) for purposes of promoting export sales, there are possibly significant effects on domestic employment resulting from government-supported competition. A government must weigh both domestic and international considerations, including complex entangling (see Lechner, 2016, concerning PTAs). The relationship may be fluid rather than static (Chorev, 2007). Negotiators may be ill-informed about domestic politics in another country (Putnam, 1988, p. 452).

*Unlike state-centric theories, the two-level approach recognizes the inevitability of domestic conflict about what the ‘national interest’ requires. ... the two-level approach recognizes that central decision-makers strive to reconcile domestic and international imperatives simultaneously. ... statesmen in this predicament face distinctive strategic opportunities and strategic dilemmas. (Putnam, 1988, p. 460)*

Domestic trade and protectionism politics may reflect “the logic of concentrated benefits and dispersed costs” – an idea associated with Olson (1965) as explained by Giberson (2010, para. 1). In classic form, this logic favors beneficiaries of government policies at the cost of average taxpayers. Lohmann (2003) provides an example of a “rural bias” in advanced economies, illustrated by the EU’s Common Agricultural Policy. Wilson (1995: xviii) developed a fuller typology combining benefits (concentrated vs. distributed) and costs (concentrated vs. distributed) into four different models of politics, one of which illustrates “concentrated benefits and dispersed costs.” This model arguably may underlie the Trump administration’s threatening higher tariff barriers to obtain better trade concessions and dispute resolution procedures more favorable to the U.S.

*The imbalances and inequities generated by the global economy cannot be tackled by protecting a few politically well-connected industries, using manifestly ridiculous national security considerations as an excuse. Such protectionism is a gimmick, not a serious agenda for trade reform. (Rodrik, 2018b, para. 1)*

Reports suggest that crucial sticking points for Canada are agricultural protection and continuation of independent dispute resolution panels to offset U.S. economic power in such disputes. Canada reportedly uses a dairy supply management system to regulate production quotas and prices (Ross, 2018). According to Ross (2018, para 2.), “Protecting that system has always taken outside importance in Canadian trade negotiations.” Canadian dairy farming reportedly concentrates in Quebec province, which is the swing vote in Canadian federal elections and facing a scheduled provincial election. The incumbent liberal party premier shifted public position from a reported apparent willingness to discuss the topic of “ultrafiltered” milk for cheese production to a reported stance that the dairy farming protection system is “nonnegotiable.” A shift in technology (ultrafiltered) has simplified cheese production. Canada has typically offered compensation to dairy farmers for adverse effects of trade deals. A study reports that Canadian dairy farming is less efficient (Slade & Hailu, 2015). Another study characterizes the dairy management system as regressive (Cardwell, Lawley, & Xiang, 2015).

Ross (2018) reported that the Trans-Pacific Partnership (TPP) rejected by the Trump administration had offered increased access to the Canadian dairy market. The Trump administration argued that the TPP insufficiently protected U.S. interests. Capaldo and Izurieta (2015) estimated TPP economic effects using the United Nations Global Policy Model. They predicted that economic growth benefits are smaller than previously projected (using full-employment models in such projections). In addition, the effects are negative rather than positive for both Japan and the U.S. They predict employment losses and increases in inequality due to TPP.

## **The UN Human Rights Regime**

Chapter 1 of the United Nations Charter (UN, 1945, Article 1, para. 1-4, and Article 2, para. 1-7) discussed a set of “Purposes and Principles.” In general terms, the purposes in Article 1, Chapter 1 organize collective measures to maintain international peace and security, promote friendly international relations “... based on respect for the principle of equal rights and self-determination of peoples ...,” promote international cooperation, and serve as a locus for “... harmonizing the actions of nations in the attainment of these common ends ...” Article 2, Chapter 1 lays out seven principles. The first principle explicitly stated “sovereign equality” of UN members, while the seventh principle distinguishes between “domestic jurisdiction” and international enforcement (under a different chapter of the UN Charter).

A global human rights regime through the UN would be a primary influence to offset a rising tide of nationalism and related phenomena. Termed the “Protect, Respect, and Remedy” framework, it adopts three guiding principles. The first principle is that national governments have the primary obligations for human rights and fundamental freedoms. The second principle, which is effectively passive, addresses business enterprises, which are required to comply with laws and respect human rights. Compliance and respect do not, however, state affirmative obligation to step forward and defend human rights against government misconduct. The third principle is a call for institutional development to create remedies for breaches of human rights and fundamental freedoms.

## **Corporate Social Responsibility**

This chapter aims to define and apply CSR for domestic firms and MNEs operating across national boundaries. This aim is achieved within a context in which the conventional WTO arrangement is under increasing stress. One must set aside SOEs as a separate category because such firms can be made directly responsible to the national government.

Windsor (2013) separates between CSR as a positive dimension (what firms should do) and corporate social irresponsibility (CSiR) as a negative dimension (what firms should not do). A working definition for CSR is that a firm should obey national law within an area of operation (unless there is a conflict with national law of the firm’s home country or with applicable international/global moral standards such as human rights) and should avoid engaging in CSiR defined as imposing harms to the greatest extent feasible. Avoiding CSiR is universal. Legal compliance can involve international conflicts and civil disobedience. CSR as a positive dimension is more about sustainable development of stakeholders, communities, and countries. Firms have moved in the direction of strategically oriented philanthropy and cross-sector partnerships to enhance reputation at constant or reduced financial cost to the firm. In a genuinely free trade global economy, economic patriotism and nationalism are matters best left to domestic consumers. Generally, even in such a global economy, goods, services, and capital are mobile

rather than labor. The circumstance suggests that there will be labor protection devices adopted by certain countries. The global economy is not a free trade setting. Therefore, as reflected in current tariff debates, CSR is shaped within the real setting. It is not an ideal theoretical formulation.

Conflicts exist for firms (even among NATO allies) caused by differences in national foreign policy. The U.S. economy is the world's most important. The U.S. sanctions on North Korea, Iran, and Russia—and sometimes the EU—do not concur with such sanctions. The U.S. is opposed to increased EU reliance on Russian energy supplies. Firms operate within these policy differences, which have also occurred previously. The U.S. and EU take different approaches to international trade negotiations. The U.S. emphasizes conflicts; the EU emphasizes dialogue (Postnikov & Bastiaens, 2014).

This difference in approach may arguably extend to CSR theorizing. Calton (2018, p. 355) pointed out that the U.S. research tradition emphasizes a search for objective evidence that investing in corporate social performance (CSP) will improve “brand image, reputation, and perceived legitimacy” and “long-term financial performance.”

In contrast, the European research tradition emphasizes “sense-making potential” through “community discourse” among multiple stakeholders to develop “shared meanings” supporting collaboration. In part, according to Calton (2018), this difference is due to the circumstance that the U.S. research tradition has not influenced business executives. The European approach is to develop processes for engaging business executives in collaboration efforts.

CSR may be different for domestic businesses and MNEs operating across national boundaries. One should distinguish between domestic CSR and multinational CSR. For the former, there may be a reasonable assumption of economic patriotism. For the latter (already tested during the Obama administration by calls for economic patriotism), any such presumption is much weaker due to profit orientation and multiple foreign markets. There is also a problem introduced by SOEs directly representing national interests unless explicitly instructed otherwise. In addition, there may be differences between privately-owned and publicly-traded firms.

The extant literature contains two very different and competing conceptions of CSR. One understanding, grounded in neoclassical economics, emphasizes a narrow meaning strictly focused on voluntary corporate altruism (Friedman, 1970). The starting point of this conception is shareholder wealth maximization, such that any altruism is a diversion of resources to a nonprofitable activity. The competing understanding, grounded in ethical and business-and-society theories, emphasizes a much broader meaning, including avoidance of CSiR, compliance with laws, and corporate citizenship activities aimed at developing societies in which the business operates. The specific conception may vary by type of country, with explicitly marked differences between advanced and developing economies (Windsor, 2017).

There are two bridges between these competing conceptions. One bridge is that the narrow neoclassical understanding rests on a presumption of compliance with laws and basic business ethics (Friedman, 1970). The theoretical neoclassical firm is not a lawless and unethical profit maximizer, although empirically specific firms may behave criminally and dishonestly. Friedman (1970) included in his notion of “rules of the game” the liberty of the firm to lobby government for benefits. However, the setting is a constitutional democracy. The other bridge is that strategically firms may engage in corporate altruism and corporate citizenship activities on the expectation of sustainable competitive advantage (Windsor, 2013).

Extant conceptions of CSR do not include any assumptions about matters such as economic nationalism or economic patriotism. There are merely two kinds of businesses. A domestic business operates within a specific country, and CSR involves how to manage within that home country. This local business is concerned with laws, ethics, and stakeholders of the home country. A MNE operates across two or

more countries, and CSR involves how to manage within the home country and various host countries. A conflict arises when there is a conflict of laws or values between countries. A MNE must decide whether home or host country considerations are more critical. Both domestic business and MNE must determine whether its corporate identity and values should base on home country conditions or a global conception that is higher than its home country conditions.

Table 1 provides a typology of three types of enterprise placed in relationship to a typology of three kinds of national political systems.

The enterprise typology is not intended to be fully exhaustive of possibilities. Instead, it identifies essential ideal-types. An enterprise buys and sells in markets. An enterprise is purely domestic, multinational (MNE), or state-owned (SOE). This typology of enterprise types is valid across all countries because enterprise types are pure (domestic, MNE, or SOE). MNEs arguably face identity problems concerning CSR obligations in the home country and host countries (see Munjal, Budhwar, & Pereira, 2018; Patnaik, Temouri, Tuffour, Tarba, & Singh, 2018).

The other typology divides national political systems or regimes among democratic capitalism, democratic social economy, and authoritarian capitalism. The U.S., Australia, Canada, Switzerland, and the UK are instances of democratic capitalism. However, there are stronger welfare state elements in Australia and Canada. Germany and Japan are instances of democratic social economy with strong welfare state elements constructed in the post-1945 era. These regimes are not socialist in orientation, strictly speaking. China and Russia are leading instances of authoritarian capitalism with a market-oriented economy under state domination and infused with significant state-owned or state-influenced enterprises. China and Russia have emerged from previously communist command economies, as have the transition countries of Eastern Europe, including Poland and Hungary. This simple typology may omit variations across countries. Developing countries may be more difficult to classify. Although there may be other variants (varieties of capitalism and socialism), these three types of regimes are the essential exemplars. SOEs exist across these regime types. However, they are more typical of authoritarian regimes or developing/emerging countries (such as Brazil), or are more likely domestic in orientation (such as local power generation or water supply).

Mapping the two typologies onto business behaviors yields indistinct arguments. Table 1 suggests that economic patriotism is more likely to occur in relative isolation with domestic businesses in democratic capitalism regimes. The call is for socially-embedded enterprises to act in the home country’s interest. This mapping does not mean there is no economic nationalism in democratic capitalism. It means that economic patriotism is the more dominant element. In contrast, economic nationalism, which can layer

*Table 1. Three types of enterprise placed in relationship to three types of national political systems*

Three Types of Enterprises	Three Types of National Political Systems		
	Democratic Capitalism	Democratic Social Economy	Authoritarian Capitalism
Domestic Business	Economic Patriotism	Economic Nationalism	Regime Political Influence
Multinational Enterprises (MNEs)	Globally Oriented		
State-Owned Enterprises (SOEs)	Home Country Regime Oriented		Regime Control

Source: Author

## **Economic Nationalism and Corporate Social Responsibility**

on top of economic patriotism, is more likely to be associated with domestic businesses in democratic social economy regimes. This mapping does not rule out economic patriotism in a democratic social economy. It means that economic nationalism is the more dominant element. The rationale for this expectation is that there is likely greater cultural homogeneity, typically, in such regimes (for example, Germany, Japan, and the Benelux and Scandinavian countries). Privately-owned MNEs are globally oriented and much less likely to exhibit patriotism or nationalism. SOEs are more likely to present home country regime orientation than do domestic businesses or MNEs. In authoritarian capitalism, while there may be economic patriotism and economic nationalism, domination by the state (and in China and Russia effectively a one-party state) is the more critical consideration. The state undertakes to influence domestic businesses and MNEs while controlling SOEs. These arguments are a matter of degree and involve economic, political, and socio-cultural elements.

SOEs gain relevance as they go multinational (Choudhury & Khanna, 2014; Cuervo-Cazurra, Inkpen, Musacchio, & Ramaswamy, 2014; PwC, 2015). Büge, Egeland, Kowalski, and Sztajerowska (2013) and Kowalski, Büge, Sztajerowska, and Egeland (2013) provided relevant data on SOEs from a combination of the 2011 Forbes Global 2,000 and 2010 World Development Indicators (WDI). They define SOEs as enterprises owned directly or indirectly more than 50.01% (of shares) by national or subnational governments. This standard captures more than 10% (204 firms) of the world's largest firms from 37 countries. Joint sales of these 204 firms amounted to \$3.6 trillion in 2011. This sales value is more than 10% of combined sales of the Forbes Global 2,000 and 6% of world gross domestic product (GDP), being equivalent to the GDP of Germany (\$3.6 trillion) and exceeding the GDP of France (\$2.8 trillion) or the UK (\$2.4 trillion). SOE shares among top 10 firms are (in descending order) 96% for China, 88% for the United Arab Emirates (UAE), 81% for Russia, 69% for Indonesia, 68% for Malaysia, 67% for Saudi Arabia, 59% for India, and 50% for Brazil. Norway (48%) is just below the 50% mark, followed by a gap from Thailand (37%). After another gap the descending order is Singapore (23%), France (17%), Ireland (16%), Greece (15%), Finland (13%), and Germany (11%). As illustrated in Figure 2 of Büge et al. (2013), reports show that all other countries fall below the 10% mark.

OECD (2014) data for 2012 covers 34 countries in the OECD area. Norway, especially, but also France, Ireland, Greece, Finland, and Germany depart from the general picture for the OECD area due to the relative importance of SOEs among top 10 firms of those countries.

*State-owned enterprises (SOEs) in the OECD area are valued at over 2 trillion USD and employ over 6 million people. Although they do not account for a particularly high share of the productive economy (2.5% of national employment on average), SOEs are highly concentrated in strategic sectors on which large parts of the private economy depend. Half of SOEs by value operate in the network industries (telecoms, electricity and gas, transportation and postal services). (OECD, 2012, para. 1)*

Kowalski et al. (2013) reported comparative data for SOEs in Brazil, China, India, Indonesia, Russia, and South Africa covering four measures as percentages of gross national income (GNI) (see their Table 4). Table 2 reorders the original data to show from highest proportion to lowest proportion of GNI among the six countries reported, and to emphasize assets and market value. China, in particular, stands out for importance of SOEs, which are less profitable in relationship to assets, market value, and sales. India stands out for relative profitability of SOEs. South Africa appears not particularly dependent on SOEs in these data. In Brazil, SOE assets are 51% of GNI. Kowalski et al. (2013) reported comparative data for SOEs in 18 OECD countries (see their Table 3).

*Table 2. Economic importance of SOEs by percent of Gross National Income (GNI) for six countries using assets and market value as the leading criteria*

Country	Assets	Market Value	Sales	Profit
China	145	44	26	2.9
India	75	22	16	4.3
Russia	64	28	16	3.0
Brazil	51	18	12	1.7
Indonesia	19	12	3	0.3
South Africa	3	1	2	1.7

Source: Data reordered from Kowalski et al. (2013), who reported countries alphabetically and placed sales and profit prior to assets and market value. Those authors use 2010 Gross National Income (GNI) data. See their Table 4.

China stands out with respect to the economic role of SOEs. That role appears to be declining. However, in 2010, it was still above 50% of total industrial assets concentrated in relatively large SOEs (Xu, 2010, para. 10). Xu uses the Second National Economic Census for 2008; a Third National Economic Census for 2013 has been completed (Xia & Dong, 2013) and a Fourth National Economic Census is underway. Studies of CSR among Chinese SOEs suggest that the government is driving the effort (Li & Belal, 2018; Zhu, Liu, & Lai, 2016).

*The Second National Economic Census conducted in 2008 reveals that of all the 208 trillion RMB total assets of the secondary and tertiary sectors (industrial and service sectors), 63 trillion – or 30 percent of total – was held by SOEs. (SOEs here correspond to state sole funded corporations and enterprises with the state as the biggest share holder.) Meanwhile, in terms of enterprise number, there were 154,000 SOEs at the end of 2008, only accounting for 3.1 percent of the total enterprise number. Hence, the big picture is clear: SOEs control a substantial part of total enterprise assets in China despite the fact that their total number is marginal. As a corollary of this observation it follows that the average size of SOEs is much bigger than that of non-SOEs. This is indeed the case. In terms of average assets, SOEs are equal to 13.4 times of non-SOEs. (Xu, 2010, para. 5)*

*SOEs represent 80% of China’s stock market capitalization, 62% of Russia’s, and 38% of Brazil’s ... Even in the developed economies of Western Europe the state is a controlling shareholder in 15% of listed firms in Austria and Finland and 10% in Italy ... SOEs represent approximately 5% of GDP in OECD countries and 10% of the global GDP ... Some examples of SOEs include the world’s largest natural-gas company, Russia’s Gazprom [see Ramaswamy, 2013], all of the 13<sup>th</sup> largest oil companies in the world based on oil reserves, and the world’s largest mobile-phone operator, China Mobile ... (Stan, Peng, & Bruton, 2014, p. 474, citing other sources deleted here)*

*When you look at the 2014 Global Fortune 500 list, 95 companies from China made it onto the prestigious ranking, a big jump from only nine in 2000. However, the majority of these companies are state-owned enterprises (SOEs) and three giants in monopoly industries – Sinopec, CNPC and State Grid – rank among Fortune’s top 10. (Liu, 2015, para. 3)*

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SOEs remain important in Russia (Sprenger, 2008), India (Jose, 2016), and Brazil despite privatization efforts. Russia and India from the early 1990s began privatization steps. An Indian law of 2013 places requirements on large, profitable companies to spend on CSR initiatives. Some Indian companies have strong reputations for CSR orientation (Srivastava, Negi, Mishra, & Pandey, 2012). A sample of 114 largest Russian firms over the period 2006-2014 found that while SOEs' stock market share declined, share of total revenues and employment increased slightly (Abramov, Radygin, & Chernova, 2017). By 2003, Brazil had moved toward a policy of encouraging private companies for foreign expansion. Recent instances of corruption in Brazil include SOEs as noted by Vianna (2014, p. 3) that "Many of the biggest cases of corruption that took place in Brazil in the last years happened within state owned enterprises (SOEs)."

*As of 2003, there was a clear shift toward the strengthening of private national companies or groups, and both the state and the entrepreneurs have been collaborating to create "national champions" or "global leading" corporations. Nonetheless, Brazil still has a bulging state-owned sector composed of over one hundred federal SOEs that have undertaken complex activities or roles in the national economy and development. (Tautz, Ramos, Pinto, Serra, & Serra, 2014, p. 3)*

A comparison of two brief case studies helps to illuminate the key issues involved in assessing economic nationalism in relationship to CSR. The Trump administration has adopted policies of deregulation, tax reduction, and threat of trade war to obtain reduced import barriers in other countries.

One of the actions has been increased tariffs on steel and aluminum imports. The United States Steel Corporation (USS) is an old integrated steel producer founded 1901 and headquartered in Pittsburgh, Pennsylvania. USS is undertaking a \$2 billion revitalization effort (Associated Press, 2018a). USS announced plans to invest at least \$750 million (one-third of the total) to upgrade its 112-year-old steel mill in Gary, Indiana (Associated Press, 2018a). Indiana and the city of Gary are considering providing \$47 million in incentives (Associated Press, 2018a). The Trump administration actions have encouraged the revitalization effort by encouraging market conditions favorable to investment in the U.S. steel industry (Fitzgerald, 2018). The same government policies appear to attract foreign direct investment (FDI). For instance, the Indian steel company, JSW Steel, has announced plans to invest large sums well in excess of \$1 billion in the U.S., including plans to modernize a closed 1929 plant acquired in Mingo Junction, Ohio (Fernandez, 2018; Fitzgerald, 2018). JSW is also expanding an existing facility in Baytown, Texas (Fernandez, 2018; Fitzgerald, 2018). The German firm Covestro has announced plans to invest \$1.7 billion to expand a Baytown, Texas plant producing polyurethane forms (Blunt, 2018). One should not interpret economic nationalism as requiring economically irrational CSR or investment actions. However, USS is partly acting to reestablish itself as a U.S. business. Its strategy matches preferences of the Trump administration. The September 2018 World Economic Outlook of the International Monetary Fund (IMF) cut the global growth forecast for 2018 and 2019 relative to July 2018 forecast by 0.2 percentage to 3.7% (Giugliano, 2018). The outlook expects reductions in growth of emerging and developing economies rather than for advanced economies except for the U.S. (Giugliano, 2018). The outlook attributed the reductions to U.S tax cuts causing a fiscal stimulus and increasing interest rates and to increased risk of trade war with China (Giugliano, 2018; see Boone, 2018).

The U.S. situation can be contrasted with two other situations. There have been a series of recent scandals in Japan and Germany. In Japan, the most prominent scandals have involved revelations of falsification of information and concealment of problems. Well-known companies involve several Mitsubishi subsidiaries (Mitsubishi Materials, Mitsubishi Cable Industries, Mitsubishi Motors, and Mitsubishi Shindoh), Kobe Steel, Nissan, Subaru, Takata (airbags), and Toshiba (focusing on its nuclear power business). The scandals include accounting manipulations, quality misreporting, and fuel efficiency cheating (Iyengar, 2017; Shane, 2017). An explanation emphasizes Japanese managers' loyalty to superiors and company, as well as reluctance to admit and report mistakes because of effects on career advancement (Shane, 2017). However, one should not discount the role of economic nationalism. Failures reflect on the country, which relies on export of goods. Scandals have also occurred in Germany, involving bribery at Siemens, labor union corruption and diesel test cheating at VW, and BASF participation in vitamin pricing cartels (Abdelal, Di Tella, & Schlefer, 2008; Parloff, 2018).

A set of countries not notably oriented to economic nationalism includes Switzerland and the Nordic states (Scandinavia). These economies are open. Switzerland is not affiliated with either the EU or NATO. These countries have emphasized domestic and global CSR initiatives. Governments and businesses generally support CSR and environmental sustainability in home and host countries. Recent sources on Switzerland include Looser and Wehrmeyer (2015), Swiss Confederation (2017), the national airline SWISS (n.d.), and the global reinsurer Swiss Re (n.d.). Recent sources on the Nordic or Scandinavian model include Strand, Freeman, and Hockerts (2015) and Midttun, Gjølborg, Kourula, Sweet, and Valentin (2015).

## **SOLUTIONS AND RECOMMENDATIONS**

Crafting solutions and recommendations involves considerable future research efforts aimed at understanding an evolving complicated world situation. Business managers must be alert to the implications of changing conditions in the home and host countries. A key recommendation is that business managers must determine what should be corporate values. Is the necessary solution to consider the profitability of the business primarily? U.S. sanctions restored against Iran compel both U.S. and European companies to reconsider their options. Are their choices a business decision, a value judgment, or both?

Google plans on re-entering the China market under censorship supervision. Simultaneously, Google faces internal employee debates concerning roles in U.S. immigration controls and a recently levied substantial antitrust fine by the EU. Apple's 2018 iPhone XS dual sim technology reportedly includes features not available in China (or Hong Kong and Macau). Instead, it substitutes slots permitting SIM cards to identify and authenticate the phone number (Barr, 2018). A Russian, Chinese, or Brazilian SOE is in quite a different situation. Its context may extend to government-influenced or government-allied MNEs from those countries. The German firm Siemens orchestrated a bribery strategy conducted across multiple countries. Such examples may help to explain what CSR and CSiR mean in practice across different operating environments. MNEs from emerging economies and developing economies are also becoming more important on the world stage.



## **FUTURE RESEARCH DIRECTIONS**

Research should and will increasingly focus on four major themes.

1. A first theme is empirical investigation into the determinants, or drivers, of the rising tide of the related phenomena of economic nationalism, economic patriotism, economic protectionism, populism, and antiglobalization. Considerable research is underway. It is essential to emphasize the crucial importance of better understanding.
2. A second theme is empirical investigation into the consequences on various countries of these phenomena. There are likely to be variable consequences and national political reactions.
3. A third theme is a practical and theoretical study of what national policies should be considering these determinants and consequences. The presumption has been in favor of free trade, but it is not clear that the WTO has had such an effect. The WTO situation does not necessarily mean that the Trump administration orientation toward renegotiating trade arrangements is the best path. One should separate the situation from the options for addressing that situation.
4. A fourth theme, which is the focus of this chapter, concerns CSR, CSiR, and CSP conceptions considering these changing world conditions. CSR now involves domestic businesses shifting toward nationalism and patriotism (or that local considerations become more important). MNEs are caught among home country, host countries, and corporate values. SOEs are likely to be responsive to home country government policies rather than to globally defined value standards. Civil disobedience means ethically-grounded noncompliance with morally objectionable laws. The U.S. is seeing a growing movement of corporate objections to state and local enactments concerning restrictions on diversity and privacy. At the same time, U.S. MNEs may elect to obey arguably equally objectionable laws in China. Google objects to privacy controls (practiced on national security rationales) at home but redesigns its approaches to re-enter the China economy. Contradictions raise issues for CSR theorizing.

## **CONCLUSION**

This chapter examines the relationship between extant conceptions of CSR and economic nationalism. A central finding is that CSR theories and practices are arguably compatible with various models for economic nationalism. In addition, they can adjust to country-specific circumstances. The chapter explains difficulties with the WTO and the UN human rights regime, occurring with a sea-change in world conditions. Rodrik (2018c) emphasized that WTO must accommodate to varying models typically emphasizing economic nationalism over international cooperation. China and Russia are undertaking aggressive initiatives in their regions as they seek to play more significant roles on the world stage. Iran and North Korea are trying to become nuclear powers. In such countries, the government tends to drive CSR policies, practices, and the activities of SOEs.

Different models are emerging in some advanced economies and developing countries. The UK is engaged in Brexit from the EU whether the process goes through to completion or not. The Trump administration is involved in renegotiating trade relations with Canada, Mexico, China, and the EU. Immigration and other pressures are generating political and economic populism in the U.S. and various European countries. Switzerland and the Nordic countries, being more open economies, generally foster global CSR efforts. Developing countries, illustrated by Brazil and India, arguably take different approaches. In this setting, CSR involves domestic businesses and home country-based MNEs moving toward nationalism. SOEs are likely to be responsive to home country government policies rather than to globally defined value standards.

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## KEY TERMS AND DEFINITIONS

**Antiglobalization:** Negative reactions by citizens and their political representatives to economic, political, and social effects of globalization.

**Corporate Social Irresponsibility (CSiR):** Managers' disregard for laws, ethics, and stakeholders that stresses short-term profits over longer-term business sustainability.

**Corporate Social Performance (CSP):** Economic, political, social, and stakeholder consequences of business decisions that may be positive (beneficial) or negative (damaging) from social or stakeholder perspectives.

**Corporate Social Responsibility (CSR):** Managers' regard for laws, ethics, and stakeholders as more important than short-term profits and stressing corporate social performance (CSP).

**Economic Nationalism:** Policy emphasis on the national interest in international economic relations.

**Economic Patriotism:** Preference by consumers and producers for home country goods and services.

**Economic Protectionism:** Trade and nontrade barriers intended to protect the home country economy from harmful effects of international economic relations.

**Globalization:** Processes of greater international interaction and integration of economies and institutions tending to reduce relative importance and roles of national territories.

**National Sovereignty:** The principle that each country has independent sovereignty over its domestic policies and arrangements.

**Populism:** Political movement and philosophy that espouses interests of and appeals to the "common person" by denigrating elites, governments, and established political parties.

**Regionalization:** Processes of greater international interaction and integration of markets and institutions occurring in specific geographic regions illustrated by the North American Free Trade Agreement (NAFTA) or the European Union (EU).

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