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JOURNAL OF INTERNATIONAL BUSINESS RESEARCH

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LETTER FROM THE EDITOR

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The Academy is particularly grateful for the financial support provided by Sam Houston State University which was instrumental in making this new journal possible. The Sam Houston faculty is active in international business research and the institution is making a name for itself as a leader in this discipline, as well as in other areas of business research. The Academy welcomes Sam Houston as a sponsor and offers this volume of outstanding work as evidence of its interest in providing additional outlets for the research efforts of scientists in the international arena from around the world.

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ARTICLES FOR VOLUME 3, NUMBER 2

ASSESSING THE QUALITY OF EARNINGS: A SURVEY OF FINANCIAL STATEMENT USERS'S PERCEPTIONS TOWARDS THE REPORTING IMPORTANCE OF SELECTED CATEGORIES OF INFORMATION

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ABSTRACT

The earnings of an enterprise provide indications of both future cash flows and future earnings. To the extent the current rules of accounting measurement contaminates the quality of earnings, it would hinder such indications. The objective of this research is twofold: to investigate the reporting importance of selected categories of information vis-à-vis assessment of the quality of earnings; and, to compare the perceptions of different user groups concerning the said reporting importance. To achieve the research objectives, two hypotheses were formulated and a mailed survey was used to collect the data. Appropriate statistical methods were used to test the research hypotheses. The findings, with one exception, did not reveal any significant differences among the perceived reporting importance of different categories of information. The findings, however, did demonstrate the existence of significant differences among the perceptions of various user groups concerning the reporting importance of the information. The results of this study may assist standard setters to promulgate "localized" financial reporting standards. Such environmentally specific standards would enhance financial statements users' ability to assess both future cash flows and future earnings.

INTRODUCTION

Financial statements user groups have a variety of specific information needs and only "specific purpose" financial statements may have the ability to address those needs. For a host of reasons, it is accepted on a priori, that satisfying specific information needs of different users through public financial reporting is both impractical and infeasible. Therefore, out of mere necessity if not for any other reason, the bodies responsible for establishing financial reporting standards throughout the world, have opted for the current framework of "general purpose" external financial reporting.

One of the objectives of public financial reporting, according to the *Statements of Financial Accounting Concepts (SFAC) No. 1*, is to provide information about the economic performance and earnings (income) of an enterprise. The other objective is to provide information useful in assessing future cash flows. To achieve these objectives, the reported earning should enjoy the necessary quality that would allow the prediction of future cash flows as well as prediction of future performance and earnings (Delaney et. al., 1997).

Measurement of income, as defined by accountants, is based on the current rules of revenue recognition and expense realization. As there are some theoretical as well as practical problems with the current rules, the quality of reported earnings resulting from their application is compromised. Income measured under the existing rules does not have the ability to capture the "true" economic substance of the transactions and cannot realize fully SFAC's stated objectives of financial reporting. Examples of the problems that are entrenched in the process of earnings' measurement include the syntactic nature of the earnings definition, the arbitrary nature of estimates involved in the earnings measurement, and the "finite uniformity" in application of accounting methods (Wolk & Tearney, 1997). These problems allow for the "management of earnings" (earnings management) via manipulation of accruals, deferrals, and discretionary items (Easton, 1985; Lipe, 1986; O'Glove, 1987; Hayes, 1995; Haim, 1998).

Earnings management that is made possible by the above-mentioned problems diminishes the "quality of earnings" reported by the firms. The concept of "quality of earnings" refers to the ability of earnings (current or past) to reflects the operational performance of an entity and correspond to the concept of "real income." In another word, the "quality of earnings" is defined as the information content of income components and other related information which would allow for an "exact" prediction of future earnings. This concept, although illusive, has evolved around the belief that there exists "real income" out there; an income number that is a "true" measure of economic activities of an enterprise and best able to predict the future performance and cash flows (Cready, 1979; Brown, 1983).

RELEVANT LITERATURE REVIEW

The significant worldwide cases of corporate scandals of the last few years have demonstrated, among other things, the failure of reported earnings to reflect economic reality of transactions consummated. These cases have resulted in a renewed demand for better quality of financial reporting by the public; and as a result, have focused the attention of the regulators and policymakers on the issue of "quality of earnings."

The recent literature has fully established that earnings management is a deliberate action on the part of corporations aimed at achieving some desired outcome: either to mislead about the underlying economic performance of the company, or to influence contractual outcomes that depend on reported accounting numbers (Healy & Wahlen, 1999). According to Healy & Wahlen, earnings management is possible for two main reasons: First, existing Generally Accepted Accounting Practice (GAAP) does not address all possible situations. Secondly, even in areas where GAAP provides a framework of accounting rules, managers may have some choices over how GAAP is applied (i.e., finite uniformity rule)[1].

The widespread use of earnings information and the role it plays in the areas of predictions and valuations (e.g., prediction of future earnings, prediction of future cash flows, firm's valuation models, and alike) coupled with the potential for financial statement manipulation, has created a new level of risk for corporate stakeholders. Perry and Williams (1994) point to the implication of reported earnings on the firm's valuation and provide an empirical evidence of the manipulation of accruals (income decreasing) prior to a management buyout. In the same vein, the study of Teoh, Welch and Wong (1998) present the evidence of a reverse manipulation of accruals (income increasing) to overstate earnings prior to equity offerings.

Other studies show that earnings management could be undertaken to influence the capital market. These studies demonstrate that earnings are managed to meet the expectations of financial analysts. According to Burgstahler and Eames (1998), firms manage earnings to meet analysts' forecasts. In particular, they find that corporations take actions to manage earnings upward to avoid reporting earnings lower than analysts' expectations.

In the face of the well-documented instances of earnings management by corporations, what appears to be an effective method of combating this practice is to find ways to extract "real income" from the reported income. This could be done either by modification of the rules of measurement (Willson, 1987; Haim, 1998; Givoly, 1985) or modification of the rules of disclosure (Farris, 1977; Easton, 85; and Bowen, 86). This paper asserts that until suitable alternative rules of measurement are found, it is only logical to provide sufficient, useful, and necessary disclosures as to enable the public to assess the quality of income; and hence, mitigate the impact of earnings management.

To support the above assertion, Dechow et. al. (1995) delineates the position that providing adequate disclosure would allow the investors and other users to take into account the effect of the accounting choices revealed in the financial statements (possibly through making their own estimates and adjustments) on the reported earnings (i.e., the adequate disclosure would enable the financial statement users to make the necessary adjustment to the reported earnings and hence improve the quality of net income). This position is consistent with the result of a study by Hirst and Hopkins (1998) that finds a clear display of the components of comprehensive income enhances analysts' detection of earnings management and improves their valuation relative to footnote disclosures.

THE STUDY

The aim of this study is to identify the information that if disclosed, would assist the process of ascertaining the "real income" from that of reported. Based on the results, the disclosure rules might be modified as to improve the "quality" of earnings reported by the firms. To that end, this study has two specific objectives: to investigate the relative reporting importance of selected information components in assessing the quality of earnings; and, to ascertain if there are any significant differences among the perceptions of different user groups concerning the said reporting importance. In view of the research objectives, two hypotheses were formulated as follows:

Hypothesis 1.	There are no significant differences among the reporting importance of different categories of information components vis-à-vis assessing the quality of earnings.
Hypothesis 2.	There are no significant differences among the perceptions of different user groups concerning the reporting importance of information components vis-à-vis assessing the quality of earnings.

THE RESEARCH DESIGN

To achieve the research objectives, a survey was conducted and using a validated questionnaire, the perceptions of selected groups of financial statement user were collected. Thirty-six items of various information components were deemed relevant and included in the survey. In the initial stage of the instrument development, 47 components were identified. The selections of the components were based on an extensive review of the relevant literature. To ensure that selected items were environmentally specific, the advice of a panel of experts was sought. Based on their knowledge of the characteristics of the market and its participants (i.e., user groups, with the exception of the government), each member of the panel was asked to evaluate the relevance of the components and make comments and suggestion[2]. An evaluation of the responses received resulted in some modifications to the initial selection. The final product was a list of 36 information components -- the basis for constructing the questionnaire.

The Instrument

The questionnaire for the study consisted of two parts. In part one, the respondents were asked to provide some demographic information; and in part two, using a five-point Likert type scale, the subjects were asked to identify their perceived reporting importance of each of the 36 components in assessing the quality of earnings. The questionnaires along with the cover letter were mailed to the subjects in three waves. In the cover letter, a working definition of the "quality of earnings" was provided and the respondents were asked to rank, based solely on their perceptions, the reporting importance of each item in assessing the quality of earnings.

Reliability and Validity of the Instrument

The external validity of any research is a function of, among other things, the reliability as well as validity of its measurement instrument. In this study, two aspects of reliability of the instrument were addressed: the consistency of measurement results for all items or group of items, and the consistency of subjects' responses to similar items. The former consistency was tested using split-half technique and the latter was tested by a test-retest approach. The tests were conducted at 95 percent confidence level. The results showed a relatively high degree of instrument reliability (a correlation of 82 and 88 percent, respectively).

A related issue to reliability is that of validity. The content validity[3] of the measurement instrument was evaluated in the pilot phase of the questionnaire development by asking the subjects to evaluate and comment on the potential irrelevance of any components of the study to the area of research. No comments were received. Absent any comments concerning the irrelevance of any of the items; and furthermore, due to the close relationship of the most components of interest with net income, a relatively high content validity was assumed.

The approach used to test the construct validity[4] was the group difference approach. Under this approach, on a priori, it was assumed that on the average, the portfolio managers (surrogates for investors) would perceive detailed reporting of the information components as more important than the tax assessors would. A t-statistic was used to compare the responses of the two groups on some randomly selected items. The results showed the presence of statistically significant differences between the perceptions of the two groups. The ability of the instrument to reveal such differences provided some indications of the construct validity of the measure (Scott, 1961).

Questionnaire Distribution

Three waves of questionnaires were distributed among the subjects. The information related to questionnaire distribution are presented in Table 1. Table 1 shows: the sample size for each of the user groups, the number of questionnaires distributed, and the response rate.

Table 1 - Questionnaire Distribution and Response Rates							
No.	Users Groups	Mailed		Received		NR	
		No.	%	No.	%	No.	%
1.	Portfolio managers	80	14.00	47	08.24	33	05.80
2.	Loan officers	60	10.50	32	05.61	28	04.91
3.	Corporate managers	120	21.10	69	12.19	51	08.95
4.	Stock brokers	70	12.30	32	05.61	38	06.67
5.	Public accountants	140	24.60	67	11.75	73	12.80
6.	Tax assessors	100	17.50	61	10.70	39	06.84
	Total	570	100.00	308	54.00	262	46.00

NR = Non - response

As shown in Table 1, the survey achieved a 54 percent response rate. Out of the questionnaires received, for a variety of reasons, a total of 34 were unusable, resulting in an overall usable response rate of just over 48 percent. The non-respondents were about 46 percent.

One of the major concerns in any mailed questionnaire is that of missing data due to non-respondents, which may lead to a bias in the results. To account for any non-response bias, a comparative analysis of the responses to each of the questions over the three waves of mailings was conducted. The results of the analysis, with few exceptions, did not show any significant differences among the answers. Notwithstanding the few exceptions, the absence of any significant differences among the responses to the three waves, might be interpreted as the lack of non-response bias in the study (Pany & Reckers, 1980).

DATA ANALYSIS

For the purpose of data analysis, the information components were classified into six categories. Each of the components represented a given aspect of a firms' activities containing information regarding the ability to generate future cash flows and future income. The six categories and their respective components are presented in Table 2.

Table 2 - Categories of Information Components

I. *Items of Income Statement -- Itemized Reporting of:*
1. sales revenue
2. operating income
3. income from continuing operation
4. net income
5. gains and losses
6. interest expense
7. depreciation expense
8. tax expense
9. administrative expenses
10 abnormal changes in sales revenue
11. abnormal changes in discretionary expense
12. extraordinary items
13. earnings per share

II. *Accounting Methods Used -- Full Disclosure of Accounting Methods and Assumptions Relating to:*
14. accounting methods used to calculate net income
15. conservative or aggressive nature of accounting method used
16. accounting estimates and related assumptions
17. accounting treatment of deferrals
18. accounting treatment of accruals

III. *Items of Balance Sheet -- Full Disclosure of Abnormal Changes in :*
19. intangible assets
20. current assets
21. fixed assets
22. other assets
23. current liabilities
24. long-term liabilities
25. stockholders' equity
26. current assets' write-offs
27. fixed and non-current asset write-offs
28. ratio of debts to stockholders' equity
29. ratio of debt and operating leverage

IV. Political and Economic Factors -- Disclosure of Political and Economic Factors Related to:
30. firm
31. industry

V. *Firm's Characteristics -- Disclosure of Firms' Characteristics Regarding:*
32. production mix
33. input resources
34. geographic dispersion of activities

Using a five-point Likert type scale covering a range of "not important" to "very important" the perceptions of the subjects were collected. The mean ratings and standard deviations concerning the relevant reporting importance of research components are provided in Table 3. (The description of the information components corresponding to different item numbers is presented in Table 2).

Table 3 - Means of Responses by All of the Groups for Each Item

Categories of Information	Item Number	Mean	Std. Deviation
Items of Income Statement:	1	4.01	0.92
	2	4.62	1.38
	3	4.12	0.96
	4	4.29	0.89
	5	4.00	1.29
	6	1.06	1.07
	7	4.21	0.98
	8	3.96	1.78
	9	4.09	0.85
	10	3.77	0.90
	11	3.35	1.25
	12	2.20	1.88
	13	4.46	0.75
Accounting Methods Used:	14	2.94	1.19
	15	2.72	0.94
	16	2.94	0.88
	17	2.88	1.11
	18	3.22	0.84
Items of Balance Sheet:	19	3.51	0.99
	20	3.45	0.95
	21	3.89	0.92
	22	3.52	1.34
	23	3.64	1.88
	24	3.33	0.93
	25	3.48	1.27
	26	3.51	0.93

Table 3 - Means of Responses by All of the Groups for Each Item			
Categories of Information	Item Number	Mean	Std. Deviation
	27	3.65	1.29
	28	3.87	0.92
	29	3.42	1.19
Political and Economic Factors:	30	3.85	0.87
	31	4.15	0.90
Firm's Characteristics:	32	4.32	1.08
	33	4.22	1.07
	34	4.10	0.84
Other Items :	35	4.21	0.85
	36	4.10	0.66
1 = Not important			5 = Very important

Two-Way Freedman Method of Analysis

The first research hypothesis dealt with the issue of any differences that might exist among the perceived reporting importance of different categories of information components. Two-way Freedman method of analysis was used to test this hypothesis. The test was conducted at 95 percent confidence level. The results are shown in Table 4. Table 4 identifies the aggregate mean score for each of the category of information, the Chi2 , and the respective probability significance .

Table 4 - The Results of Two-Way Freedman Analysis				
Category of information	Mean	Chi^2	P	Accept (A) Reject (R)
Items of income statement	3.85	42.80	0.99	A
Accounting methods used	2.94	21.19	0.03	R
Items of balance sheet	3.57	40.86	0.99	A
Political and economic factors	4.05	44.27	0.99	A
Firm's characteristics	4.16	79.04	0.99	A
Other items	4.18	57.59	0.99	A

As shown in Table 4, the null hypotheses could not be rejected for all, but one of the categories. This finding supports the notion that with the exception of the category of "accounting methods used," there are no significant differences among the reporting importance of other categories of information components studied.

Kruskal-Wallis Overall ANOVA

The second hypothesis of the study concerned any significant differences that might exist among the perceptions of different user groups. The population of the study were divided into six groups as follow: The population of the study were divided into six groups as follow: stockholders, loan officers, corporate managers, financial analysts, public accountants, and tax assessors.

Due to relatively small and uneven user groups' sizes as well as the ordinal nature of data, the Kruskal-Wallis ANOVA was utilized to test the hypothesis. This analysis provides for an overall test of agreement among the different groups surveyed. The results of the test are presented in Table 5.

Table 5 - The Results of the Kruskal-Wallis ANOVA

Group's Name	Mean								
	X_1	X_2	X_3	X_4	X_5	X_6	Chi^2	P	Accept (A) Reject (R)
Items of revenue and expenses	4.1	2.5	4.2	2.8	4.1	2.5	18.10	0.028	R
Accounting methods used	3.9	2.9	2.9	3.1	4.0	1.9	12.34	0.034	R
Items of balance sheet	3.5	2.8	3.8	3.9	4.1	2.6	21.74	0.007	R
Political and Economic factors	4.1	2.1	4.8	4.2	2.6	2.8	11.47	0.041	R
Firm's Characteristics	4.7	2.8	3.9	4.1	4.1	2.2	15.47	0.008	R
Other items	3.9	2.6	3.7	4.2	3.9	2.1	13.26	0.012	R

To compare the perceptions of different user groups, a response score for individual respondents to each of the six reporting categories was calculated.[5] As shown in Table 5, the research hypothesis for all categories were rejected. These results suggest the existence of significant differences among the perceptions of different user groups.

Tuskey-HSD Method of Analysis

The Tuskey-HSD method of analysis is designed to detect any differences which might exist among different groups or different treatments. To determine which groups of the population differed in their perceptions from others, this method was used. The results are shown in Table 6.

Table 6 - The Results of Tuskey-HSD Analysis

Group's Name	X_1	X_2	X_3	X_4	X_5	X_6
Items of revenue and expenses		★		★		★
Accounting methods used		★	★	★		★
Items of balance sheet sheet		★				★
Political and Economic factors		★			★	★
Firm's Characteristics		★				★
Other items		★			★	★
X_1 : Portfolio managers						
X_2 : Loan officers						
X_3 : Corporate managers						
X_4 : Stock brokers						
X_5 : Public Accountants						
X_6 : Tax assessors						

Table 6 shows, for the most part, two groups of respondents ranked the reporting importance of the items less than the other groups. The (*) in each of the columns of Table 6 represent the particular user groups whose perceptions were significantly different from the rest. The results show the perceptions of the tax assessors, and loan officers were significantly different from the other user groups and that the differences were pervasive.[6] These two groups ranked the reporting importance of the items lower than the rest of the respondent groups.

As for the perceptions of the remaining four groups, although some certain pattern of responses could be detected; nonetheless, the results were mixed. Overall evaluation of the results suggests that the portfolio managers attached a higher degree of reporting importance to the information components. This result is not surprising, given the nature of their activity. As Table

6 depicts, similar perceptions to those of portfolio managers also held true for corporate managers, stockbrokers, and to a lesser extent, for public accountant.

COMPARATIVE ANALYSIS OF RESPONSES

Comparative analysis of responses were divided into two groups: different items within each category of information (intra-category comparison) and different categories of information (inter-category comparison). As for the former, with few exception, a relatively consistent pattern of responses may be observed (please see Table 3). With respect to inter-category comparison, however, the overall results suggest an inconsistent pattern (please see Table 4 for the mean ratings of different categories).

The information in Table 3 suggests that the major exceptions to the overall consistent pattern of responses within each category were the interest expense and extraordinary items. The perceived importance of these two items was markedly lower than the rest in the category of "items of income statement." The lower perceived importance associated with interest expense could be explained by the insignificant role that debt plays in the corporate capital structure of firms in Iran. For a variety of reasons (e.g., non-existent systematic debt financing market for the private sector, religion, and culture) capital structures in Iran are mostly driven by equity financing. Hence, the total amount of interest expense, in comparison to other expenses, is rather insignificant. As for the extraordinary items, it appears that the very necessary conditions for their recognition as such, explain their relatively low importance.

With respect to the categories of information dealing with qualitative information, an observation that is worth noting is related to the disclosure of "accounting methods used." For the most part, the components of this category received the lowest perceived reporting importance. These results are consistent with the theory of "functional fixation," which is predicated on the assumption that users employ accounting numbers without much regards as to how those numbers are generated. This finding is consistent with prior research by Cook and Wallace (1990) into the behavior of accounting information users in developing countries. In their study, Cook & Wallace found the information users in developing countries place more value on quantitative than qualitative information.

Inconsistent with the above result was the high-perceived reporting importance of the other two categories of qualitative information included in the study. One of the two categories dealt with factors relating to the disclosure of firm's characteristics and the other concerned disclosure of political and economic factors. The high-perceived reporting importance of the latter might be viewed as an evidence of users' awareness of the content value of "political and economic" information. In view of the current political and economic climate in Iran, this finding appears justified.

As for the items of the balance sheet, another category of components, they received an overall mean rating of around 3.50. These ratings represent an average degree of perceived importance, which might be explained by the indirect relation of balance sheet items to earnings.

The last two components of the study classified in the "other items" category, received mean values of more than four. The first of these two items addressed the issue of inflation and the next dealt with forecasted financial statements. As for the former, the current inflationary condition of the Iranian economy seems to explain its perceived importance. With respect to the perspective financial information, due to the very nature of the item (i.e., prospective orientation), its high reporting importance for the assessment of future cash flows and net income appears to be self-explanatory.

DEMOGRAPHIC INFORMATION

In the first part of the questionnaire, the respondents were asked to provide information about their position title, education, major area of study, professional certification status, and years of professional experience. In addition, they were asked to indicate public accounting experience, if any. While the position titles of the respondents are presented in Table 1, other demographics are shown in Table 7.

Table 7 - Demographic Data

Demographics	Number (n)	Percent (%)
Educational background		
Some college education	40	7
Four-year college degree	365	64
Master's degree	148	26
Doctorate	17	3
Total	570	100
Respondents' major area of study		
Accounting	283	50
Finance	221	38
Management	45	8
Others	21	4
Total	570	100

Table 7 - Demographic Data		
Demographics	Number (n)	Percent (%)
Professional certification status		
None	290	51
Certified Public Accountant	190	33
Certified Financial Analyst	65	11
Certified Management Accountant	12	2
Certified Internal Auditor	5	1
Others	8	2
Total	570	100
Years of professional experience		
Less than three years	36	6
More than three but less than five years	72	13
More than five, but less than ten years	86	15
More than ten years	376	66
Total	570	100
Respondent's public accounting experience		
Yes	276	48
No	294	52
Total	570	100

As Table 7 illustrates, the respondents were well educated (over 64 and 26 percent held four-year or master's degrees, respectively). More than 89 percent of those surveyed had either an accounting or finance educational background and about 49 percent were professionally certified. Public accounting certification (CPA) led the way by accounting for 68 percent of professional certifications held by the respondents. The work experience of an overwhelmingly majority of the respondents exceeded ten years, and almost half of those surveyed had public accounting professional experience.

The demographic information may support two assertions. First, respondents represented a broad cross-section which would tend to reduce the possibility of any systematic bias in the study. Second, their background (i.e., area of study and the level of education, length, and type of work experience, and professional certification) backs the notion that those surveyed were knowledgeable about the topic and the nature of the study. The presence of these criteria seem to strengthen the validity of the study, and hence, improve the reliability of the results.

LIMITATION OF STUDY

There are certain limitations concerning this study that may restrict its external validity. These limitations might influence interpretations of the results and/or its potential implications. They are presented below.

First, for improving the reliability of research findings, the study used portfolio managers as surrogates for the investors. Along the same line, stockbrokers were used as the surrogates for financial analysts (currently there is no profession of financial analyst in Iran and stockbrokers, in actuality, do perform the tasks usually performed by financial analysts). To the extent that in either of the two cases, the surrogates used were not "good" proxies for the intended original groups, this might have affected the findings.

Second, in the comparative analysis of the responses to the three waves of the questionnaires, there were statistically significant differences observed in responses to questions concerning items 17, 21, and 30 (for the description of the items, please see the relevant pages). The significant differences among the responses to the three waves of the questionnaires might be an indication of non-response bias for the three items.

Third, to compute an average score for components within each category of information, their relative weight were assumed equal. This assumption seems justified due to the similar nature of items in each of the categories. The relative consistency of responses to the components within each category also provided some empirical support for such assumption. However, to the extent, the weight of some components might have been different from one another; such a difference(s) might have influenced the results.

Fourth, corporate managers included in the study represented the listed companies in the Tehran Stock Exchange and their perceptions may not necessarily correspond with those of their counterparts in the non-listed corporations.

Fifth and last, the study used a mailed questionnaire. Accordingly, it may suffer from the typical inherent limitations of such an instrument.

SUMMARY AND CONCLUSIONS

The objective of this study was to improve the quality of financial reporting via determining the perceived reporting importance of selected information components vis-à-vis assessment of the quality of earnings. The study consisted of two research hypotheses. To accomplish the objective of the study, 36 relevant information components were selected. The components were classified into six categories covering a wide range of information content. The population of the study consisted of different user groups of financial accounting information. The data for the study were collected using pre-piloted and validated questionnaires.

Based on the result of the study the category containing "items of revenues and expenses" were perceived to be of relatively high importance, with the exception of the interest expense and the extraordinary items. The importance of the qualitative information category dealing with the "full disclosure of accounting methods and assumptions" was ranked the lowest. This result was consistent with prior research supporting the existence of the notion of "functional fixation" in developing countries.

Inconsistent with the above finding was the relative high importance of the other two categories of qualitative information covered in the study. This apparent inconsistency seems to suggest an improved level of awareness on the part of the user groups in Iran with respect to the information content of political and economic condition.

As for the comparison of the perceptions of different users, the tax assessors and the loan officers were the two groups whose perceptions were significantly different from the rest. These two groups, for the most part, attached lower values to the reporting importance of the information components studied. Concerning the remaining four groups, despite the existence of some similarities among their perceptions, the overall results were mixed.

The results of this study may assist the process of promulgating financial reporting standards that are environmentally specific, and accordingly, more suitable for making economic decisions in Iran and other countries with economic and other environmental characteristics similar to that of Iran. Replication of this study in other developing countries may pave the way for the "localization" of standard setting based on empirical evidence; a well overdue practice that may assist achieving the articulated objectives of financial reporting.

ENDNOTES

1. One of the ways to manipulate accounting income is by using conservative accounting methods. Although it is often claimed that the practice of conservatism in accounting produces higher quality earnings; Penman and Zhang (1992) provide empirical evidence that conservative accounting can yield to a lower quality earnings. The same is true when companies use specific accruals such as loss provisions for loans, claim loss reserves for property-casualty insurers, and deferred tax valuation allowances (Basu, 1997).

2. Based on some suggestions received, "abnormal changes" in the components of the balance sheet were emphasized. Such emphasis was intended to capture the "full" content of any information indirectly related to earnings.

3. Content (or face) validity of the instrument concerns the questions of whether the instrument actually measures the intended objective and also whether it does so adequately (Churchill, 1976).

4. Construct validity is concerned with the issue of construct, concepts, or traits measured by the instrument. It involves understanding of the underlying factors of an obtained measurement and pertains to traits that are not directly observable (Churchill, 1976).

[5]. Mathematically, the formula to calculate the scores is as follow:

$$Az = \frac{\sum_{i=1} F_i}{n}$$

Where:

A = score of each group
z = index of groups, where z = 1 through 6
F = each factor with index i
n = number of items within each group
i = factor number

6. The differences in the perceptions of the loan officers from the rest of the user groups could be mainly explained by the fact that extending credit by the banking system in Iran is highly regulated. Such regulations require the loans to be collateralized by tangible assets, and in most cases, real estates. Furthermore, in the instances that a loan is granted, the value of the collateral, relative to the amount of the loan, is often so excessive that as a result, the risk of default is practically eliminated. Thus, due to a virtual non-default risk associated with any default, the use of most financial information in making credit decision is seemingly inconsequential. Concerning the tax assessors, their lower level of perceived reporting importance for the research components could be explained from two perspectives. First, the fundamental basis for tax assessment usually centers on the two principles of compliance with the existing tax laws and the past history of the firm with respect to such compliance. From this perspective, thus, the issue of using financial information to assess the "quality of earnings" appears irrelevant. Second, the process of tax assessment is often environmental specific. The tax assessment in Iran is mostly driven by the tax assessor's judgment.

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THE POSSIBILITY OF CORPORATE SOCIETAL STRATEGY IN CHINA

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ABSTRACT

In the transition from a command economy based on a strong, socio-political ideology to a free market economy, the entrepreneur or corporate executive finds himself in an environment in which the values fundamental to business are questioned and questionable. Entrepreneurial opportunities to profit in the near term tend to obscure the tong term need for a corporate societal strategy in order to sustain and maximize future profit potential. Many of the issues facing joint ventures and enterprises in China stem from this situation. An examination of business performance in China spotlights the need for developing strategies to bind profit maximization to societal value. Recent studies in ethical decision making indicate that a convergence of societal values is in process.

INTRODUCTION

Transition from a command economy based on strong, socio-political ideology to a free market economy, creates an environment in which the values fundamental to business operations are both questioned and questionable. Gross market imperfections, which may be viewed as the product of the uncertainty surrounding socio-economic values, characterize the transition and appear to provide tremendous numbers of opportunities for firms to earn instant profits. (Shi, 1996.) In transitional economies, and in particular in China, it is the perception of profit potential that attracts international joint-venture investment. (Yan, 1995.) The expectation of many Western joint venture participants (and their governments) is that as profits are made, as market practices and systems are established, the popular political conscience will necessarily become democratized. In other words, the value set that underlies Western market capitalism will be validated and adopted.

Speaking before the Asia Society's "Asia Goes Global Conference in Seoul, Madame Li Guohua, Vice-Minister of Foreign Trade and Economic Cooperation, reported a 16.5% annual rate of expansion for China's economy. She credited foreign investment and joint ventures as the engine driving this growth. By the end of 1995, a total of 120,000 projects with foreign investment had started operation with paid-in investment amounting to $135.4 billion USD. "China must stick to the policy of reform and opening - up in order to keep the momentum of the Chinese economy only by maintaining social and political stability can we guarantee the success of up-up." The implication was, that if growth falters, frustration of popular expectations of middle class life styles coupled with growing political consciousness would result in social and political unrest. To keep power in the hands of the current regime, China will continue to improve the investment climate, perfect relevant laws and regulations, and enable foreign invested enterprises to gradually enjoy national treatment." At the same time, the government will stay active in the loop in that:

> Industrial guidance and regional orientation of foreign investment will be put into practice." (Li, 1996.)
> Growth and profitability are the means to an end rather than the end itself.

The theory of corporate societal strategy suggests that maximization of current profit and the optimization of future profit potential are dependent on the ability of the enterprise to balance power and to develop legitimacy by satisfying stakeholder aspirations and expectations (Ansoff, 1979; 1985) Raymond Kao suggests that, in as much as "a corporation is a community of entrepreneurs created for the purpose of creating wealth for the individual and adding value for society", part of the mandate of corporate strategy is the linking of the corporation to the environment through the establishment of understandable realistic stakeholder expectations. From this perspective, the joint venture corporation plays a significant and active role in determining the new value set and preferred rules of the game that will evolve from the transition. (Ansoff, 1985; Kao, 1995) An examination of joint-venture experience in China along the dimensions of power balance and legitimizing activity follows.

LEGITIMACY: MEETING EXPECTATIONS

Any discussion of corporate legitimacy must begin with an analysis of who the stakeholders are and what their expectations are. In the context of a transitional economy, such discussion must also include an examination of what changes are probable and possible in the construct of the group of stakeholders and how the discontinuities of transition may effect their expectations

Recent studies of the dynamics of U.S.-China joint ventures indicate that the principles or joint venture partners have different but not incompatible expectations (Yan and Gray, 1994; 1995. and Yan ,1996), as well as different criteria for evaluating performance of the venture, (Hill and Hellriegel, 1994). In a study of 90 joint ventures (Levitt, 1997), formed between 1990 and 1992, located across 17 Chinese provinces it was found that the strategic objectives of the U.S. partners were:

Profit
China market Penetration/growth
Low cost sourcing
The Chinese partner expectations were:
Acquisition of technology
Acquisition of market based management skills
Development of export markets/foreign exchange currency

Determination what market will be served has been seen to be at the heart of many of the joint venture issues. The Western partners seek Chinese domestic market, while the Chinese partner has targeted export. The Chinese government frequently has established regulations and/or other obstacles to prevent or slow product distribution with in China in order to promote exports and facilitate acquisition of foreign exchange currency. (Xirt, Kin and Taylor, 1993) The experience of Procter and Gamble, AST, and McDonnell Douglas, as reported in the popular press, suggested that lack of contractual clarity on market expectations can be either disastrous for the joint venture or be the basis for dialogue that ultimately leads to clarity, stronger participation and enhanced performance. The Chinese partner's goal of acquiring technology and skills coupled again with lack of contractual clarity has had a number of consequences. Most highly publicized is the issue of intellectual property protection for which both law and enforcement practice have lagged far behind Western expectations. For the Chinese government, the more immediate issue is the diffusion of information access to the public at large. In authoritarian regimes, control of information access has been a means of consolidating power. In China, greater informational access has led to greater consumer demand and awareness, and contributes to labor force mobility. This puts pressure on the government, still intolerant of dissent, to preach nationalism and pride in economic achievement in order to justify its continuing grip on power. It meant that the government has seen it necessary to stay involved in the process of joint venture partner selection as well as in the selection of personnel to staff joint ventures. (Wong, 1995; Child and Lu, 1995; and, Cao, 1995.) In China, as in other transitional economies unmet expectations for both information and product access at the consumer level has led to the institutionalition of black markets and shadow economies.

The construct of most joint ventures in China puts Chinese partners in top positions, as CEO and as head of the board of directors (this was joint venture law until 1990 and continues as practice in most instances) with expatriate management from the Western partner filling the top operational/functional positions. Between government participation in the hiring practice, the Chinese partners input and language/cultural~~ barriers, the functional manager has little choice in the selection of his subordinates. (State Commission, 1993.)

Employee expectations of management authority and competence, work ethic and compensation were shaped under two generations of iron rice bowl practices. Employees learned to expect managers to be involved in, almost parental in the daily lives of employees. Most Western managers see enterprises as job providers only, and the requirement to be available and involved in the personal lives of employees as an awkward misplaced function that takes them away from the business of business. (Cao, 1995.)

Compensation expectations (Chinese employees) are somewhat dichotomous: on one hand, growing materialism and middle class aspirations place considerable importance on salary and buying power; on the other hand, the tradition of not wishing to be singled out and a strong desire to maintain harmony leads employees to not address salary issues directly. The employee expectation, especially at the line supervision level, is that, in the market economy, fairness in pay, recognition and respect are automatic (Cao, 1995.) If these expectations go unmet, passive retaliation in the form of slow downs in production, low morale and low commitment to schedules or increases in petty theft are experienced (Khong and Trigo, 1994.) (Expatriate management frequently misses the cue, seeing these as cultural phenomenon rather than symptoms of deeper issues.)

POWER BALANCING

The joint venture in China, in recognizing the expectations of the stakeholders, soon discovers that it is participating in an environment in which three economies, each with its own rules of the game and governance, are operating in parallel and in competition; each seeking to perpetuate itself. The command economy is not gone. It remains the primary employer, the training ground of managers, the source of Chinese investment and the basis of comparison. It is the support of and is supported by the centralized government power, which remains the chief aim of the Chinese Communist Party. Lack of profitability and efficiency are its problems. (Li, 1996.

The market economy is a reality in some sectors and in some regions. Laws and regulations, financial and capital markets, systems and procedures are in existence, though still lacking developed enforcement and arbitration capabilities. The market economy is the aspiration and the expectation of many stakeholders - but the definitions of "market economy" differ. For many, (Americans in particular), "market economy" is defined by their own experience and must necessarily include political democracy, Judeo-Christian ethics and a historical pattern of industrialization that emulates their own. (Rosa and Bowes, 1993.) This is not the same "market economy" envisioned by the Chinese Central Government, which seeks to maintain power, "a strong Socialist values and the prosperity of a market economy. "(Deng, 1991) The transitional economy is a stop-gap, a series of regulations and business practices that has developed in an incomplete and ad hoc manner since 1978, and which participates fully in neither of the previously describe economies. It is marked by gradualism in acceptance and by temporary or transitory regulations and rules of the game - but without well defined time limits. This is the economy in which joint ventures do business - the real-time experience. It is plentiful in opportunity and in risk. Many see their advantage in preserving an "incomplete economic system" in which daring, the right connections and the possibility of pleading ignorance are the keys to success. (Shi, 1996; Campbell 1989) The venture in China, then, must balance both the expectations and aspirations of stakeholders internal to the firm with the strategic influence of the stakeholders external to the firm in a highly discontinuous, turbulent environment. Strategic thrust and the management capability to match such an environment must be "creative environment creating". (Ansoff, 1979 and 1985.) The power to create the environment in which business will done can only be derived from a strong corporate culture - a corporate culture which is neither Chinese nor Western, but which meets current expectations and shapes future expectations in the greater community. This would be a societal strategy that includes:

Legitimacy
Social responsibility
Proactive participation in shaping the rules of the game is the core vision of such a corporate culture.

In order to explore the current manifestations of the possibility of societal strategy in China, an examination of the decision making on ethical issues brings in situ focus to theoretical platitudes. Such an empirical study follows.

METHOD AND DESIGN

The current study replicates the method and design used in previous studies in this series, continuing the vein of management and business ethics literature that uses vignettes to present various kinds real life of ethical dilemmas (Fritzsche and Becker, 1984: Becker and Fritzsche, 1987; Premeaux and Mondy, 1987). In an effort to facilitate wider generalization and comparison with previous studies, the vignette set developed by Becker and Fritzsche was used. (Vignettes Appendicized) Instrument and hypotheses replicate those used in similar studies beginning in 1993. Similar subject groups were selected to aid the comparison.

INSTRUMENT

The instrument was derived from the Becker and Fritsche instrument and presents five vignettes. For each vignette, two responses were solicited. First, subjects were asked to indicate on a 0 to 10 point Likert Scale what their own decision would be to the scenario issue. Second, they were asked to indicate the reasoning behind their decision. To do this, options were presented in multiple-choice format, including an open-ended option.

HYPOTHESES

Two hypotheses were tested for each vignette.

Hypothesis 1:	Chinese and U.S. subjects will select the same behavioral choice when faced with the same ethical dilemma.
Hypothesis 2:	Chinese and U.S. subjects will select the same rationales to justify their behavioral choices.

SUBJECTS OF THE CURRENT STUDY

Subjects in the Chinese sample were approximately 49 managers from primarily government organizations (93.9%). The managers were roughly 90% male, and the age range was from the late 20's to early 40's, with an average age of 35.1. Subjects in the U.S. sample were approximately 81 managers from a wide variety of primarily service organizations (83% with 21% in health care). The managers were roughly 53% male. The age range was from the late 20's to early 70's, with an average age of 34.6. All respondents were attending graduate level management training. The U.S. sample was from two universities with one in a large Southern city and one from the West Coast. The Chinese sample was two different provinces in China.

RESULTS

The findings from the U.S. and the Chinese samples are summarized in Tables 1 through 7. The average scores and standard deviation of the likelihood of taking the action in each vignette are summarized by country in Table 1. A "0" means "definitely would not" take the action and a "10" means "definitely would." For each vignette, ANOVA (Analysis of Variance) was used to see if the average score from the Chinese sample was significantly different from that of the U.S. sample. The ANOVA results are summarized in Table 2.

Table 1: Descriptive Statistics of Likelihood to Take Action			
	N	Mean	Std. Deviation
Vignette 1			
USA	81	4.84	3.11
China	49	5.69	3.34
Vignette 2			
USA	81	3.49	3.23
China	49	3.43	2.71
Vignette 3			
USA	81	1.83	2.16
China	49	1.71	2.65
Vignette 4			
USA	81	2.67	2.91
China	49	1.57	2.59
Vignette 5			
USA	81	7.89	2.76
China	49	7.92	2.98

Table 2: Summary of ANOVA results						
		Sum of Squares	df	Mean Square	F	Sig.
Vignette 1						
	Between Groups	22.286	1	22.286	2.179	0.142
	Within Groups	1309.322	128	10.229		
	Total	1331.608	129			
Vignette 2						
	Between Groups	0.130	1	0.130	0.014	0.906
	Within Groups	1186.247	128	9.268		
	Total	1186.377	129			
Vignette 3						
	Between Groups	0.389	1	0.389	0.070	0.792
	Within Groups	709.580	128	5.544		
	Total	709.969	129			

Table 2: Summary of ANOVA results						
		Sum of Squares	df	Mean Square	F	Sig.
Vignette 4						
	Between Groups	36.623	1	36.623	4.697	0.032
	Within Groups	998.000	128	7.797		
	Total	1034.623	129			
Vignette 5						
	Between Groups	2.653E-02	1	2.653E-02	0.003	0.954
	Within Groups	1035.673	128	8.091		
	Total	1035.700	129			

Hypothesis 1 suggested that there would be no difference in the selection of behavioral choice when faced with an ethical dilemma between Chinese and American subjects. As shown in Table 2, Vignette 4 is the only one that has significant ANOVA results among the 5 vignettes.

Vignette 4 describes an editor who wants to publish an authoritative account of the history of the atomic bomb. The editor is unable to persuade the author to omit the final chapter containing a detailed description of how a bomb is made. With significance in ANOVA, this implies that the average scores for both countries are statistically different in Vignette 4. Both sample means were on the low side but the U.S. sample (2.67) is significantly higher than the Chinese sample (1.57) (see Table 1). In another words, both the Chinese and the American respondents were inclined not to publish the book but the Chinese were much less likely than the American. As for the other four vignettes, the data does not support significant difference between the two nations.

The findings in this study are consistent with the Whitcomb, Erdener, and Li (1998) study in four out of the five vignettes. The only inconsistency is in Vignette 1. In this study, there was no significant difference in two countries but the Whitcomb et al. study found that the Chinese gave significantly higher action score than the American.

Hypothesis 2 suggested that Chinese and American respondents would select the same rationales to justify their behavioral choices in each case. Chi-square test of independence was used to test this hypothesis. The results were summarized in Tables 3 to 7. Among the five vignettes, Vignette 1 and 5 reported p-value less than 0.05. This implies that some of the rationales used to justify their behavioral choices are different in the two countries.

Table 3: Vignette #1			
Reasons for decisions (frequency distributions)			
Choice	Reason	U.S	China
A	Against company policy	4.9%	8.2%
B	Illegal	9.9	6.1
C	Bribe; unethical	23.5	8.2
D	No one is hurt	4.9	2.0
E	Is an acceptable practice in other counties	28.4	10.2
F	Is not unethical, just the price paid to do business	13.6	46.9
G	Other	14.8	18.4

Chi-Square Tests			
	Value	df	Significance Level
Chi-Square	23.646	6	.001

Table 4: Vignette #2			
Choice	Reason	U.S	China
A	Unethical for Smith to provide and unethical For employer to ask	30.9%	30.6%
B	Unethical for employer to mislead Smith when He was hired	11.1	10.2
C	Protect Smith's reputation	2.5	4.1
D	Provide some but not all information	14.8	10.2
E	Decision based on whether security agreement is in force.	28.4	42.9
F	To keep job; loyalty to new employer	4.9	0
G	Other	7.4	2

Chi-Square Tests			
	Value	df	Significance Level
Chi-Square	6.718	6	.348

Table 5: Vignette #3

Choice	Reason	U.S	China
A	It would be illegal	37.0%	46.9%
B	Concern for the environment/life	30.9	18.4
C	Risk of getting caught with resulting negative Consequences too great	18.5	20.4
D	Not their fault; equipment would be installed If available	3.7	4.1
E	The pollution would not really hurt the environment	1.2	8.2
F	Large potential with low risk	4.9	2.0
G	Other	3.7	0

Chi-Square Tests

	Value	df	Significance Level
Chi-Square	8.917	6	.178

Table 6: Vignette #4

Choice	Reason	U.S	China
A	Too dangerous to world safety	58.0%	61.2%
B	May create image detrimental for company	9.9	6.1
C	Concerned with legal ramifications	6.2	20.4
D	Don't see responsibility as theirs to make choice	4.9	2.0
E	Those who wants the information can get it now From other sources	12.3	8.2
F	Other	8.6	2.0

Chi-Square Tests

	Value	df	Significance Level
Chi-Square	9.247	6	.100

Table 7: Vignette #5			
Choice	Reason	U.S	China
A	Ward has no additional responsibility; loyalty Will keep him quiet	3.7%	12.2%
B	Risk of injury or death too low to halt sale	4.9	2.0
C	The company has a responsibility to the Public; criminal and dishonest to remain silent	38.3	69.4
D	Risk to firm's image, profitability, and long run Potential too great to remain silent	14.8	10.2
E	Chances of causing injury or death too great To remain silent	38.3	4.1
F	Other	0	2.0

Chi-Square Tests			
	Value	df	Significance Level
Chi-Square	26.004	6	.000

The first vignette concerns a bicycle company. They must make a payment to a foreign country businessman if they want to gain access to his country's market. The payment will result in $5 million in annual profit for the company. From Table 3, the biggest discrepancy between the two countries is Rationales C, E, and F. 23.5% of the American respondents believed that bribe is unethical (Rationale C) while only 8.2% of the Chinese respondents shared the same belief. 28.4% of the American respondents verses 10.2% of the Chinese respondents justified their decision by claiming that it is an acceptable practice in other counties (Rationale E). However, 46.9% of the Chinese respondents rationalized their decision by stating it is not unethical and is just the price paid to do business (Rationale F) when only 13.6% of the American respondents agreed.

Vignette 5 concerns that an auto parts contractor will face bankruptcy if its buyer finds out that a part sold by the contractor is defective. From Table 5, the major difference in the choices of supporting reason is in Rationales C and E. The Chinese respondents predominantly (69.4%) chose Rationale C: The company has a responsibility to the public; it is criminal and dishonest to remain silent, while only 38.3% of the American respondents shared this belief. On the other hand, 38.3% of the American respondents verses 4.1% of the Chinese respondents reported Rationale E: Chances of causing injury or death are too great to remain silent.

The results for Hypothesis 2 are slightly different from the Whitcomb et al. (1998) study. While Vignettes 1 and 5 have shown significant results in this study, Whitcomb et al. had significance in all five vignettes.

CONCLUSIONS, SUMMARY AND AFTERTHOUGHTS

Two hypotheses were tested in the current study of cross-cultural, ethical decision-making. The results of this current study were then tested against the results of the same survey administered ten years ago as reported in the Whitcomb et al. paper (1998). The findings for the first hypothesis indicate that the decisions made by both Chinese and U.S. respondents were not significantly different in four out of five scenarios and are consistent with the findings of the earlier study. The second hypothesis deals with the rationales underlying the decisions. Results of the current study indicate significant, cross-cultural differences in the decision-making rationale for two out of five scenarios. The previous study, however, found significance for all five scenarios. This suggests that, perhaps, the cultural gap is narrowing and that the critical thought pattern is becoming increasingly similar. Further study would be required to connect this narrowing of the cultural gap to the economic transition and the changes in institutional environments.

The process of decision making in an ethical context has direct impact on the possibility of societal strategy in firms. The implications for socially responsive firms in China appear to be increasingly similar to those in Western countries. The potential implications for firms seeking to do business in both China and the U.S. are encouraging that the basis for cross-cultural understanding are improving albeit slowly and incrementally. The implications for future research in this vein are rich in possibility, calling for continuing studies including examinations of regional differences within and between the two countries, exploration of alternative scenarios, and the development of alternative hypotheses.

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INTERNATIONAL DIPLOMACY AND ETHICS: RELEVANCE FOR COMMERCE

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ABSTRACT

Diplomats are not guided by any specifically designed code of ethics ratified by the international political community. While individual countries such as the United States include Foreign Service personnel within the scope of their generic rules of professional conduct for government employees, diplomats per se are not identified according to the uniqueness of the ethical challenges confronting them. Nor are diplomats distinguished by their categories; whether they are assigned to embassies or as ad hoc mediators in crisis situations, as delegates to conferences or as representatives in the negotiation of treaties and Conventions. It is the position of this author that residential diplomats, those serving in their countries' embassies abroad, constitute a population whose duties and role suggest ethical principles which could well become foundational for any future international code of ethics. Six such principles are proposed. The significance of each is applied to aspects of international commerce, for example, how ethical commitment might influence the nature of assistance provided by embassy staff to a business seeking to establish itself in the embassy's receiving State. Scholarly expertise from the disciplines of diplomacy and international business demonstrates that the inherent affinities between these disciplines are made most apparent when ethical issues are the subject of analysis. Contrary to the image often generated by the media and even by the White House, residential diplomacy should be recognized as a positive contributor to the betterment of order and stability throughout the contemporary world.

INTRODUCTION

Rhetoric surrounding the recent U.S. invasion of Iraq regularly cited the apparent failure of prolonged diplomatic processes. President George W. Bush informed the nation during his televised speech of March 17, 2003, that the plan to send military force against Iraq was justified because of reasons which included Iraq's bad-faith negotiations with American and UN diplomatic representatives. According to the President, since the 1991 end of the Persian Gulf War, "the world has engaged in 12 years of diplomacy," and that, "The Iraqi regime has used diplomacy as a ploy to gain time and advantage."

The obvious conclusion is that Iraq's interaction with members of the world community was motivated solely by a national interest skewed at the hands of a tyrannical leadership, and by a deliberate preponderance of fraudulent efforts to thwart accountability. Iraq has been portrayed as maliciously irresponsible and unethical in the sum of its diplomatic ventures. But two points invite further consideration.

First, the general public has been sent a distinct message via the White House and the media that what transpired throughout successive meetings involving Iraq depicts the entirety of diplomatic practice. Given the purported failure of this kind of diplomacy, diplomacy itself was portrayed as having failed. Indeed, the popular press often suggested that the worth of conventional diplomacy was now radically reduced in significance and in credibility. Kevin Whitelaw, writing for *U.S. News & World Report* on March 24, 2003 (18-20), referred to a pre-invasion diplomatic session at the UN as resembling "a junior high school dance - painfully awkward, with every one self-consciously trying to score points with the same newly popular countries. The great powers spent the week cajoling and pressuring the six developing countries that just happened to be undecided nonpermanent members of the Security Council." The scene was described as chaotic, with the United States resorting to "devious strategies" to solicit the support of the "worried six" for its invasion design. Similarly, Fareed Zakaria, journalist for *Newsweek*, stated on March 31, 2003 (47), that the invasion scenario meant not only a threat to the continued viability of the UN, but signaled a serious obstacle in terms of "rebuild(ing) international trust between Washington and some of its key allies." According to Zakaria, the mood amounted to sheer "score-settling," with "prizes for bad diplomacy."

International law and theory, however, recognize typologies of diplomacy in addition to the specialized negotiations of concern in the instance of Iraq. Although such ad hoc diplomatic intervention exercises a visible albeit controversial role, one must not overlook, for example, the fact that nations' State Departments continually appoint personnel to residential embassies dispersed around the globe. Each of these embassies, with ambassadors as the centerpiece of diplomatic focus, represents their country's willingness to engage a host country. That engagement delivers mutual benefit, as in the case of providing assistance for the extension of trade and commerce. And it would be erroneous to deem that form of diplomacy as politically decrepit or moribund. Residential diplomacy is not a failure.

Second, any criticism of Iraq's diplomatic performance as unethical presumes either an explicit or implicit code of ethics which Iraq has violated. But positing a link between diplomacy and ethics is fraught with ambiguity and uncertainty. No identifiable ethical code exists. What does exist is the prevalence of a version of the Golden Rule. Treat our embassy staff with fairness and respect. We will do the same for yours. Honor diplomatic immunity for our ambassadors; we will do the same for yours. Recognize the extraterritoriality of our embassies in your midst, and your embassies will be regarded as inviolable in our land. It is noteworthy that in the major treaty document pertinent to diplomacy, the 1961 *Vienna Convention on Diplomatic Relations* (CDR), the word 'ethics' is conspicuously absent.

Scholars may argue to the contrary that Article 41 of the Convention clearly states that diplomatic agents have a "duty….to respect the laws and regulations of the receiving State," along with "a duty not to interfere in the internal affairs of the State." Nor may a diplomat participate in "any professional or commercial activity" for "personal profit." But duties, whether affirmative or restrictive, are not an automatic equivalent for ethical principles and norms. Said duties may derive from no more than operational expediency. The Preamble to the Convention may accurately reflect an underlying philosophy when it seeks "to ensure the efficient performance of functions of diplomatic missions." Eileen Denza, acknowledged as possibly the most authoritative commentator on the Convention, recalls that a central influence upon its formation was "the theory of functional necessity (Denza, 1998, 10)." It is a theory known to seldom encourage an ethical approach.

Minus designated ethical axioms and principles with regards to diplomacy, one can hardly renounce the "ploy" attributed by President Bush to Iraq and yet ignore the "devious strategies" reported by Whitelaw about the United States. Morality in the field of diplomacy is shown, at best, to tend to equate with pragmatism. At worst, it validates the view of Talleyrand that, "The only good principle is to have none (Freeman, 1997, 175)."

It is reflection upon the status of diplomacy in light of President Bush's remarks which prompts questions basic to the theme for the remainder of this essay. Is it possible to examine the nature of residential diplomatic activity and thereby derive ethical principles intrinsic to that activity? And might those ethical principles exert an influence upon international business?

METHODOLOGY

An essay's obvious limitations preclude an exhaustive and definitive analysis. But they are sufficient to permit a review of data provided by several authors who are considered notable in the area of diplomatic research. Their names include: G. R. Berridge, Keith Hamilton, Richard Langhorne, Harold Nicolson and Adam Watson. Each investigates how residential diplomacy might be assessed. Each articulates strengths and shortcomings within the diplomatic system. Each has a perspective on the historical dynamics which contribute to the birth of contemporary diplomacy. And each asserts that diplomacy is so inherently fluid and expansive that it naturally accommodates political, social and economic change.

One such change is the accelerated development of transnational commerce. Reinforced by advances in communications technology, an entrepreneur can now advertise in Berlin the product of a business pursuit operating out of a garage office in Idaho. But such a domestic illustration is scarcely typical or complex. The scenario becomes more provocative when the goal of a company is to access foreign markets or to exchange products or to establish a branch abroad. That determination touches the legal sphere, from the local to the national to international levels. Consequently, the presence of an embassy located in a favored location serves as an invaluable liaison.

Larry A. Dimatteo and Richard Schaffer (with B. Earle and F. Augusti) are authors whose works delve the intricacies of the legal and political environment of international business. While both scholars discuss content aside from the role of embassies, their findings readily lend themselves to a recognition that where ethical principles are articulated in terms of residential embassies, international business will inevitably be impacted. This essay intends to connect aspects of their scholarship with that of academics versed in diplomacy. Should the attempt prove successful, the simple next step is to realize that residential diplomacy's potential for an ethical paradigm may yield comparable benefits for every other organization and initiative which aspires to cultivate ties through embassy contact.

The format of this essay consists of the proposal of six ethical principles. Each will be shown to reasonably emerge from residential diplomacy. And each will be related to the international business agenda.

Ethics: Transformation of thought applicable to behavior

"Ethics does not aim at saying what a corporation or community does consider important, or what it proclaims to be important, but at what a corporation or a community ought to consider important." This statement from, Ethics and Society (Facione et al., 1991, 9), argues that the goal of ethics is knowledge. As persons become more informed, more aware, more competent to investigate the motives, values and rationale in the thought behind their actions, their behavior will conform. Organizations and, indeed, society may mature. The same can be said of diplomacy and of the international community. The knowledge that there is latitude for ethical principles to be applied to residential diplomacy means that its actions need never be governed by arbitrary fluctuations of political and social mood.

I. Diplomacy: There is necessity to search for common ground.

Adam Watson describes residential diplomacy as providing governments a mechanism by which "to learn what other governments want and what they object to (Watson, 1983, 20)." His view is that diplomacy inevitably reflects the interplay between the dynamics of communication and the task of bargaining. That interplay is purposeful. According to Watson, diplomacy habitually seeks to mitigate differences between sovereign states. Therefore, diplomacy consistently inclines towards the reconciliation of those particular differences which culminate in conflict. And it may likewise serve to preempt the onset of conflict.

The position of residential ambassadors is such that it allows them to observe how problematic issues and situations are not only stated, but how they are experienced in the ongoing life of their host country. By contrast, diplomatic delegates to multilateral conferences, as well as the ad hoc ambassadors referred to by President Bush, are most likely to gather no more than a series of brief and cursory glimpses of the effects of an issue upon a people. From these gleanings, filtered as they are through the political lens of professional negotiators, delegates posit the nature and substance of a presumed pattern. Moreover, the reality of a supposed pattern is often based less on fact than upon interpretation. And that urge to specify a pattern may well be swayed by the expectations of one's own government to find a pattern. Not surprisingly, minus adequate evidence, psychological pressure may lead to the creation of a pattern and then to the insistence that it be believed.

Some critics fear that this phenomenon parallels the WMD argument which largely compelled the invasion of Iraq. The intelligence system, information supplied by allies, the testimony of disillusioned Iraqis, all had counted as persuasive evidence. There was certainty that weapons of mass destruction existed and were poised for the annihilation of innocents perceived to be enemies of the Iraqi regime. But considering that the WMD arsenal was presumed to be unmistakable and conclusive, by now either concrete examples should have surfaced or definite clues pointing to their whereabouts. Still waiting. Meanwhile, supporters of the argument claim that what we are witnessing is another instance of how a malevolent Iraqi administration has succeeded in concealing the country's stockpile of WMD. However, with the escalating proof of official Iraq's exaggerated confidence and sheer ineptitude, it is staggering to imagine that that same administration was capable of sustaining so Herculean a rouse. Admittedly, "it is too early to conclude that Iraq had no weapons of mass destruction," but decisions must rest on data more substantial than "some figment of our fevered imaginations (Zakaria, June 16, 2003, 33)."

Watson demonstrates that the residential diplomat, conscious of the temptation to placate a home or host government, is apt to avoid this serious pitfall. The government, especially the President, needs assurance that diplomats are free to exercise the courage "to speak their minds ….. because they owe …..their best judgments (Herz, 1983, 176)." A 1964 study submitted to the Committee of Government Operations for the U.S. Senate succinctly framed the residential ambassador's service. An ambassador is "called upon to view the society as a whole, to analyze the forces working for change, and to relate the problems of his country to wider problems and policies ….. his reports must penetrate more deeply while the horizon of relevance has widened (idem, 89)." Residential diplomacy lends itself to truth telling as a responsibility, and to empathy as a byproduct of exposure to a host country's milieu. It is that empathy which is also crucial to a balanced and moderate response to conflict (Folberg & Taylor, 1984, 87-89). And it is that empathy which is able to transform problems into challenge, and which welcomes opportunities to progress from national self-interest to shared and interdependent interests.

The search for common ground is tantamount to acceptance of a vocation to promote global solidarity. It denotes the ethical conviction that humanity develops according to communitarianism; the will to cooperate in the fair and equitable distribution of the world's resources and in the procurement of its possibilities. Residential diplomacy comprehends by experience what qualifies as entitlement to the world's patrimony. And it comprehends where, when and by whom, barriers are erected to obscure the legitimacy of that entitlement's voice and vision.

Political scientists are acutely mindful of the disposition of industries to want to relocate to nations where legislation (e.g. environmental) is less rigorous than in the United States. Paul and Anne Ehrlich, of the Department of Biological Sciences at Stanford University, have delved that rationale. Their research convinces them that environmental protection actually enhances the commercial sector. Profits soar as "a healthy local environment helps….attract….skilled labor." Moreover, with heightened personal satisfaction comes increased labor productivity. Neither the pollution of air, water and land, nor the devastation of rain forests, afford any real guarantee that savings and profits are even minimally secure. Most probably, the adverse consequences stemming from environmental loss and damage will initiate those very circumstances in which far greater costs will accrue to society as a whole, to the taxation enterprise and to overall citizenry health. Commerce cannot thrive where a population's survival is jeopardized (Ehrlich, 2001, 393-403).

In keeping with the ethical principle of seeking common ground, for example, the diminishment of conflict and its underlying sources, residential diplomacy may exert a profound influence. Businesses immersed in internationalism find themselves confronted by prospective legislation when acting as "polluters in an affected country," and are likely to face censure from regional and multilateral agencies for any number of reasons. The legal and political terrain is marked by such features as a global ban on toxic substances, regulations on the movement of hazardous wastes, sanctions against trade in endangered species and penalties for depleting the ozone layer (Schaffer et al., 2002, chapter 21). But there are glaring inconsistencies and shortcomings in the implementation and monitoring of protectionist treaties, among them the Basel Convention and the Montreal Protocol.

Since embassies normally contain an economic section with an Environment, Science and Technology Officer, they are empowered to advocate the imperative of standards and to promote strict compliance with the same *(Inside a U.S. Embassy*, 1996, 22-23). Similarly, embassies enjoy a foreseeable association with every business from their home country which aspires to establish itself in a host country. The ethical search for common ground embraces a crucial realization that the planet is fragile; with no one excused from vigilance.

II. Diplomacy: There is facilitation of legal and humane contact networks.

Article 3 of the CDR refers to "promoting friendly relations between the sending State and the receiving State." Ludwig Dembinski's appraisal of the Article emphasizes that the diplomatic mission is essentially "a mission of goodwill." That characterization of diplomacy is said to be so truly fundamental that goodwill may be presumed even when an embassy declares views that are found displeasing by a host state. Dembinski further notes that the maintenance of goodwill requires the mission to become prone towards concrete initiative. Diplomatic presence does not adhere to passivity (Dembinski, 1988, 42-43).

The tenor of Article 3 naturally recommends efforts by residential embassies to buttress conditions in their host country. This is most conspicuous with regards to developing countries, given that their poverty level possibly stands in sharp contrast to that of the diplomat's home country. Ambassadors frequently activate their 'contact network' to help, for example, with loan acquisition from international lending agencies, with the reduction of debt payments and with motivating investors to consider financial involvement with the host country. But one also encounters historical situations where the ambassadorial adjustment of a line of connections may have passed beyond the border of diplomatic acceptability. The Frondizi era in Argentina saw the U.S. Ambassador endeavor to "hold (President) Frondizi in office at least long enough for …. much-disputed oil concessions to pay off." Ultimately, following a revolution which the U.S. underwrote, the Brazilian military administration adhered to "their commitments" in response to this "modern style dollar diplomacy" and "they signed the investment guarantee treaty," desired by their American sponsors and detested by their Brazilian compatriots (Hanson, 1970, 21-23). The latter event does not reflect the ethical principle of facilitating "legal and humane contact networks." Of what does that principle consist?

Residential ambassadors have ample opportunity to maneuver proverbial sticks and carrots. But what is seen in the Frondizi example is that dollar diplomacy was geared to the gratification of respective agendas. The focus of the U.S. ambassador's concern was not upon what was mutually beneficial from an ethical perspective, but upon what was mutually lucrative from an economic one. No attention was devoted to long-term effects delivered to the overall population of either nation, only to the interests impacting select and elitist constituencies within that population. Those interests were presumed to be appropriately equated with loyalty to government, its leadership and its purpose.

Of course, an ambassador would be derelict for discounting the goals of their own country's commerce, profit included. But the ethical principle endorses a recognition that the international involvement of those businesses must be mindful that their 'world citizenship' obligation extends well beyond the immediacy of whatever political administration currently in office. There is definite legitimacy to the issue of precisely how that involvement will progressively shape the contours of a host nation's total identity and destiny. There is nothing laissez-faire about an ambassador's activation of their contact network. It is never a matter of simply 'helping out one's own' and then consigning economic outcomes to invisible forces. Ambassadorial help by way of systematic contacts must be both legal and humane. For while legality pertains to conformity with the breadth of national legislation and policy, humanity pertains to what actualizes the self-worth and capacity for contribution embodied within each and every individual. It is only when legality and humanity are in tandem that a diplomatic mission's voice of authentic goodwill is achievable.

Larry A. DiMatteo outlines avenues by which a business might be established in a foreign country. He immediately draws attention to the fact that legal requirements "vary dramatically from one country to the next (DiMatteo, 2003, 74)." Processes and norms tend to be complex and vast. And they necessitate not only familiarity with local legal expertise, but also with legislators versed in the renewal and reform of their nation's legal obligations as regards the influx of external investment. With U.S. embassies being ever mindful of the importance of market and related trends for their home businesses, there is almost always an Economic Officer assigned to the roster of embassy personnel. For example, when this position was filled by Jay Bruns of the American embassy in Tokyo, Bruns summarized his duties as not only "communicating constantly" with the Ambassador, Walter F. Mondale, but also of having to continually compile data about the "daily news of the Japanese economy and political developments." In terms of the utilization of the embassy's contact network, Bruns' words are apt. "The key ….. is the ability to make a lot of judgment calls for what is doable (*Inside a U.S. Embassy*, ibid. 19)." Doable suggests an awareness of limitations, whether they are practical or theoretical. Doable similarly implies an abiding respect for commitments that are moderate and promises that are reasonable. Doable has a moral connotation, namely that there are lines, as with the Frondizi affair, which may not be crossed. However, within those lines there is ample space for assistance which is real; assistance which is consciously ethical.

Doable also admits of the possibility of options, each with a differing degree of merit. DiMatteo asserts that companies must thoroughly evaluate their proposed level of foreign involvement. Perhaps the result is merely to hire a foreign agent or to conclude "management agreements" that are disposed to bypass tax liability. Perhaps, however, prudent strategy leads to the establishment of a branch office. But the prerogatives of the branch office approach are not uniform. DiMatteo tells how Indonesia reduces such a representative office "to signing sales contracts, collecting payments, and other general business activities." A better move might be to either "purchase an existing company" or to erect "an independent subsidiary." But governmental regulations and the prevailing commercial culture can pose a hazardous labyrinth. Protection of a business name may be easily resolved by registration "as a foreign trademark," but imagine how daunting the plight in 1990 Russia when the "law on Enterprises recognize(d) no fewer than ten forms of business enterprises." Despite changes over the next four years, major differences remain between what businesses anticipate in the U.S. and in Russia. For example, "unlike U.S. laws ….. Russian law grants subsidiaries express rights that can be used against the parent company." Similarly, with the advent of the European Union, foreign companies must now become aware of "an advanced competition law system." If they seek to purchase a business situated in a EU nation, the "purchaser must clearance from Directorate IV of the European Commission." And the applicable law is highly nuanced (DiMatteo, ibid., 75).

Such rigors of protocol for establishing a business on foreign soil surely invite recourse to the hire of a law firm which specializes in international commercial pursuits. That step would appear to conclude all problematics. Or does it? While that preference is laudable, its worth does not diminish the wisdom of close collaboration with the traditional embassy. Residential diplomats, with contact networks far exceeding the resources of a single law firm, are also motivated ethically to interpret issues from vantage points other than those argued by a paying corporation client.

III. Diplomacy: Endorses a labor philosophy in which workers are not a commodity

Philosophical presuppositions are central to understanding commercial activities. In America, for example, the common view is that no one earns entitlement to a job. Employment security is anything but assured. This contrasts with the European idea which allows employees to "acquire a property interest in their jobs over time." As the years pass, that property interest increases. And the American view radically differs from the Japanese belief that a specific employment actually "defines a person" as well as largely determines their position relative to society. "An individual is expected to hold a job for the same company for a lifetime (Schaffer et al., ibid., 595-596)."

Phrases such as "property interest" and "position in society" indicate a pervasive awareness of both the dynamics and subtleties by which employment policy operates in foreign settings. What is implied is a combination of factual knowledge and of social disposition. Ethically, such a blend presumes a non-judgmental openness to experiencing how various cultures interpret the very nature of work and of worker. And it means the resolve to consider the manner and degree to which the dignity and humanity of workers are promoted in a labor context. That humanity may not be reduced, especially to becoming simply another mode of expendable capital.

Ethical commitment also entails sensitivity to those fears and preoccupations which may so plague a local mindset that domestic labor becomes burdened by misperception and inaccuracy. Any effort to introduce a foreign presence could readily be perceived as a threat, instead of as a boon linked to mutually beneficial cooperation. The residential embassy must remain not only attuned to the reality of its host country's attitude and behavior towards the employee relationship, but must be equipped to gauge how labor responses are tied to structural tenets, and whether or not that labor philosophy permits flexibility. This is illustrated by Reiter Webb, Agricultural Attaché for the U.S. embassy in Cairo during 1976-78. Webb observed a dilemma surrounding Egypt's "key crop," cotton. Egypt produced high-value "long-stapled" cotton, suitable for sale to the Parisian fabric industry. But Egypt chose to retain the bulk of its own cotton to supply local markets with such items as cotton towels and socks. Webb reasoned that Egypt could gain immense profit by the cheap import of U.S. "medium-and-short-stapled" cotton for its everyday usage, allowing for the export of its own "high-quality cotton at double the price." But the proposal was hampered for "several long months" by a fear. Egypt was convinced that it "would import foreign pests along with the foreign cotton." Webb confronted that fear by arranging several visits by Egyptian authorities to Long Beach, California, and where they could inspect the caliber of U.S. fumigation facilities for cotton. The Egyptian cotton trade soared (*Inside a U.S. Embassy,* ibid, 95). But this would not have been the case had the resident diplomat, Webb, contented himself to issue a market analysis. Rather, he took seriously the initial dominance of Egyptian fears. His approach was incremental, patient and tolerant. His answer did not consist solely of rational discourse. His assertions had to be progressively verified by their own experiential observations. Only then could change - and with it prosperity - become feasible. Webb adjusted to the Egyptians' logic. His acceptance meant that they could allow themselves to be persuaded to adjust to his.

There is another basis by which the residential embassy becomes thoroughly aware of its host country's labor philosophy, that being because embassies may choose to employ the nationals of the receiving State, with that State's consent (*CDR*, Articles 8, 37 and 38). The inclusion of a consent rule is because receiving States have often "shown mistrust if not outright disapproval of their nationals taking up service within foreign missions in their own territory (Dembinski, ibid., 102-103)." Such mistrust is not infrequent elsewhere. It is exactly this worry which caused the Founders of the American Republic to insist that the Constitution require that candidates for the Presidency include "No person except a natural born citizen, or a citizen at the time of the adoption of this Constitution (Article II, Section 1, para. 5)." There was dread during the formative era lest an agent of England somehow advance to the Presidency, and thus be able to destroy the infant republic due to their foreign allegiance and sentiments. History aside, no naturalized citizen is still considered to be adequately above suspicion, even while an estimated 37,000 noncitizens serve in the U.S. armed forces (Barone, 2003, 26). The provision of the Vienna Convention recognizes the receiving State's concern, but does not frame it as absolute. On a related personal note, I recall once having contacted the Canadian consulate in Detroit for information. After commending the staff member for his superb knowledge about Michigan academe, he replied by stating that I should not be surprised since he was a U.S. citizen "employed by the Canadian government." The same adroitness could equally be applied to counsel pertaining to issues of labor relations. Besides the availability of an external cadre of professional expertise, embassies are mindful of the effects of the knowledge resource circulating throughout the ranks of their own personnel.

Embassy staff, when it includes the nationals of the receiving State, is also most likely to be cognizant about how their own country's employment practices are being modified by Western influence. Such companies as the NKK Corporation and Nissan, located in Japan, convey signs that they are reconsidering traditional Japanese views about "lifetime employment and strict seniority advancement systems (Schaffer et al., ibid., 596)." Still, social policy emphasis upon the corporate obligation to safeguard the identity, dignity and solidarity of employees is generally defended abroad. Residential diplomacy occupies a privileged opportunity to acquaint those home country businesses inclined towards entering a foreign arena with the ethical propriety of this outlook.

Similarly, there is an opportunity to voice serious caution where receiving States seem to deliberately propose discrimination. For example, "the Baltic countries formerly part of the Soviet Union, have passed laws mandating discrimination against the ethnic Russian minority (idem at 597)." While mindful of the requirement that embassies not meddle in the affairs of their host nation, it remains ethically appropriate for embassies to at least 'diplomatically' urge respect for the articles of the *Universal Declaration of Human Rights* (UDHR), of which Articles 1, 7 and 23 contradict the Baltic legislation.

IV. Diplomacy: Exercises intent to develop economic relations

This theme is derived from Article 3(e) of the CDR. The text of the Article refers to the sending and receiving States in terms of "developing their economic, cultural and scientific relations." The language is rather reminiscent of the UN Charter when, in 1945, it described the role of the General Assembly as "promoting international co-operation in the economic, social, cultural, educational, and health fields (Article 13b)." By 1948, an apparent ideal of cooperation in certain of these areas was being described as a right, namely, a "right freely to participate in the cultural life of the community,….and to share in scientific advancement and its benefits (UDHR, Article 27, para. 1)." Elsewhere, for example, in the *International Covenant on Civil and Political Rights* (1966), international economic cooperation was interpreted as capable of engendering its own proper and specific "obligations …. based upon the principle of mutual benefit (Article 1, para. 2)." Clearly, for the purpose of addressing economic relations, what is evident is that diplomatic efforts to cooperatively develop those economic relations are not merely advised or recommended. They are a dimension of the diplomat's essential mandate.

Prior portions of Article 3 have been analyzed previously in this essay, but this segment now warrants attention. The thrust of the Article advocates the kind of "friendly relations" which embrace a goal that is developmental. Yet said development is not meant to be defined exclusively. Its lens is bifocal, for the advantage of both the country of origin and the host country. Prior discussion has considered the importance of prompting businesses to invest in a receiving State, with aspirations for a win-win outcome on behalf of all parties concerned. But the notion of "developing …. relations" suggests additional presuppositions. For example, relations imply duration. There is more at stake than transience. There is a desire for prolongation, for extension of reciprocal interaction. An arrangement to bid on a product is an instance of a minimalist relationship. However, Article 3 seeks to develop a relatedness which is holistic and ongoing. That development is able to alter the very underpinnings of each other's society. What is implied is that encounter transforms. Encounter may influence positively how each society sustains itself (economic), expresses itself (cultural) and discovers itself, its environment and its future (scientific). What the ethical principle signals is the validity of an intention to sponsor enhancement. The exercise of that enhancement means that diplomacy perceives of development as a dynamic process. It is a process which transitions patterns from their current existential level to an elevated actualization of their power and potential.

A literal reading of Article 3(e) might suggest to some scholars, however, that this author has incorrectly interpreted the term 'their' in "their relations" by emphasizing mutuality. The overall theme of the Article appears to deal strictly with how a diplomatic mission should understand the elements of its role from the angle of effects upon the sending State. The reasoning is that an embassy is required to see itself first and foremost as the faithful agent of that state. Anything pertinent to the receiving State is therefore beyond the scope of this Article's provision. But this position, however prevalent, must be counter-argued. If a sending State determines that its embassies are obliged mainly to develop their own economic and other relations, then they are deducing that relations which seem to be bilateral really only have primary value in as much as their consequences are experienced unilaterally. The effect of these same relations upon the partner State need not be addressed. However, relations, especially if they are meant to be "friendly" (which the Article also states) cannot truly be both one-sided and relational. Thus, what has been said in the preceding paragraphs about the development of those relations is remains tenable. Experts concur. Dembinski's goodwill theory of diplomacy asserts that "proposals concerning mutual relations presented by the missions a priori have to be received with goodwill by the receiving State (Dembinski, ibid., 43)." The expectation is that the goodwill is as bilateral as it is simultaneous. Eileen Denza prefers to think of Article 3(e) as seeking to distinguish "developing economic relations" from non-permissible "commercial activities whose purpose is to generate profits." The latter use of embassy facilities could lead to the removal of diplomatic status (Denza, ibid., 35). Again, bilateral relational development in accord with the Article is not overruled.

The above discussion about possible academic disagreement is not a digression. It is definitely crucial for ethical inquiry. For if diplomatic involvement with economic relations belongs almost entirely to the zone of sending State interests, then so does accountability for the manner in which that development occurs. A state should only be accountable to the measure that its own interests are injured. But if "developing economic relations" is genuinely bilateral, a sending State becomes ethically and legally liable for harm delivered upon the receiving State and vice versa. Presently, opposing sides in this debate are visible in the aftermath of global operations by such U.S. multinationals as Del Monte, Citigroup, Exxon Mobil, Coca-Cola and Occidental Petroleum. The claim has been made that "corporations that partner with foreign governments or paramilitaries should be held legally responsible for human-rights abuses that occur during their projects." Corporations contend that they lack sufficient control to prevent such incidents. The Bush administration agrees and labels the issue as one of unwarranted intrusion upon the prerogatives of foreign policy. Meanwhile, Unocal is an example of a company which many say "bears responsibility for the brutal forced labor alleged to have accompanied construction of a natural gas pipeline in Burma" during the 1990s. The Burmese military "rounded up men ….to work." Refusal meant execution. Village inhabitants are outraged a decade later. "Unocal knew from its outside and inside sources that anytime the military did anything it was with forced labor, torture and abuse (Lavelle, 2003, 31)."

Residential diplomats might - and, ethically, should - alert businesses to the dark side of indulging in commercial enterprises with suspect governments. Who better to be aware of their antics? And who better to acquaint businesses with controversies that are motivating the kind of shift in juridic and political attitude which could eventually visit a corporation that responds rashly to the lure of facile profit? Residential diplomacy then may render an invaluable service. But if it elects to remind investors of possible risks, and thereby dissuades them from pursuing an economic move, the fate of "developing economic relations" is adversely sealed. The embassy needs an alternative approach. Certainly, it is imperative to disclose the aforementioned dangers, yet as part of a paradigm of what might be called parameter modeling. Imagine an example.

The government of the hypothetical State of Euphoria is ruled by a volatile and harsh administration. Worse, it lusts after foreign investment, and announces that the Euphorian populous is 'guaranteed' willing to meet all labor needs. Unions are outlawed. Taxes are low. Moderately skilled workers are plentiful, and they can be coerced. Alas, but human rights compliance is regrettably rare. But the proverbial blind eye is known to usually accommodate any such national deficit. Enter a foreign company, convinced that massive profits loom on the Euphorian horizon. Discussion ensues with the embassy to Euphoria. The reality of the picture, honest but grim in spots, is communicated. What is the next step? It is, I believe, to identify respective interests. On the American side, the corporation wants maximum Euphorian cooperation and zero-sum threat from employees who just might become agitated by legal activists. The corporation also hopes for media coverage at home which extols how it strives to improve the condition of such oppressed workers as those of Euphoria. Euphoria wants the corporation's investment, accompanied by a public image abroad which is attractive for further foreign business. The embassy is professionally - and ethically - required to "develop … economic relations." One recalls, though, that to develop is not synonymous with to sanction a status quo, particularly where that status quo has an earned reputation for contempt of the humanity of its citizens.

Is there any strategic agenda which could possibly meet the interests of all three actors? Perhaps, yes. The embassy could arrange to facilitate a negotiation process with the proper stratum of Euphorian government bureaucrats. A proposal would be introduced. The foreign company puts forth its request to establish a presence in Euphoria. And Euphoria is invited to assist in creating a 'model' corporation which could become acclaimed throughout the political and commercial world. The marketing department would handle advertising and recruitment. Human Resource Management would conduct training, supervision, etc.. The aim would be to form a company workforce which authentically reflects the spirit of the UDHR's bid that "everyone has the right …. to free choice of employment, to just and favourable conditions of work (Article 23, para.1)." When constituted, this 'model'company, fully fashioned after labor parameters and principles generally acknowledged internationally, would be publicized extensively.

The majority of interests are met. The Euphorians, by conceding a free hand to the company to design and implement its own employment style, can then declare that they are actually human rights supportive; that they are pliable with incoming investment entities and that they are unquestionably suitable for further consideration by the international business community. The company, by compromising on the reasonable diversion of a relatively minor percentage of its profit margin (for public relations objectives) acquires a 'good' corporate reputation at home and abroad, evidence of 'clean hands' in business dealings and public proof of an ability to cooperate and ethically negotiate with foreign officialdom. The embassy becomes the viable broker for the company-Euphoria interaction and gives testimony of its ethical translation of Article 3(e)'s mindset. The key, of course, consists of a determination to accurately assess and to publicize whatever the success of the model itself (e.g. increased productivity, statistics on employee health, on profit, etc.). And it assumes the same by way of documenting and publishing the success of the company-embassy-Euphoria process of dialogue.

What is the difference between this form of dialogue on commercial parameters and the type of 'carrot' which the United States offers China, for example? The idea here is that 'favored nation' trading status can be bartered for concessions on human rights. Logically, this inducement can elicit improvement in China's deplorable human rights record. But it is a compromise, not a conversion. China need never admit, even to itself, that its human rights attitude may be seriously flawed. China need only conclude that common sense and prudence mean a superficial adjustment, at least for the moment, of its behavior. By contrast, the parameter model permits Euphoria to realize that its continual investment in the foreign company's procedures and mentality amount to a real boon when that company's investment in Euphoria becomes upheld as a worldwide showpiece. There is affirmation followed by persistent reaffirmation, all of which confirms that neither control nor profit is being naively relinquished. Instead, they are so refined and reshaped that control evolves into influence, a less fragile and more versatile phenomenon, and profit diversifies even beyond monetary calculation. Doubtless, critics may retort that the model is simplistic, idealistic and out of touch with the harshness and competitive rigors of international commerce. But who is persuaded that many of the models flourishing in today's international marketplace are anything more than a disguise for obsessively self-serving economic policies? If so, then the contemplation of another contender model is as timely as it is vital.

V. Diplomacy: Enables a venue for input on behalf of reform

DiMatteo's study devotes several chapters to topics which include international contracting, documentary transactions, the transportation of goods, international trade financing and international trade regulations (ibid., chapters 5-11). In his typically analytical and succinct manner, DiMatteo informs readers, for example, that "the two fundamental risks of international exporting are the seller's payment risk and the buyer's delivery risk (ibid., 243)." Authoritative documentation is critical for the lessening of these risks, just as it is an aspect of formalities demanded by the various trading countries. This gives rise to a recital of such legal terminology as the Commercial Invoice (a bill with information about the numerous details relating to the transaction), Bills of Lading (a contract between a common carrier and the owner of goods), the Certificate of Inspection (attesting to specifications of shipped goods) and the Shipper's Export Declaration (for submission to U.S. Customs). Two documents of the same class are directly relevant to diplomatic activity. The Certificate of Origin, an import document prepared by a third party, may be obtained from "an official of (a) consular office." And there is also the Consular Invoice which is, as its name implies, "an invoice certified by the consul of the country of import." This invoice verifies "the value, quantity and quality of the goods (idem, 254)."

The preceding reference to a consul begs the question as to whether a consulate and an embassy are equivalent. They are not, hence the appropriateness of two distinct international Conventions in their regard. But they are definitely affiliated. Article 27 of the CDR, for example, speaks of the protection proper to "free communication on the part of the mission (diplomatic) for all official purposes." The mission is said to be responsible for "communicating with the Government and the other missions and consulates of the sending State, wherever situated." If no relationship involving consulates was meant, no communication between them would have to be protected.

The express purpose of a consulate is mainly to safeguard and advance the commercial interests of a sending State in a foreign country. Further, a consulate often performs roles usually associated with diplomatic missions (e.g. issuing passports, visiting nationals in prison, etc.) And while consular officers are not categorized technically as diplomatic agents, it should be noted that the distinction between a consul and a diplomat has become "much less clear" during the second half of the twentieth century (Berridge & James, 2001, 47). Hence, it is hardly surprising that the language of Article 3(e) of the CDR, discussed earlier, somewhat approximates that of Article 5(c) of the 1963 *Vienna Convention on Consular Relations*, when the latter refers to "ascertaining…developments in the commercial, economic, cultural and scientific life of the receiving State." But there is a difference. It consists of the fact that consulates must "ascertain" developments, while residential diplomats must actually promote that development. In many cases, however, particularly within a receiving State's capital city, the separate consulate is replaced by a consular section "within a state's diplomatic mission (Berridge & James, ibid, 48)." It is along this line that the American Foreign Service Association has published an "Embassy Flow Chart" in which a consular section is shown to deal with citizenship services (e.g. visas, immigration, refugees), with an economic section handling areas such as trade, export promotion, finance, investment, civil aviation and international organizations (*Inside a U.S. Embassy*, ibid.,10).

Regardless of whether one connects the Consular Invoice and the Certificate of Origin to a distinct consulate or to the division of an embassy, the same rationale applies. The sending State empowers its resources for the concrete betterment of commercial transactions. Residential diplomats are committed to improve and expand upon the breadth of those transactions. They are trained to be as aware of corporate financing based upon "a general loan from a commercial bank," as they are when that loan originates in "a government agency (DiMatteo, ibid., 309)." They are expected to be as attentive to the "*Ten Rules Pertaining to International Letters of Credit* (idem, 325)" as they are to the Hague Rules when these grant exemptions from liability for loss or damage in the movement of goods (idem, 292). And they are asked by their State Departments to be alert to the provisions of international Transport Conventions which regulate carriage by air, rail, road, sea or their multimodal combination (idem, 272-274). All this is but the tip of the proverbial iceberg.

Dembinski, it will be recalled, indicated that his notion of a goodwill basis for cultivating diplomatic relations requires an embassy to take continual initiative. Dembinski asserts that embassies should be engaged in a constant search for ways to improve every manner of relations between the sending and receiving States. Given that embassies are mindful of so much of the international commercial system outlined by DiMatteo, it is obvious that their diplomats are regularly called upon to participate in those conferences and negotiations which lead to the authorship of changed regulations and of new treaty Conventions. This is a normal course of events. A now classic text by Sir Douglas Busk, The Craft of Diplomacy, stated that at least since 1967, it has become inevitable that, "faced by constantly shifting complexities, the exporter is forced to rely more for information and assistance on Embassies abroad (Busk, 1967, 73)." The consequence is that there are major British embassies in which "the economic section will be larger than the political;" sometimes with "a body of officials large enough to staff a medium-sized embassy completely (idem,75)." Their task is not only to nourish foreign trade, but to compile numerous specialized reports for the departments of the British government. This information aids the evolution of Britain's own trade policies, as well as provides a resource to assist Britain's highest diplomatic levels as they participate in international summits, programs and deliberations.

The British experience is not unique. And it proves that there is wisdom to be tapped where embassy personnel interacts throughout a host country. Experience undoubtedly confers insights which could be invaluable for the modification of existing international commercial agreements. This remains true despite the likelihood that their recommendations will be strongly motivated by what they believe to be of greatest benefit for their sending State. But there is a dissenting voice. And it cannot be ignored or muted.

Scholars of diplomacy are only too familiar with the burdens placed upon embassies when they are demanded to be thoroughly knowledgeable about the vast arena of international business. R.P. Barston, also commenting upon British missions, states that many of them must employ "non-permanent personnel .... to augment ....diplomatic services." The collective result is that "the norms associated with the conduct of negotiations …. is becoming less universal (Barston, 1997, 27)." Accompanying this ever greater supplemental reliance upon national and regional expertise, is the realization that embassies may have become less than adequately equipped to address the range of commercial issues posed to them. Keith Hamilton and Richard Langhorne have raised the widespread concern that there are - and should be - grave "doubts about the quality of commercial reporting by diplomats (Hamilton & Langhorne, 2002, 237)." There are, according to these academics, problems with Foreign Service recruitment and training and with credibility as to competency about international commerce. The ethical implications are striking. In summary, the axiom of the medieval scholastics is trustworthy. One cannot give what one does not have. Nations are ethically bound to provide what they purport to offer. It follows that they are similarly bound to seek as much reliable data as possible when sending diplomatic representatives to a negotiation table, for example, having to do with the revision of transport regulations. And if there is question either about the impartiality or qualitative substance of information submitted by their own embassy staffs, the ethical response is to attempt to broaden and to refine the reporting mechanisms. The ethical bottom line also has to do with openness to input.

Embassies seem to prefer to gather information by indirect methods. Diplomatic culture tends to be cautious about directness, almost as if expecting the response to be deliberately untruthful or woefully jaded. I am reminded of the ambassador who told me, "Whenever I ask one question, I am looking to see if the answer fits another question which I purposely did not ask." During the ensuing conversation he mentioned that he would soon attend a UN workshop on the plight of migrant workers. "But neither myself nor my embassy staff really know anything about the subject," he said. "So I told them that I wanted them to do research for the next several weeks." I asked him whether that research consisted of actually talking to some of the many migrant workers in the country to which he was assigned. "No. They will research the findings of top experts! Presumably they will have spoken to migrants." Presumably. But these are experts with their own research projects and methodologies, none of which may be applicable to the time and to the problems being confronted by this workshop. I sincerely wondered if the ambassador's contribution to that workshop would have gained significantly if only the research had included direct conversation with members of the population which he was delegated to discuss.

Input entails creative initiative, exactly as advocated by Dembinski. Especially with the advent of highly efficient computer technology, inviting businesses to provide reaction to embassy query is rather easily accomplished. Nor should that query be confined to commercial groups centered only in a sending State. The possibility is intriguing to think of an embassy's effort to compile information, where its diplomats first declare a desire simply to have their formal positions better conform to general fairness, equality and practical justice.

VI. Diplomacy: Stands as witness to unqualified integrity

Diplomacy has not always been identified with moral rectitude. Sir Harold Nicolson in his, Diplomacy, traces the history of the diplomatic concept, particularly contrasting the Old and New diplomatic methods. He characterizes the latter as being more sensitive to universal mores and values and less prone to official secrecy; the variety of diplomacy which public opinion might scrutinize and find beyond reproach. But this approach to diplomacy has been anything but historically consistent. For example, the era of the Byzantine Empire saw "a recrudescence of diplomacy in its most unconstructive form. Diplomacy became the stimulant rather than the antidote to the greed and folly of mankind. Instead of co-operation, you had disintegration; instead of unity, disruption; instead of reason, you had astuteness; in place of moral principles you had ingenuity (Nicolson, 1988, 20)." Nicolson says that it was this conception of diplomacy which filtered into Venice, elsewhere into the medieval European continent and down to the modern period. When speaking about the days of absolute monarchy, Nicolson illustrates by reference to "boudoir diplomacy." This was an epoch of "many shabby experiments." Diplomats did not hesitate to bribe court functionaries and even to steal government documents. "They strove by every means in their power to win the support of the reigning favourite." Indeed, they went so far as to help replace a ruler with "some successor more amenable to their influence (idem, 31)." But Nicolson also observes that following the cessation of Napoleonic hostilities and throughout the Nineteenth century, a greater emphasis came to be placed upon diplomatists having attributes of moral integrity, moral influence and "moral accuracy (idem, 58 and 60)." Subsequently, the norm became more in keeping with the motto ascribed to Baron Sonnino, Italian Foreign Minister, when in 1918 he counseled diplomats that "aliis licet: tibi non licet" ("What is right for others is not right for us.") (idem, 59 and 147). Nevertheless, contemporary diplomacy has been tainted by the abject condition of segments of its lineage. Recall what was said by Kevin Whitelaw in the introduction to this essay about U.S. maneuvering at the pre-invasion UN meeting. Recall, too, the 1989 invasion of Panama and the enforced removal from power of Manuel Noreiga. Although hardly a candidate for canonization, there are rampant reports that the same Noreiga had been on the CIA payroll "for more than thirty years (*Newsmaker Profiles*, 3)." Could it be that Sonnino's axiom as been rearranged to now read, "What is not right for others is right for us?"

There is a crucial step beyond the logic of Sonnino and his intellectual descendants. That step is the assertion that what is right is right in and of itself. Philosophical ethics recognizes opposition between a school of thought which holds that ethics is primarily subjective and another which insists that objective ethical criteria must be sought after and identified. Thomas I. White, however, views the contrast more as "what counts most is what you think" versus "what counts most is what you think (White, 1988, 9-16)." For White, the common denominator is always the 'you'. There is no necessary 'us' with regards to any kind of evaluative technique. Left to myself and the first position, my thinking can be moored to distorted rationality. Nor does the situation improve with the second option, where the only reckoning device is the 'I' who conducts the thinking. Whichever, subjective preference obliterates objectivity and sometimes to the degree that any bid for formal ethical objectivity is dismissed as illusory and extreme. Remember the Clinton-Lewinsky episode and President Clinton's bold exclamation to the nation, "I did not have sex with that woman." Since he had decided unilaterally to adopt a non-conventional definition of sex (excluding oral activity), according to his own definition he was telling the truth. The only problem to emerge was that his definition lacked any real semblance of critico-historical or popular consensus. Still, even this leads to other intellectual dilemmas. For if a definition is comprised solely and ultimately of what you think or what you think, consensus adds nothing. But then again does consensus mean that a whole society cannot be wrong? Who would argue that consensus equates with rightness? If that yardstick was to be applied, then any prejudice - if widespread enough - becomes morally acceptable. The inevitable conclusion is, quite literally, unthinkable. Yet, indications are that some species of this overall rationale was adopted by CEOs and executives of ImClone, Tyco, Enron, Freddie Mac, WorldCom and Adelphia, to name but a few of the latest scandal-plagued mega-companies (*Time,* June 23, 2003). Because of the deluge of such malfeasance, there are those who argue that support for a notion of a universal ethics amounts to sheer impossibility.

Universal principles, despite their lack of popularity, are conspicuous in international affairs. For example, it is not by accident that the adjective "universal" was prefixed to the *UN's Declaration of Human Rights* (UDHR), a document cited throughout this essay. While the document's status remains controversial in international law, scholars tend to concur that the Declaration is an "elaboration of the inchoate human rights obligations in the UN Charter" and that, to some extent, it contains provisions which "were, or may have become, obligations under customary law." But without doubt, "the Declaration was designed to be universal (Henkin et al., 1999, 322-323)." Logically, if the Articles of the Declaration are presumed to have universal applicability, the same is true of their underlying principles. An example comes to mind. Article 17(1) states that "everyone has the right to own property alone as well as in association with others." Likewise, "everyone has the right to the protection of the moral and material interests resulting from any ….. production of which he is the author (Article 27, No. 2)." The right is to a protected ownership; the implied principle is that all individuals are entitled to possess what they acquire or produce by legitimate means. It is a principle which, especially in Western philosophy, has a celebrated history. *America's Declaration of Independence* (1776) extols unalienable rights, among them "life, liberty and the pursuit of happiness;" rights flowing from "the laws of nature and of nature's God." These are rights which are both universal and divinely sanctioned. Their phraseology derives from the Seventeenth-century British philosopher, John Locke. Locke, however, who had served as a diplomat in Brandenburg, did not select "pursuit of happiness." He completed the triplet with "and property (Cohen & Fermon, 1996, 243)." As with the UDHR, Locke universalized the right to ownership of the fruit's of one's labor.

Primacy of ownership definitely translates for international business, reflected in such diverse contexts as that of *Intellectual Property Rights* (IPRP. There it is said that "host countries can promote or undermine potential transfers of Intellectual Property Rights through a variety of direct and indirect means (Schaffer et al., ibid., 513)." What inaugurates those 'means'? As early as 1883, the Paris Convention gave "a trademark holder in any signatory country a right of priority." This was augmented in 1970 by the Patent Cooperation Treaty and the efforts of the *World Intellectual Property Organization* (WIPO), a UN agency established in 1967 (idem, 514). A companion matter, copyright, was treated by the 1886 Berne Convention, its 1979 amendment and by the Universal Copyright Convention. DiMatteo lists these among the sixteen treaties presently administered by the WIPO (ibid., 382). Each has been enacted to secure the actual and "moral rights of authors (idem, 383)." DiMatteo explains by enumerating that there are "Ten Rights of Authors and Artists" which are still in force under the Berne Convention. And he outlines how they are bolstered by the structure of TRIPS, the 2000 *Agreement on Trade-Related-Aspects of Intellectual Property* (idem, 384-387).

DiMatteo and the scholar-author team headed by Schaffer recognize that there are problems associated with the enforcement of IPR laws. For example, in 1994 a "relative of the Chinese premier opened a huge laser disk and compact disk factory with the capacity to manufacture 5.5 million CDs and 1.5 million laser disks a year." IPR protection laws were violated flagrantly; while Westerners were refused access for inspection (Schaffer, ibid., 528). These same experts are equally aware of the impact of differing philosophies upon the concept of ownership. Marxist theory, for instance, "regards intellectual innovation as a product of society….Society is the true author (and) benefits should be owned by the state (idem, 525)." Observance of the Articles of the UDHR is not immune to tensions or contradiction. Yet the sum of those tensions and contradictions neither automatically invalidates the Declaration nor its universalist orientation.

But it is not only host countries which "can promote …. through a variety of direct and indirect means." A sending State "can promote" in a comparable manner. Residential diplomats are presumably - and hopefully - determined to eliminate all residue of deceit and duplicity from their profession. Theirs should be a drive to explore whatever "direct and indirect means" available by which to promote the objective and universal principles embodied in international covenants. The elicitation of those means is central to their responsibility as a witness to integrity, just as it is central to the ethics of that responsibility. For integrity means a willingness to slowly but assuredly inform the business community that its dealings abroad could ultimately degenerate into self-destruction and self-defeat, financial gains aside. The preventive is to allow pressures inclined towards economic subversion to be redirected towards economic subvention. The preventive lies where diplomatic courage stirs commercial conscience - such that commercial conscience may value the progress of its profit less than the progress of others' peace.

CONCLUSION

The six preceding ethical principles are but a small sample of the many which could be proposed. Since the *Vienna Convention on Diplomatic Relations* (CDR) is an example of an international agreement which defines and clarifies the essential role of diplomats, it is feasible that a parallel document could be devised which enunciates the ethical content of that role. International commerce, as has been shown, would be a beneficiary of attention devoted to this area. Moreover, a quest to identify and articulate common principles is familiar elsewhere in the realm of social science scholarship. In addition to such aforementioned UN texts as the *Universal Declaration of Human Rights* (UDHR), there is indication of related academic interest. Research by Rushworth M. Kidder, president of the Institute of Global Ethics, has dealt with the question of whether there may be "a set of values ….(which) ethical people around the world might agree on." He concluded that eight values appear to be universal, these being: truthfulness, love, fairness, freedom, unity, tolerance, responsibility and respect for life (Kidder, 1998, 230). Comparable research pertinent to the exercise of diplomacy is both reasonable and necessary.

Three further conclusions emerge from this essay's discussion:

- Academics continually endeavor to locate themes appropriate for the preparation of projects such as dissertations and book manuscripts. In-depth examination of the diplomacy-ethics and the diplomacy-ethics-international commerce issues merits their consideration. The topics are timely, relevant for business, valuable for politics and seriously under-studied! An intention to investigate this subject matter has the potential for grant funding, for sabbatical release, for Fellowship candidacy, for interdisciplinary collaboration and for outreach to countries' State Departments, Departments of Education, Inter-governmental Organizations (IGOs), Non-governmental Organizations (NGOs), and transnational business enterprises.
- The ethics-diplomacy-international commerce triad is neither incidental nor peripheral. It is of genuine importance. Globalization demands not only that each of these sectors reflects competence, but that they also be grounded in solid and enduring principles. Popular disregard for political and commercial leadership appears to soar daily. Any attempt to broadly address irregularity, as well as to assert the urgency of preserving ethical emphases, boosts the confidence of general society in the reliability of its core institutions and organizations.
- It is correct to say that each State must hold its elected political officials ethically accountable. But it is also accurate to say that said accountability must reach non-elected government employees. Therefore, the U.S. acts appropriately when appealing to Executive Order 11222 ("Prescribing Standards of Ethical Conduct for Government Officers and Employees") and 12834 ("Ethics Commitments by Executive Branch Appointees") as a basis for fostering "integrity …. in all official actions (EO 11222, Section 101)." However, due

to inconsistency among the legislation of the various individual nations, a more uniform international code of ethics proper to diplomats seems suitable. That step would not degrade the sovereign authority of any single State, but would herald a recognition that the representatives of each State may be trusted by peoples well beyond the borders of their respective countries. A treaty-style Code would enable that broad trust to be more secured and safeguarded. The concept embraces the ideal expressed in 1992 by UN Secretary-General, Boutros Boutros-Ghali, when he reminded the international community that "the time of absolute and exclusive sovereignty …. has passed." Today's leaders of States must not only comprehend this, but they must "find a balance between the needs of good internal governance and the requirements of an even more interdependent world (*Agenda for Peace*, 1992, No. 17)."

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RESOURCES AND PERFORMANCE: THE FIRM'S RECOVERY FROM ECONOMIC CRISIS

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ABSTRACT

A firm's response to economic volatility is a topic of interest to managers and academics alike. This study examines the relationship between resources for marketing and financial capabilities and performance of firms in recovery from economic crisis in Thailand. The authors researched this timely topic by collecting data from the Thailand market. Marketing capabilities (market orientation & strategic flexibility) and financial capabilities (financial strength & financial diversification) were chosen as independent variables. The results indicated that financial strength and financial diversification, as well as strategic flexibility, had positive influences on firms' performance. However, financial capabilities had greater influences on performance than marketing capabilities. Comparing these two types of capabilities sheds light on the resource allocation decision between the two functional areas when firms operate amid an economic crisis.

INTRODUCTION

In the global economy, domestic and international firms become more susceptible to economic crises, regardless of where they originate. Increased globalization and emergence of the network economy bring more direct and indirect effects of an economic crisis to firms (Achrol & Kotler, 1999). Although the Asian financial crisis, which began in Thailand in 1997, has passed, it continues to impact market conditions and firm performances in Asia and beyond. Among firms that have survived such a difficult time, it seems important to address the question of why some have recovered and now perform well while others do not. What we learn on how they have utilized certain strategies and resources will provide much insight to practitioners and researchers. Here we draw from a resource-based view in strategic management for identifying and justifying key determinants (Morash & Lynch, 2002). An understanding of the importance of the relationship between resources and performance and how these resources can be used to help a firm respond effectively to major crises may shed light on resource allocation decisions between the two functional areas: marketing and financial capabilities. This study also examines whether marketing capabilities play a more critical role than financial capabilities in explaining changes in a firm's recovery from economic crisis.

LITERATURE REVIEW AND HYPOTHESES

Relevant literature on economic crises, marketing capabilities and financial capabilities are reviewed in this section. Economic crises affect the ability of firms to manage a critical event. We use the resource-based view to help us understand how these firms exploit their capabilities to face the challenges of an economic crisis. Comparable effects of marketing and financial capabilities in managing this critical event are also considered.

Economic Crisis

International economic crises have emerged many times over the past decades. In the Central and South America crisis of 1982-1983, Mexico, Brazil, and Argentina were unable to make regular payments to international creditors. In 1992, a wave of speculation attacked the European Monetary Systems (Kim & Haque, 2002). When the Mexican government devalued its currency against the U.S. dollar in 1997, the crisis had widespread effects on currencies of both Latin and non-Latin American countries (Koo & Kiser, 2001).

The Asian financial crisis which emerged in Thailand in 1997, rapidly affected economic systems and stability in many countries in Asia and beyond (Wong, 2001). It was a surprise to people, managers, and researchers because economic growth of these countries had been fast and showed healthy signs since 1990. This crisis raised many questions. Why had the crisis occurred? How can we prevent an economic crisis from recurring? How do we manage if it recurs? Thus, the emergence of the Asian financial crisis has become an interesting academic study.

To clearly understand and learn from the Asian financial crisis, many studies have investigated causes of the crisis and its effects. Crisis occurs from the vulnerability of speculative attacks, the instability of apparent economic fundamentals, and the inability to sustain domestic macroeconomic policies (Dekle, Hsiao & Wang, 2002; Long & Tian, 2002). Its major features include government policies in those countries, overinvestment, disintermediation, inflated asset priced, unstable foreign exchange rates and high interest rates.

How did the Asian financial crisis affect firms' business operations? Pearson and Clair (1998) describe a crisis as a high impact situation that is perceived by critical stockholders to threaten the viability of the organization. Some firms have gone bankrupt and unemployment rates have risen steeply in the crisis-affected countries (Manning, 2002). Many of the firms which survive have worked very hard to achieve competitive advantage and succeed in doing business. In Singapore, large firms pursuing the prospector-oriented strategy (high innovation) have a lower uncertainty in financial results, a more long-term orientation for decision making, and more decentralized control (Shih & Young, 2001). The prospector-oriented strategy seems to have helped these firms survive during the Asian financial crisis. Agami (2002) also investigated how firms in Thailand, the Philippines, Malaysia, Indonesia, and South Korea survived during the crisis. He noted that cross-border mergers and acquisitions caused these firms to eliminate inefficient companies, reduce debt, and enhance economic, operation, and strategy performance. In order to survive, firms need to better concentrate on local activities, such as exploiting local borrowing, importing inputs from several local suppliers, exporting products and services to markets in unaffected countries, and building up local ownership of assets (Mudd, Grosse & Mathis, 2002).

Many studies have attempted to explain and understand why the crisis had happened, how it affected firms in their businesses and operations, and how firms survived during the crisis. Few studies have paid attention to how firms respond to it. Our research focuses on what characteristics of resources help firms recover from an economic crisis by emphasizing marketing and financial capabilities. After a significant period in crisis firms have more opportunity to make sense of the crisis and learning can ensue. We apply the resource-based view to conceptualize the relationships between firm resources and performance in the context of recovery from the crisis. The resource-based view focuses on the strengths and weaknesses of firms and then analyzes a pool of their internal resources to strategic-factor markets rather than external environments (Barney, 1986; Eisenhardt & Martin, 2000; Wernerfelt, 1984). This theoretical framework helps us understand how firms survive and succeed in the turbulent time. Next, we review literature on the resource-based view and present our theoretical model.

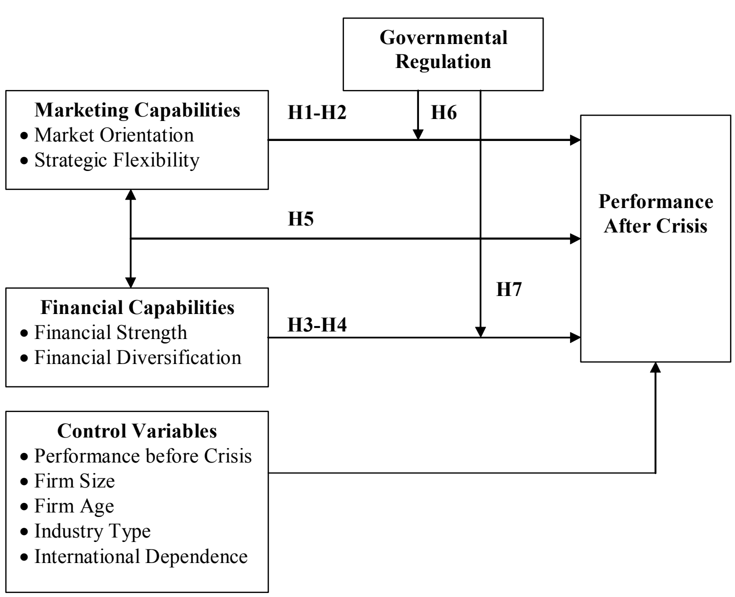
Resource-Based Determinants of a Firm's Performance in an Economic Crisis

According to the resource-based view, firms' internal resources are keys to creating and sustaining competitive advantage and to achieving superior performance (Barney, 1991; Morash & Lynch, 2002). The resources that sustain competitive advantage are valuable, rare, imperfectly imitable, and imperfectly substitute (Wernerfelt, 1984). Differences in resources not only allow firms to achieve competitive advantage and to survive and succeed through the crisis but also influence performance before and after the crisis. Efficiently managing and exploiting their resources seem to play significant roles in explaining the level of performance.

Marketing capabilities and financial capabilities are proposed here as enhancing firms' performance. Under the umbrella of marketing capabilities we include market orientation and strategic flexibility. Market orientation becomes key to help firms achieve competitive advantage and increase performance through highly and rigorously competitive environments (Matsuno & Mentzer, 2000). Strategic flexibility affects firms' survival and performance and greatly influences their superior performance in turbulent times (Subbanarasimha, 2001). Financial capabilities include both financial strength and financial diversification. Financial strength is a necessary prerequisite of any business activity and operation and strategic implementation (Barney, 1986). Financial diversification reflects the ability of firms to minimize uncertainty of competitive environments through exploiting several products, markets, and funding (Barney, 1995). Financial strength also includes a firm's investment in human capital, research and development. Figure 1 presents our theoretical model, which summarizes the hypothesized relationships of marketing and financial capabilities to performance. Next, we discuss and develop hypotheses on how these capabilities relate to firms' performance.

Figure 1

Model of the Relationships between Firms' Capabilities and Performance



Marketing Capabilities

Marketing capabilities represent the ability to screen, use, and disseminate market information, to deal with competitive situations, and to manage an uncertain future (Verona, 1999). They help firms better understand the constantly changing consumer characteristics. Firms with greater marketing capabilities seem to easily meet customer needs, requirements, and expectations, through identifying and exploiting marketing concepts and activities to gain competitive advantage

(Hooley et al., 1996). Accordingly, we propose that marketing capabilities help firms efficiently and effectively survive in a crisis and achieve performance in doing business. Both market orientation and strategic flexibility are key marketing capabilities of firms to deal with uncertain competitive environments of crises and maximize performance (Pelham, 1999; Subbanarasimha, 2001).

Market orientation.

Market orientation has been a buzzword in North America for about ten years. Market orientation refers to the generation and dissemination of market intelligence that is composed of information about customers' current and future needs, and exogenous factors that influence those needs, such as competition and government regulation (Kohli & Jaworski, 1990). It becomes a key determinant of competitive advantage and performance. Much strategic management research has been devoted to investigating the relationships between market orientation and performance. Market orientation plays a significant role in explaining firms' performance in doing business (Dawes, 2000; Harris, 2001; Hult & Ketchen, 2001). Firms with market-oriented strategy tend to emphasize a philosophy of marketing concepts, which include customers, marketing activities, and profit-oriented goals. Firms gather and use information more actively and openly to better serve customer needs. In the context of small firms, market orientation also directly and significantly influences firms' effectiveness and has a great impact on their profitability (Appiah-Adu, 1997; Pelham, 2000). With rigorously competitive environments and highly dynamic markets, the market orientation-performance relationships tend to be stronger (Homburg & Pflesser, 2000; Matusno & Mentzer, 2000). Further, market orientation also directly influences firms to generate innovations in products, procedures, and systems (Baker & Sinkula, 1999). How does market orientation help firms survive and succeed through the crisis? During the crisis, business environments vary and continuously change. They are uncertain and unpredictable. Competition in markets is also more aggressive. Firms must know what customers and markets want and have abilities to fulfill their needs. They need to understand the strengths and weaknesses of competitors. Knowledge about the customers, markets, and competitors in the critical time effectively encourages firms to achieve competitive advantage and gain superior performance. Marketing-oriented firms seem to better survive through the crisis. The first hypothesis is established below.

H1:	Market orientation is likely to have a positive influence on performance after the crisis.

Strategic flexibility.

Strategic flexibility is a proactive part of a firm's competitive advantage and a critical component of a firm's ability to deal with turbulent environmental conditions and highly competitive environments (Pauwels & Matthyssens, 1999). It refers to a capability of firms to be proactive or respond quickly to changing competitive conditions and develop and/or maintain competitive advantage (Hitt, Keats & DeMarie, 1998). Increased flexibility helps firms adjust to situations of changing competition quickly, and implement decisions under conditions of uncertainty effectively. In a turbulent environment, strategic flexibility is needed to help firms respond to changing market conditions (Subbanarasimha, 2001). Sanchez (1997) also suggested that firms can manage their businesses and operations through creating strategic flexibility and leveraging to prepare for an uncertain future. For advancing hyper-competitive conditions such as in the telecommunication industry, flexibility is required for firms that want to exist in the business (Smith & Zeithaml, 1996). Thus,

H2:	Strategic flexibility is likely to have a positive effect on performance after the crisis.

Financial Capabilities

Financial capabilities are one of a firm's resources for gaining competitive advantage and performance (Barney, 1995). They represent the ability of firms to manage, to search for sources of funding instruments such as debt, equity and retained earnings, to serve all their operations and activities, and to support their strategic implementation (Wernerfelt, 1984). Financial capabilities, including financial strength and financial diversification, enable firms to survive and succeed during a crisis. According to Greene, Brush, and Hart (1999), external funding sources are often unavailable. Firms' financial strength and diversification enable them to implement appropriate strategies during a turbulent environment.

Financial strength.

Financial strength refers to firms' financial backing. It allows the firms to enter a strategic factor market and to acquire the resources needed to implement a product market strategy (Barney, 1986). These financial advantages include more sources of funding, low interest rates, and high liquidity of financial operations. Firms with financial strength can improve existing products and services and develop new products and systems to better serve their customers (Greene, Brush & Hart, 1999). Financial strength encourages firms to gain competitive advantages in an imperfect market and achieve high performance in a perfect market.

During a recovery from crisis, financial strength explicitly plays an important role in enhancing firms' performance. The Asian financial crisis in 1997 was caused by unstable currencies, high interest rates, and short-term capital inflows (Chan-Lau & Chen, 2002; Deckle, Hsiao & Wang, 2002). In general, firms have a hard time improving their financial strength in the short run. However, firms that have the ability efficiently to manage their sources of funding and exploit their financial strength tend to survive in the crisis. Hence,

H3:	Financial strength is likely to have a positive influence on performance in a recovery from the crisis.

Financial diversification.

Diversification refers to the ability of firms to reduce risks from uncertainty of competitive environments through expanding activities from one to many products, markets, and funding (Hoskisson & Hitt, 1990). Firms with greater diversification seem to achieve competitive advantage and perform better than firms without diversification. The concept of financial diversification here also reprensents a combination of product and international diversity. Product diversification concentrates on an expansion into new products. International diversification represents an expansion across the borders of global regions and countries into different geographic locations or markets (Hitt, Hoskisson & Kim, 1997). Firms with extensive product lines might make use of their brand equity to sell a lower-priced item. Firms with much product breadth might be able to find domains less affected by the crisis. Financial diversification reflects firm-specific sources of revenues and materials that normally yield lower risks and rents (Mahoney & Pandian, 1992). An expansion of sources of revenues and materials into different customers, products, and suppliers reduces risks from operations. By and large,

H4:	Financial diversification is likely to have a positive effect on performance after the crisis.

There are different influences of these capabilities on performance after a crisis. Marketing capabilities emphasize how firms meet customer needs to increase their performance; financial capabilities pay more attention to how firms manage and exploit their funding sources to support their strategic implementation. It is conceivable that financial capabilities precede marketing capabilities, as the former makes financing of the latter possible. In recovery from the Asian financial crisis, firms explicitly needed to have long-term sources of funds, low interest rates and flexible payment by currencies other than U.S. dollars. Less attention was directed toward selling products and services. Therefore,

H5:	Financial capabilities are likely to have more positive influences on performance after the crisis than marketing capabilities.

Moderating Effect of Governmental Regulations

In general, governmental regulations can be either advantageous or disadvantageous to firms' operations. The Thai government has introduced numerous policies and regulations to improve the nation's stability and help firms survive and succeed (Chotigeat & Lin, 2001; Kim & Haque, 2001). First, it accepted the economic reform program under International Monetary Fund (IMF) guidelines to maintain its financial system. For instance, the Thai government was required to have a balanced budget by increasing the consumption tax, reducing government spending, and maintaining high interest rates to stabilize the Thai baht and to reverse capital outflows. Second, restricted offshore forward-trading in baht was implemented to stabilize the currency. Third, it closed down many its own domestic financial companies and local banks to reorganize the financial sector. Fourth, it created new government agencies to handle the assets of the now defunct financial companies. Fifth, a new bankruptcy law was passed to speed up the bankruptcy process. Finally, it introduced a special spending package aimed at jump-starting the stalled economy, encouraging consumer spending, and creating a half million jobs. The changes in governmental regulations stemming from the crisis suggest the important influence of such regulations. Governmental regulation measure in this paper is idiosyncratic in nature, as it measures the firm's interface with the government and seemingly affects all businesses in varying degree throughout Thailand. According to the implementations during the crisis, we expect governmental regulations to manifestly enhance the relationships between firms' capabilities and performance.

H6:	Governmental regulations have positive moderating effects on marketing capabilities-performance after the crisis.
H7:	Governmental regulations have positive moderating effects on financial capabilities-performance after the crisis.

In light of these hypothesized relationships, a survey was conducted and the empirical models are constructed, as explained in the next section.

EMPIRICAL FRAMEWORK

Sample

The data source used in this study is an original survey conducted from small to medium size firms in four regions of Thailand: central, eastern, southern and northern regions. The hypotheses posit a relationship between specific capabilities and firm performance after the crisis. In order to include the notion of crisis and examine the importance of these capabilities with regard to recovery from the crisis, the 1998-2001 time period surveyed was chosen. Data were collected through personal interviews with managers and owners of the firms from February to April of 2002. Of 250 firms contacted to participate in the study, 98 surveys were completed. The actual response rate of the surveys obtained was 39 percent. The responding firms were characterized as small to medium size firms.

Variables

All of the variables were obtained from the survey. A dependent variable was a continuous variable representing performance after crisis. The longitudinal measures of the performance of the firm average profit margin after the economic crisis reported in this survey was 3.5 percent with the range of -1 to 6 percent. Independent variables include three different categories: marketing capabilities (market orientation & strategic flexibility), financial capabilities (financial strength & financial diversification) and governmental regulation. Market orientation consists of four sub-constructs: information generation, information dissemination, response design and response implementation. Thirty one items were used to measure market orientation, introduced by Jaworski and Kohli (1993). They include ten items of information generation, seven items of information dissemination, seven items of response design, and seven items of response implementation. Strategic flexibility was measured via six items, developed by Grewal and Tansuhaj (2001). These items evaluated the degree to which firms deal with market changes through organizational adjustment and flexibility. Financial capabilities are made up of financial strength and diversification. Four items were used to capture financial strength (Greene, Brush & Hart, 1999). The first item mirrored the sound financial plan while the next two items measure continued improvement of financial position as assessed by sufficient cash flows and working capital. The last item appraised support of financial institutions and related authorities or agencies as suggested by resource based theory. Furthermore, financial diversification was measured via five items (Mahoney & Pandian, 1992). Overall, these five items gauged the degree of firms' dependence on one key customer, supplier and product line.

Governmental regulations were added as a moderating effect of the relationship between firm resources and export performance. In order to examine variation in these government regulations and to test for the importance of this effect, executives' perceptual differences on the same government policy instrument are employed due to difficulty in data collection across different Asian countries. Governmental regulations have a threefold impact on a firm through research and development, enforcement action and ability to respond to change in regulations. Other exogenous control variables that may impact the hypothesized relationships include performance before crisis, industry type, international dependence, firm size or number of employees (Burgel & Murray, 2000), and firm age or number of years a firm has been in existence (Zahra, Ireland & Hitt, 2000).

Method

First, factor analysis was utilized to investigate the underlying relationships of a large number of items and to determine whether they can be reduced to a smaller set of factors. The factor analyses conducted were done separately on each set of items representing a particular scale due to few observations. Then, the ordinary least squares (OLS) method is used to estimates factors affecting a firm's performance after crisis (Aulakh, Kotabe & Teegen, 2000). A model is structured as shown in Tables 3.

RESULTS

The results from factor analysis are presented in Table 1. Given the difficulty of using Western-designed scales in other cultures, the four dimensions specified by Kohli and Jaworski for market orientation were found. All factor loadings are greater than the .4 cutoff as recommended by Nunnally and Bernstein (1994). In addition, the statistical analysis suggests adequate levels of fit. Table 2 shows correlations and descriptive statistics of all constructs. Seven measurement models according to seven hypotheses are estimated as shown in Table 3. Interaction terms induced by governmental regulation along with the main effects are included in the last two models.

Table 1: Results from Factor Analysis		
Measurement Model	Range of Standardized Factor Loadings	x^2 (d.f., *p* Value)
Information Generation (IG)	.53-.77	138.81 (45, *P* < .01)
Information Dissemination (ID)	.44-.79	98.91 (21, *P* < .01)
Response Design (RD)	.57-.80	111.78 (21, *P* < .01)
Response Implementation (RI)	.44-.84	79.30 (21, *P* < .01)
Strategic Flexibility (SF)	.61-.81	174.17 (36, *P* < .01)
Financial Strength (FS)	.72-.84	118.59 (66, *P* < .01)
Financial Diversification (FD)	.71-.81	94.64 (10, *P* < .01)
Governmental Regulation (GR)	.71-.82	247.85 (45, *P* < .01)

Table 2: Descriptive Statistics									
Variables	IG	ID	RD	RI	SF	FS	FD	GR	PM
Information Generation (IG)		.450**	.274**	-.145	-.032	.127	.336**	.068	.046
Information Dissemination (ID)			.422**	-.173*	.098	.219*	.336**	.319**	.130
Response Design (RD)				-.174*	.182*	.205*	.114	.181*	-.014
Response Implementation (RI)					-.151	-.188*	-.191*	-.197*	.000
Strategic Flexibility (SF)						.383**	.034	.297**	.258**
Financial Strength (FS)							.228*	.305**	.277**
Financial Diversification (FD)								.299**	.272**
Governmental Regulation (GR)									.215*
Profit Margin (PM)									
Mean	3.71	3.87	3.85	0.54	3.69	3.81	-.95	-1.05	3.50
Standard deviation	0.66	0.62	0.68	0.65	0.62	0.63	0.72	0.43	1.12
Note: ** Correlation is significant at the 0.01 level (1-tailed) * Correlation is significant at the 0.05 level (1-tailed)									

Table 3: Results from the Ordinary Least Squares Model

(Dependent Variable = Firm's Performance)

Independent Variables	Hypotheses 1	2	3	4	5	6	7
Market orientation:							
Information Generation	-.005 (.134)				-.079 (.130)	.039 (.139)	
Information Dissemination	.168 (.143)				.053 (.139)	.042 (.166)	
Response Design	-.080 (.132)				-.114 (.126)	-.139 (.140)	
Response Implementation	.032 (.119)				.128 (.115)	.125 (.123)	
Strategic Flexibility		.258*** (.113)			.212** (.126)	.289*** (.132)	
Financial Strength			.277*** (.112)		.175 (.127)		.180* (.124)
Financial Diversification				.272*** (.110)	.266** (.122)		.198* (.116)
Governmental Regulation						.123 (.157)	.069 (.122)
IG x GR						-.036 (.165)	
ID x GR						.192 (.130)	
RD x GR						-.109 (.137)	
RI x GR						.018 (.162)	
SF x GR						-.242* (.124)	
FS x GR							-.165 (.106)
FD x GR							-.068 (.096)
R^2	.024	.066	.076	.074	.185	.191	.164
F-Statistics	.546	6.61***	7.78***	7.43***	2.72***	1.68*	3.41***

Note: Standard error is in parentheses. * $P < .10$, ** $P < .05$, *** $P < .01$

All market orientation components are insignificant: information generation (H_1: b = -.005, $p < .97$), information dissemination (H_1: b = .168, $p < .17$), response design (H_1: b = -.080, $p < .49$) and response implementation (H_1: b = .032, $p < .77$). If the coefficients are not statistically different from zero, the sign of those coefficients is irrelevant. In light of insignificant market orientation variables, strategic flexibility is crucial and directly affects firm navigation out of the crisis (H_2: b = .258, $p < .01$).

The most interesting aspect of these results is the manner in which financial capabilities significantly and positively influence firm performance after crisis as is evident from two significant components: financial strength (H_3: b = .277, $p < .01$) and financial diversification (H_4: b = .272, $p < .01$). Are these financial capabilities likely to have more positive influences on performance after the crisis than marketing capabilities? All variables are based on the same scale and only two variables: strategic flexibility (H_5: b = .212, $p < .05$) and financial diversification (H_5: b = .266, $p < .05$) are significant. Therefore, the size of coefficients of these two variables may suggest that financial diversification have more direct effect on performance after the crisis than strategic flexibility. Of course, these two variables are a subset of financial capabilities and marketing capabilities. Moreover, in this particular equation, all market orientation components: information generation (H_5: b = -.079, $p < .48$), information dissemination (H_5: b = .053, $p < .65$), response design (H_5: b = -.114, $p < .30$), response implementation (H_5: b = .128, $p < .22$) and financial strength (H_5: b = .175, $p < .13$) are insignificant.

When governmental regulation is introduced into model 6, strategic flexibility and its interaction with governmental regulation significantly influence performance after crisis. While strategic flexibility directly affect performance after a crisis (H_6: b = .289, $p < .01$), its interaction term with governmental regulation imposes a negative influence (H_6: b = -.242, $p < .10$). All market orientation components: information generation (H_6: b =.039, $p < .74$), information dissemination (H_6: b = .042, $p < .77$), response design (H_6: b = -.139, $p < .24$) and response implementation (H_6: b = .125, $p < .26$), governmental regulation and its interaction with market orientation components market orientation components are insignificant. The last model shows that while both financial strength (H_7: b = .180, $p < .10$) and diversification (H_7: b = .198, $p < .10$) are significant, their interaction with governmental regulation and governmental regulation itself are insignificant.

DISCUSSION

The 1997 Asian financial crisis started in Thailand. In so far as it is dynamic, its aftermath continues to affect market conditions and a firm's performance in that region. It is imperative to address the disparity between firms that have survived such a crisis and those that failed. This study highlights two major insights into a resource-based view in strategic management: marketing and financial capabilities. The critical role of a firm's marketing and financial capabilities in recovery from economic crisis was examined. Giving the boundary spanning nature of marketing one would expect the marketing constructs to be more highly related to governmental regulation. In fact, the high correlations of governmental regulation with financial variables were found. This may be because the crisis in Asia was a financial crisis. Furthermore, strategic flexibility had a direct impact on performance after the crisis while market orientation was not statistically significant. Our research found that among firms in recovery from the economic crisis only strategic flexibility and financial capabilities tend to enhance a firm's performance. In addition, financial diversification reveals a stronger impact on firm's performance than strategic flexibility. Although the determinants of strategic flexibility and financial capabilities are essential, this presentation does not mean that a fully integrated resource-based view has been developed. It does provide a consistent way of analyzing the effects of marketing and financial capabilities on firm's performance. The allocation of the future marketing and financial resources, or the evaluation of current policies and the program promoting firm's performance and stability requires an understanding of these determinants.

IMPLICATIONS

Theoretical Implication

This research adds to the knowledge and the literature on economic crisis and the resource-based view (market orientation, strategic flexibility, financial strength, and financial diversification). Among marketing capabilities (market orientation and strategic flexibility), our study seems to indicate that strategic flexibility is in fact a key determinant of the firm's recovery from an economic crisis. However, market orientation is not statistically significant in explaining firms' performance. Further, our study shows that financial capabilities have a stronger positive influence on performance than marketing capabilities.

Policy Implication

We also provide important implications to firms' executives and managers. Our study helps managers identify key resources that may be more critical during a turbulent time of an economic crisis. Managers should focus on the importance and development of skills for marketing capability (strategic flexibility). Strategic flexibility plays a significant role in helping managers survive during a crisis. Greater strategic flexibility encourages firms to achieve more competitive advantage and gain higher performance. Likewise, managers should give more attention to building the knowledge and skills to manage their funding sources and diversify revenue sources. Additionally, firms with high financial strength and diversification seem to better manage and recover from the crisis. More financial strength helps firms implement appropriate strategies to fulfill customer needs and expectations, and to maintain and increase performance. Unlike the other capability variables, financial strength cannot be changed in the short run. Therefore, financial diversity seems to be more important than strength. Further, more diversified sources of revenues enable firms to reduce their operations' risks and gain more benefits from uncertain business environments.

Understanding how firms have utilized certain resources over the period of resource scarcity during an economic crisis should provide insight for practitioners and researchers. The practical implication of this research is that in recovery from economic crisis, especially in financial crisis environment, a firm's financial capabilities are relatively more important than strategic flexibility. Firms need to diversify such that their revenues will not depend solely on one key customer and product line or limit their production to a single supplier. However, sound financial position involves more than just diversification. Firms seeking financial strength must maintain not only sufficient cash flows and working capital, but also support of financial institutions and related authorities, or agencies as suggested by a resource-based view.

CONCLUSIONS

Economic crises and the proper firm reactions make for interesting issues. The Thai experience in recent years is rich and capable of providing insight. This study attempted to find out what resources are more critical to firms as they recover from a major economic crisis. The empirical tests indicate clearly that although strategic flexibility as a marketing capability is significant, financial capabilities are more influential to firm's performance after the crisis. Yet, there is room for future research to include other capabilities from the marketing and financial functions, as well as other areas of a business. There should also be more studies across national markets for generalization of these results. Such research will contribute significantly toward our understanding of how firms deal with a more frequently occurring phenomenon of the economic crisis that comes with increased globalization.

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THE RELATION BETWEEN GROWTH AND INFLATION RATES IN LATIN AMERICA

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ABSTRACT

Inflation has long been a problem for countries in Latin America. While some countries have made progress in addressing the problem, other countries have not been able to achieve sustained economic growth. Keynesian thought posits the notion that inflation and growth can be positively related, while other theories suggest that inflation is detrimental to long-run growth. Various empirical studies yield conflicting results. This study applies two Granger causality tests to seventeen Latin American countries in order to determine possible long-run relations. For most of the countries, no causality is found, while unidirectional causality and bi-directional causality is found in a limited number of countries.

INTRODUCTION

Historically, many Latin American countries have been plagued by inflation problems though the problem has not been universally severe. During the past few decades, some of the countries have made considerable progress toward controlling inflation while others still struggle in the battle against inflation. Some countries in the region have also encountered difficulties in maintaining respectable economic growth rates. The purpose of this paper is to explore the relations that appear to exist between inflation and economic growth in selected Latin American countries and to note some of the econometric problems that exist in analyses of this nature.

There is far from universal agreement regarding the relation between inflation and economic growth, and this relation has long held a central position in macroeconomics. The traditional Keynesian view would hold that inflation can act as a stimulus to economic growth. This view is typically expressed through a short run Phillips curve tradeoff (Paul, Kearney, and Chowdhury, 1997) that arises due to sticky prices and wages. Thus, in the short run, faster real growth may be associated with inflation (Motley, 1998). However, the Phillips curve tradeoff tends to disappear as economic agents are able to anticipate price changes. These views were especially prominent in the 1960's and continued into the 1980's (Bruno and Easterly, 1996).

There are strong arguments that inflation is detrimental to economic growth, especially in the long run. Inflation makes it difficult for economic agents to make correct decisions since changes in relative prices become obscured (Harberger, 1998). Inflation imposes variable costs, especially menu costs. If inflation is high, the variability of inflation may also be high and this complicates the task of forecasting inflation. If inflation cannot be correctly anticipated, both savers and investors may be lead to make decisions that are detrimental to economic growth. This view is traditional and, in spite of the Keynesian views promulgated in the 1960's and thereafter, this view is incorporated into models of the new-growth literature (Bruno and Easterly, 1996).

The empirical evidence regarding the inflation-growth relation is mixed. Fischer (1993) found that real GDP growth is negatively related to inflation in cross sectional regressions and that low inflation is not necessary for growth. Using extreme bounds analysis, Levine and Zervos (1993) found that there is not a significant negative correlation between growth and inflation. They suggest that if inflation persists over a long time period, economic agents find mechanisms to adjust so that growth is not affected. However, cross-country regressions involving socio-economic variables often produce fragile results (Levine and Renelt, 1992).

Grier and Tullock (1989) found that the average level of inflation had a neutral effect on growth in the OECD countries but for the remainder of the world, inflation had a significant negative effect on growth. For Latin America, they found no statistical relation between inflation and growth. Barro (1997), in a world wide cross sectional analysis, found a negative relation between inflation and growth, though the effect could not be isolated for inflation rates below 20 percent. Other research by Barro (1996) indicates that the experiences of high inflation have adverse effects on investment and growth. Kocherlakota (1996) supports Barro's findings of a negative slope coefficient between growth and inflation and further shows that high growth tends to generate low inflation.

Until the 1970's, many studies found the negative effect of inflation on economic growth to be statistically insignificant, and in some instances, the effect was found to be positive (Sarel, 1996). The high and persistent inflation rates experienced by some countries during the 1970's and 1980's brought about a rethinking of the inflation-growth link.

The preceding review of cross-sectional studies, while not exhaustive, does not provide clear evidence of the growth-inflation relation. There are numerous problems associated with the use of cross-country regression analysis. Levine and Renalt (1992) and Temple (1999) review some of the methodological problems. Pooled cross-country data sets tend not to be informative regarding what happens in the lower ranges of inflation (Bruno and Easterly, 1998). The empirical relation between growth and inflation appears to be different for Africa and Latin America (Ericsson, Irons, and Tryon, 2001).

Time series analysis, which does have the advantage of unmasking relations for individual countries, has yet to provide evidence of a universal relation between growth and inflation. Paul, Kearney, and Chowdhury (1997) performed Granger causality tests on 70 countries for the 1960-1989 time period. For 40 percent of the countries, no causality was found; for approximately one-third of the countries, unidirectional causality was found; and for approximately one-fifth of the countries, bidirectional causality was found. In 19 of the countries, the direction of causality ran from growth to inflation, while the direction ran from inflation to growth for seven countries.

In this analysis, the correlation between the growth and inflation rates for each of the 17 Latin American countries is examined. Then the data are subjected to Granger causality tests in order to determine if long run relations exist and to determine the direction of causality. The data cover the 40-year period from 1961 through 2000.

DATA

Annual data used for the 17 Latin American countries were extracted from the World Bank's World Development Indicators: 2002 (cd-rom version). Annual inflation rates reflect annual percent changes in the CPI. Changes in the CPI are used in place of the GDP deflator since, by construction, the GDP deflators are negatively correlated with growth rates (Sarel, 1996). For this study, economic growth rates are defined as annual percent changes in real GDP. The countries included in the study are those Latin American countries for which 40 years of annual CPI and GDP growth rates could be obtained.

As a first step in analyzing the growth-inflation relation, the simple correlation coefficients between the annual percentage increases in the real GDP growth rate and the CPI were examined for the each country, and those correlation coefficients appear in Table 1. Only two countries, Paraguay and Uruguay, have positive coefficients, and in both cases, the resulting p-values are extremely large. Only two of the countries, Costa Rica and Mexico, had reasonably high coefficients, and in both instances, the level of significance is quite high.

Table 1: Growth-Inflation Correlations, By Country, 1961-2000

Country	Correlation Coefficient	p-value
Argentina	-0.40	0.01
Bolivia	-0.21	0.19
Columbia	-0.18	0.27
Costa Rica	-0.69	0.00
Dominican Republic	-0.26	0.11
El Salvador	-0.36	0.02
Guatemala	-0.21	0.20
Haiti	-0.18	0.26
Honduras	-0.30	0.06

Table 1: Growth-Inflation Correlations, By Country, 1961-2000		
Country	Correlation Coefficient	p-value
Jamaica	-0.19	0.24
Mexico	-0.60	0.00
Panama	-0.08	0.63
Paraguay	0.13	0.41
Peru	-0.45	0.00
Trinidad & Tobago	-0.00	0.98
Uruguay	0.15	0.35
Venezuela	-0.26	0.10

Table 2 shows the mean growth and inflation rates for the 17 countries. These rates are the simple arithmetic average rates for the 40-year time period. Only three of the 17 countries had average growth rates below two percent, and seven countries had average growth rates in excess of four percent.

Table 2: Mean Growth And Inflation Rates		
Country	Mean Growth Rate	Mean Inflation Rate
Argentina	2.59	242.90
Bolivia	2.74	353.78
Columbia	4.23	19.25
Costa Rica	4.87	14.18
Dominican Republic	5.43	11.95
El Salvador	3.10	9.78
Guatemala	4.05	9.22
Haiti	.95	10.32
Honduras	3.99	8.57
Jamaica	1.95	16.16
Mexico	4.72	26.83

Table 2: Mean Growth And Inflation Rates		
Country	Mean Growth Rate	Mean Inflation Rate
Panama	4.54	2.85
Paraguay	4.52	13.09
Peru	3.14	331.25
Trinidad & Tobago	3.75	8.18
Uruguay	1.93	53.12
Venezuela	2.72	17.01

Three of the countries (Argentina, Bolivia, and Peru) had triple-digit average inflation rates. Argentina experienced triple-digit inflation in 15 of the 40 study years. Bolivia only had that experience for three of the 40 years, but in one year the inflation rate was in the 5-digit range. Panama had the lowest average inflation rate, but its economy has been dollarized for quite some time.

The correlation coefficients indicate that, for 15 of the 17 countries, a possible negative relation exists between growth and inflation, while a positive relation could exist for two of the countries. However, the preceding correlation analysis indicates nothing about the direction of causality. Furthermore, well-known difficulties with time series analysis may be present. If the data are nonstationary, then the results found may be spurious (Murray, 1994).

METHODOLOGY

In order to gain insight into the direction of causality between inflation and growth, two causality techniques will be used. While no statistical test can indicate true causality, inference can be made as to which variable may precede another variable.

The first technique is the test for Granger causality (Granger, 1969). With Granger causality, to determine if growth (Y) "Granger causes" inflation (P), the following two regression equations are estimated:

$$P_t = \alpha + \sum_{i=1}^{m} \beta_i P_{t-i} + e_t \tag{1}$$

$$P_t = \alpha + \sum_{i=1}^{m} \phi_i P_{t-i} + \sum_{i=1}^{n} \delta_i Y_{t-i} + u_t \tag{2}$$

The first equation is the current inflation values regressed on lagged values of inflation. The second equation adds lagged values of growth to determine if past values of growth assist in the prediction of current values of inflation. An F-test is then used to determine whether the coefficients of the lagged growth rates in the second equation may be considered to be zero. To test for causation from inflation to growth, the test is repeated where growth is regressed on past values of growth and then compared to the regression of current values of growth regressed on past values of growth and inflation. The direction of causation between growth and inflation can be one of four possibilities: inflation to growth, growth to inflation, bidirectional between growth and inflation, or no relationship between growth and inflation.

The second technique used to investigate the direction of causality is the method used by Paul, Kearney, and Chowdhury (1997). This variation of the Granger causality model allows for "instantaneous causality" by allowing current values of inflation to play a role in determining current values of growth and vice versa. The authors consider this to be advantageous for annual data due to the speed with which information is transmitted through an economy. The model used in this paper differs slightly from the one suggested in Paul, Kearney, and Chowdhury (1997). Paul, et. al., includes the growth rate of money as a possible determinant of inflation. This paper excludes this variable since the focus is on the relationship between inflation and growth only. The following models will be used to further test for causality. For these models, the significance of the coefficients will be used to determine the direction of causality.

$$P_t = \alpha + \sum_{i=1}^{l} \phi_i P_{t-i} + \sum_{i=0}^{p} \gamma_i Y_{t-i} + v_t \tag{3}$$

$$Y_t = \alpha + \sum_{i=1}^{q} \lambda_i Y_{t-i} + \sum_{i=0}^{r} \eta_i P_{t-i} + z_t \tag{4}$$

RESULTS

Before proceeding with the causality tests, it is important to determine the order of integration of the data. Estimation of the equations requires the use of stationary data. If both growth and inflation rates are nonstationary, cointegration tests are a more appropriate technique to discern long-run relationships and Granger causality. Dickey-Fuller (1979, 1981) and Phillips-Perron (1988) Unit Root tests are two commonly used techniques to determine whether or not time series is stationary. More than one test is typically used due to the low power of the tests. If the tests confirm one another, greater confidence can be placed in the results (Enders, 1995).

Table 3 reports the results of the unit root tests. The lag length was selected using Akaike Information Criterion (AIC). After selecting the lag length, the selection of appropriate model is addressed. The choice for the models includes a time trend and constant, a constant, or no time trend or constant (none). The power of unit root tests is very sensitive to the deterministic regressors selected. The models were selected using the technique outlined by Doldado, Jenkinson, and Sosvilla-Rivero (1995). The null hypothesis of the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) test is the time series contains a unit root or integrated of order one. Failure to reject the null means the series is integrated of order one, I(1), or higher while rejecting the null means the series is stationary or integrated of order zero, I(0).

The five-percent MacKinnon Critical Values for both the ADF and PP test statistic for a lag of zero and no constant or time trend is -1.96. Since most of the models fit this description the reader is referred to MacKinnon (1991) for other critical values.

Table 3: Unit Root Test Results For Growth And Inflation Rates

Country	Var.	Lag	Model	ADF	PP	Conclusion
Argentina	Y	0	None	-4.83	-4.83	I(0)
	P	1	None	-3.69	-3.29	I(0)
Bolivia	Y	0	None	-3.34	-3.34	I(0)
	P	0	None	-5.39	-5.39	I(0)
Columbia	Y	0	Constant	-3.65	-3.65	I(0)
	P	0	Constant	-2.75	-2.75	I(1)
Costa Rica	Y	0	Constant	-4.50	-4.50	I(0)
	P	0	Constant	-1.75	-1.75	I(1)
Dominican Republic	Y	0	Constant	-6.14	-6.14	I(0)
	P	0	None	-1.26	-1.26	I(1)
El Salvador	Y	1	None	-2.49	-2.14	I(0)
	P	0	None	-1.20	-1.20	I(1)
Guatemala	Y	0	None	-1.63	-1.63	I(1)
	P	0	None	-2.14	-2.14	I(0)
Haiti	Y	1	None	-3.40	-6.36	I(0)
	P	0	None	-1.76	-1.76	I(1)
Honduras	Y	0	Constant	-4.75	-4.75	I(0)
	P	0	None	-1.14	-1.14	I(1)

Table 3: Unit Root Test Results For Growth And Inflation Rates						
Country	Var.	Lag	Model	ADF	PP	Conclusion
Jamaica	Y	1	None	-2.43	-4.01	I(0)
	P	0	None	-0.95	-0.95	I(1)
Mexico	Y	0	Constant	-4.12	-4.12	I(0)
	P	2	None	-1.08	-1.58	I(1)
Panama	Y	1	Constant	-3.95	-4.13	I(0)
	P	0	None	-1.05	-1.05	I(1)
Paraguay	Y	0	None	-2.12	-2.12	I(0)
	P	0	None	-1.63	-1.63	I(1)
Peru	Y	1	None	-3.43	-3.54	I(0)
	P	0	None	-1.22	-1.22	I(1)
Trinidad & Tobago	Y	1	None	-1.82	-4.06	I(0)
	P	0	None	-1.13	-1.13	I(1)
Uruguay	Y	2	Constant	-4.73	-3.96	I(0)
	P	0	None	-1.31	-1.31	I(1)
Venezuela	Y	0	Constant	-5.53	-5.53	I(0)
	P	4	None	-1.41	-1.82	I(1)

The ADF and PP test gave conflicting results for the growth rate for Trinidad & Tobago. In this case, the order of integration was determined by the PP test. The reason for favoring the PP test is due to the assumptions required for both tests. The ADF test assumes the error terms are independent with a constant variance. The PP test assumes the error terms are weakly dependent and heterogeneously distributed. Due to the nature of the data, the assumptions for the PP test are more reasonable than the ADF test.

For the growth rate variables, sixteen are stationary and one is nonstationary. For the inflation variables, three are stationary and fourteen are nonstationary. When the null hypothesis of a unit root is not rejected, this means the time series could be integrated of order one or higher. For the growth and inflation rates that were found to be nonstationary, these variables were checked for higher orders of integration. While the results are not reported here, it can be concluded that the nonstationary variables are integrated of order one. For the variables having unit roots, the first difference of the variable is used in the estimation of the causality regressions.

Table 4 reports the results of the Granger Causality Tests as discussed in the methodology section. A lag length of two was chosen for the tests. These results should be interpreted with caution due to the nonnormality and/or heteroscedasticity of the error terms. At the ten percent level of significance, it appears the growth precedes inflation in Columbia, Honduras, and Venezuela. Inflation precedes growth in Haiti. There is no detection of bidirectional causality between inflation and growth for any of the countries using this technique. The statistical evidence indicates that for the majority of the countries (Argentina, Bolivia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Jamaica, Mexico, Panama, Paraguay, Peru, Trinidad & Tobago, and Uruguay) there is no causal relationship between growth and inflation.

Table 4: Results Of Granger-Causality Test

	Ho: Inflation does not Cause Inflation		Ho: Growth does not Cause Inflation	
Country	F-Value	p-Value	F-Value	p-Value
Argentina	2.39	0.11	0.17	0.85
Bolivia	0.69	0.51	2.11	0.14
Columbia	0.52	0.60	4.53	0.02
Costa Rica	1.01	0.38	0.96	0.39
Dominican Republic	0.04	0.96	0.99	0.38
El Salvador	0.95	0.40	0.06	0.94
Guatemala	0.44	0.65	0.73	0.49
Haiti	2.69	0.08	0.10	0.91
Honduras	1.28	0.29	2.49	0.10
Jamaica	1.12	0.34	0.52	0.60
Mexico	0.34	0.71	0.63	0.54
Panama	1.30	0.29	0.85	0.44
Paraguay	1.40	0.26	0.54	0.59
Peru	0.63	0.54	2.09	0.14
Trinidad & Tobago	2.24	0.12	0.32	0.73
Uruguay	1.15	0.33	2.26	0.12
Venezuela	1.27	0.29	4.80	0.0

Table 5 reports the results of the Paul, Kearney, and Chowdhury (1997) alternative variation of the Granger causality test. This model allows for instantaneous causality between growth and inflation. The previous model only allowed for a lagged relationship. To expedite the reporting of the results, only the countries where a statistically significant relationship is evidenced will be given in Table 5. The table reports the regression coefficients and the p-values. As stated before, these results should be interpreted with caution due to the violation of assumptions concerning the error term. Where applicable, the regression results have been corrected for heteroscedasitcity.

Table 5: Alternative Granger Causality Test

Inflation Model (Equation 3)							
Country	α	P_{t-1}	P_{t-2}	Y_t	Y_{t-1}	Y_{t-2}	Adj R^2
Argentina	343.61	0.546	-0.197	-42.307	-7.579	-16.883	0.41
	(0.01)	(0.00)	(0.26)	(0.01)	(0.64)	(0.30)	
Costa Rica	2.716	-0.243	-0.086	-2.578	0.967	1.086	0.33
	(0.73)	(0.18)	(0.68)	(0.10)	(0.14)	(0.22)	
Honduras	-3.044	0.045	-0.112	-0.611	0.748	0.490	0.12
	(0.27)	(0.83)	(0.59)	(0.15)	(0.09)	(0.28)	
Mexico	1.099	0.083	-0.323	-2.317	0.892	1.236	0.26
	(0.88)	(0.67)	(0.34)	(0.00)	(0.45)	(0.20)	
Venezuela	-6.702	0.412	0.476	-2.543	3.438	0.317	0.33
	(0.20)	(0.12)	(0.07)	(0.00)	(0.00)	(0.76)	
Growth Model (Equation 4)							
Country	α	Y_{t-1}	Y_{t-2}	P_t	P_{t-1}	P_{t-2}	Adj R^2
Argentina	3.926	-0.049	-0.256	-0.004	0.000	0.002	0.26
	(0.00)	(0.77)	(0.12)	(0.01)	(0.89)	(0.20)	
Costa Rica	2.361	0.410	0.111	-0.125	-0.052	0.021	0.39
	(0.03)	(0.04)	(0.54)	(0.00)	(0.19)	(0.55)	
Haiti	0.786	0.093	0.130	-0.034	0.025	-0.178	0.05
	(0.29)	(0.57)	(0.41)	(0.68)	(0.78)	(0.05)	
Venezuela	0.894	0.409	0.072	-0.086	0.081	0.090	0.17
	(0.36)	(0.05)	(0.71)	(0.01)	(0.10)	(0.06)	

Note: Parameter estimates with p-values in parenthesis.

Using this alternative model, growth "causes" inflation in Honduras and Mexico. Inflation "causes" growth in Haiti. There is a bidirectional relationship for Argentina, Costa Rica, and Venezuela. There was no relationship between growth and inflation for Bolivia, Columbia, Dominican Republic, El Salvador, Guatemala, Jamaica, Panama, Paraguay, Peru, Trinidad & Tobago, and Uruguay. Table 6 provides a summary of the results of both causality tests. As might be expected, more relationships are detected between inflation and growth rates when instantaneous causality is included in the model.

CONCLUSION

This study has explored the possible relationship between real GDP growth and the rate of inflation, as measured through the GDP deflator, in Latin America over the period of 1961 to 2000. In addition to correlation analysis, Granger causality is used to investigate the nature of the relationship between growth and inflation rates.

The correlation analysis revealed mixed results. For countries where the correlation coefficient is statistically significant, the relationship between growth and the rate of inflation is negative. However there are two possible problems with this analysis. First, the correlation analysis does not indicate the causal flow of the relationship. Is growth having a negative impact on inflation or vice versa? Second, this analysis may yield spurious results if the data is nonstationary.

Unit root analysis is conducted prior to the estimating the Granger causality models. In the cases where the variable is determined to be nonstationary, the variable is first differenced prior to the estimation of the Granger causality models. Two forms of Granger causality tests are conducted. The interpretation of these results should be treated with caution since, due to the nature of the data, the regression models tend to experience violation of the assumptions about the error terms.

For the seventeen countries under study, there was no statistical evidence of a relationship between growth and inflation in eleven countries (Bolivia, Columbia, Dominican Republic, El Salvador, Guatemala, Jamaica, Panama, Paraguay, Peru, Trinidad & Tobago, and Uruguay) using the Paul, Kearney and Chowdhury (1997) variation of the Granger causality test. In these countries, economic growth and inflation are not statistically linked. In Haiti where inflation tends to "cause" growth, the preponderance of the evidence indicate an adverse relationship between inflation and growth. For this country, increases in inflation may lead to decreased economic growth. In Honduras and Mexico where growth "causes" inflation, the negative relationship is more beneficial for the economy. For these countries, as the economy experiences positive growth, this tends to decrease inflation. Argentina, Costa Rica, and Venezuela have more complicated relationships between inflation and growth. Growth and inflation appear to have bidirectional causality.

Table 6: Summary Of Results

Granger Causality Test			
Y==>P	P==>Y	Y $\Leftrightarrow$ P	No Causality
Columbia	Haiti	None	Argentina
Honduras			Bolivia
Venezuela			Costa Rica
			Dominican Republic
			El Salvador
			Guatemala
			Jamaica
			Mexico
			Panama
			Paraguay
			Peru
			Trinidad & Tobago
			Uruguay
Alternative Test for Granger Causality			
Y==>P	P==>Y	Y $\Leftrightarrow$ P	No Causality
Honduras	Haiti	Argentina	Bolivia
Mexico		Costa Rica	Columbia
		Venezuela	Dominican Republic
			El Salvador
			Guatemala
			Jamaica
			Panama
			Paraguay
			Peru
			Trinidad & Tobago
			Uruguay

For the Latin American countries used in Paul, Kearney, and Chowdhury (1997), fifteen (Bolivia, Columbia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Panama, Paraguay, Peru, Trinidad & Tobago, Uruguay, and Venezuela) of the countries are also used in this study. For these fifteen countries, the same general conclusion was reached about causality for Costa Rica (Y $\Leftrightarrow$ P) and Honduras (Y==>P). Also, both studies conclude that there is no statistical evidence of causality between growth and inflation for El Salvador, Guatemala, Jamaica, Paraguay, Trinidad & Tobago, and Uruguay. While this study differs in the model (see endnote 1) and the time period used, the studies reach similar conclusions for eight of the fifteen countries. However, the fragility of the results of statistical analysis indicates a need for continual analysis and model development.

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TARIFFS IN GLOBAL BUSINESS: CONCEPT, PROCESSES, AND CASE EXAMPLES

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ABSTRACT

This manuscript examines the concept and processes of tariffs in global business. In the flowing sections is a review of the market-entry literature, an examination of purposes and types of tariffs, a critical analysis of four case examples of tariffs in global business involving the steel, lumber, automobile, and textile industries, and a discussion of the use of foreign trade zones in managing a firm's tariff exposure. The manuscript features a comprehensive literature review that may be of value to global business practitioners and researchers.

INTRODUCTION

After a month at sea in a container aboard a cargo ship, a product lands at a port in a host country. Then begins the process of moving the product through the various host-country governmental offices related to country entry and customs. Priced conservatively on export from its home country, the product must be competitive in the host-country market. A recent market research study indicates that the host-country promises to be a profitable market for the exporting firm, but it is a price-sensitive market and the product's price, therefore, must be competitive with local products.

The market-entry process moves smoothly at the port. The firm's host-country distributor adroitly handles the documentation for country entry. All is going well with the processing activities at the port until the host-country government levies a tariff of 60% on the specific product type and country-of-origin locale of the product imported to the host country. At the imposition of the tariff, the landed cost of the product increases from (X) in host-country currency to [(X) + 0.60(X)]. At a tariff-imputed landed cost of [(X) + 0.60(X)], the product likely will not be competitive, particularly in the host country's price-sensitive market.

MARKET-ENTRY LITERATURE

The opening vignette typifies an unfortunate experience of some managers in international market-entry transactions. A foreign market is selected, a product is shipped, and upon arrival a higher than anticipated tariff is levied. While it is possible to request "advanced tariff classification" from a country to which a product is being exported to know the likely amount of tariff beforehand, tariff schedules in a host country sometimes will change without prior notification. The change more often than not is an increase in tariff. This results in the landed cost of a product increasing significantly as the result of an increase in tariff, thereby affecting a product's price competitiveness within a host-country market.

Nations affect market-entry behaviors of home-country firms seeking entry to host-country markets through trade policies, the mix of national customs, laws, procedures, rules, and tariffs that govern international trade (Strange, 1988; Behrman & Grosse, 1990; Brewer, 1993; Shleifer & Vishny, 1994; Aswicahyono & Hill, 1995; Loree & Guisinger, 1995; Markusen, 1995; Braunerhjelm & Svensson, 1996; Barrell & Paine, 1997; Kehoe, 1998, Rugman & Verbeke, 1998; Globerman & Shapiro, 1999; Editorial, 2003; Cellich & Jain, 2004; Kahn, 2004; Kehoe, 2004, Griffin & Pustay, 2005). In addition to trade policies, market-entry behavior is influenced by variables such as the market-entry decision processes and managerial motivations at work in a firm, a firm's level of export intensity, the interplay of host-country culture and market-entry processes, and the international experiences of a firm's management.

The actions of governmental and non-governmental institutions impact the market-entry decision processes and affect a firm's market-entry strategies. For example, market-entry policies and rules (e.g., tariffs and quotas) within a host country drive decisions whether to ship a product in complete form to a host county or to ship in component parts for assembly within the country.

Similarly, country-of-origin policies of a host country affect decisions whether or not to ship directly from home to a host country or to transship through another country. Literature describing and modeling these and other considerations in the market-entry decision process is complex and robust. Among the more interesting research about managing market-entry decision processes of multinational firms are articles and books by Tookey (1964), Kindleberger (1969), Horst, (1972), Stopford and Wells (1972), Hymer (1976), Johanson and Vahlne (1977), Killing (1983), Root (1983) Thomas and Araujo (1985), Beamish and Banks, 1987; Gomes-Casseres (1987), Roehl and Truitt (1987), Kogut (1988), Anderson and Narus (1990), Kim and Hwang (1992), Lei and Slocum (1992), Erramilli and Rao (1993), Haverman (1993), Parkhe (1993), Smith and Zeithaml (1993), Inkpen and Birkenshaw (1994), Dalli (1995), Li (1995), Buckley (1996), Duffy (1996), Quelch and Klein (1996), Gomes-Casseres (1997), Buckley and Casson (1998a), Buckley and Casson (1998b), Davis, Desai and Francis (2000), Pan and Tse (2000), Meyer and Estrin (2001), Leonidou, Katsikeas and Samiee (2002), Muralidharan (2003), Harris (2004), Oum, Park, Kim and Yu (2004).

Market-Entry Decision Processes and Managerial Motivations

While describing and modeling market-entry decision processes is interesting, at a deeper level of abstraction is a need to understand the motivations of managers for entering the international business arena. Horst (1972), Grubaugh (1987), Zitta and Powers (2003) and Samli (2004) suggest that managers enter host-country markets seeking growth, profits, technology enhancement, and to satisfy a desire for a global presence. Doukas and Lang (2003) posit a need for diversification as a managerial driver of foreign direct investment, while Hejazi and Pauly (2003) argue that domestic capital formation is a significant motivator of international market entry. Muralidharan (2003) suggests the exploitation of "arbitrage opportunities in product, financial and other resources markets that may exist across various country operations" motivates international market entry decisions. Claggett and Stutzman (2003) posit managers move to international diversification in order to increase revenues and to lower volatility, thereby enhancing overall firm performance. Bruner (2004) says managers seek to increase returns, reduce risks, or both in entering foreign markets. Tyson (2004) suggests managers seek "low-wage production platforms" to serve domestic and global markets as a motivation for international-market entry. Wilson (1980), Yip (1982), Woodcock, Beamish and Makino (1994), and Uhlenbruck (2004) explore international market entry through a lens of acquired foreign subsidiaries. Knight and Cavusgil (2004) argue that managers in some firms aspire to be a "born-global firm" by entering foreign markets at or near to a firm's founding.

In addition to understanding managerial motivations for engaging in international business, another interesting area of literature focuses on describing the control of an international-market entry. Initially of a descriptive nature, but of late more empirically based, the control-related literature is rich in content and managerially relevant. It includes research by scholars such as Kindleberger (1969), Dunning (1981), Davidson (1982), Root (1983), Jain (1989), Yip (1992), Dunning (1993), Root (1994), Bengtsson (1998), Cheng and Kwan (2000), Keegan and Green (2000), Dunning (2003), Kim, Park and Prescott (2003); Safarian (2003), Sundaramurthy and Lewis (2003), Choi and Beamish (2004), and Samli (2004). Particularly managerially relevant is an Import Handbook by Feinschreiber and Crowley (1997). Focusing primarily on importing to the United States, the book is a useful resource about importing to any country as well as exporting.

Market-Entry and Export Intensity

A subset of studying reasons for market entry involves developing an understanding of the drivers of export intensity. Among determinants of export intensity are such factors as the relationship of export intensity to firm size and governance structure (Kaynak & Kothari, 1984; Beamish & Munro, 1986; Miesenbock, 1988; Namiki, 1988; Cuplan, 1989; Holzmuller & Kasper, 1991; Bonaccorsi, 1992; Chetty & Hamilton, 1993; Filatotchev, Dyomina, Wright & Buck, 2001;

Samli, 2004). A desire to achieve first mover advantages (Lieberman & Montgomery, 1988; Quelch & Deshpande, 2004; Samli, 2004; Griffin & Pustay, 2005) also affects export intensity, as does a manager's ability to marshal the appropriate resources required for market entry (Madsen, 1989; Louter, Ouwerkerk & Bakker, 1991; Chang, 1995; Aulakh, Kotabe & Teegen, 2000; Samli, 2004). Likewise affecting export intensity are prior international experiences, motivation, orientation and skills of management (Johnston & Czinkota, 1982; Levitt, 1983; Welsh & Luostarinen, 1988; Aaby & Slater, 1989; Dichtl, Koeglmayr & Mueller, 1990; Andersson & Svensson, 1994; Leonidou, Katsikeas & Piercy, 1998; Quelch & Deshpande, 2004; Samli, 2004).
Characteristics of a product, a brand's global reputation, and the channels of distribution in use all impact export intensity (McGuinness & Little, 1981; Anderson & Coughlan, 1987; Peng & Ilinitch, 1998; Anderson & Narus, 1990; Steenkamp, Batra & Alden, 2003; Johansson & Ronkainen, 2004; Quelch & Deshpande, 2004). Home-country location relative to host-country markets (Davidson, 1980; Caves & Mehra, 1986; Agarwal & Ramaswamy, 1991; Aulakh, Kotabe & Sahay, 1996; Gwin & Kehoe, 1999; Jeannet & Hennessey, 2004; Samli, 2004) affects export intensity through the availability and quality of global logistics resources. Finally, such micro managerial aspect as pricing in international markets (Piercy, 1981a; Samiee & Anckar, 1998; Griffin& Pustay, 2005), buyer and seller relationships (Egan & Mody, 1992; Dyer, 1996; Piercy, Katsikeas & Cravens, 1997; Peng & Ilinitch, 1998; Peng & York, 2001), and transaction cost (Anderson & Gatigon, 1986; Erramilli & Rao, 1993; Kahn, 2004) affect export intensity.

Culture and Market Entry

An interesting and well-conceptualized literature concerns culture and market entry. Part of the literature is descriptive in nature as typified by the work of Kluckhohn and Strodtbeck, 1961; Converse, 1972; Hofstede, 1980; Redding, 1980; Hamilton and Biggart, 1988; Kogut and Singh, 1988; Clark, 1990; Kanungo, 1990; Kale and McIntyre, 1991; Shane, 1992; Shane, 1994; Barkema, Bell and Pennings, 1996; Meschi, 1997; Thomas and Mueller, 2000; Gannon, 2001; and Ferraro, 2002. Another aspect of the literature is pragmatic and perhaps more managerially relevant. That literature seeks to analyze the impact of cultural distance in the market-entry decision. Evidence suggests that as perceptions of country risk and cultural distance increase, managers are less likely to use wholly-owned approaches to market entry, rather instead to use strategic alliances and joint ventures so as to dampen the country risk and cultural distance factors (Agarwal, 1994; Sutcliffe and Zaheer, 1998; Brouthers and Brouthers, 2001; Oum, Park, Kim and Yu, 2004).

International Experiences

The depth and variety of international experiences of management arguably influence a firm's approach to international market entry (Pavord & Bogart, 1975; Piercy, 1981b; Welsh &

Luostarinen, 1988; Andersen, 1993; Leonidou & Katsikeas, 1996; Leonidou, 1998; Samli, 2004). These experiences impact such factors as the need for collaboration (Kogut 1989; Ring & Van de Ven, 1992; Dyer, 1997; Sundaramurthy & Lewis, 2003; Griffin & Pustay, 2005), for control (Gupta & Govindrajan, 1991; Sohn, 1994; Fladmoe-Lindquist & Jaque, 1995), for flexibility (Kogut, 1985; Cellich & Jain, 2004), and for trust (Geringer, 1991; Sako, 1992; Sako & Helper, 1997; Zaheer, McEvily & Perrone, 1998) in an international market-entry venture.

CONCEPT AND TYPES OF TARIFFS

Winston Churchill reportedly understood the power of tariffs. At the conclusion of an international visit, he advised his hosts as follows. "You young gentlemen have entertained me royally, and in return I will give you a priceless secret. Tariffs! These are the politics of the future, and of the near future. Study them closely and make yourselves masters of them, and your will not regret your hospitality to me." (Churchill, 1902)

A tariff is a tool used by government to affect market-entry behavior. It is the most common type of governmental control imposed on global trade (Daniels, Radebaugh & Sullivan, 2002; Samli, 2004). Tariffs are part of a government's trade-control infrastructure (Globerman & Shapiro, 2003), the mix of institutions, laws, policies, procedures, and regulations that impact on global trade operations. Tariffs and other trade controls signal the extent of market openness in a host-country market and thereby influence investment decisions of global firms. Nations uses tariffs to discourage imports to the country, to protect home-country industries, to penalize other counties for imposing tariffs on a home-country's products, to penalize other countries not aligned politically with a home country, and to generate revenues for the home country (Lascu, 2003).

A nation may levy a tariff as an export tariff when a product leaves its home country, levy as a transit tariff when a product passes through a country enroute to its destination, or levy as an import tariff when a product enters a host-county. The United States constitutionally prohibits export tariffs (Jeannet & Hennessey, 2004), while other countries allow them. The use of import tariffs is routine in international trade and, as such, this research focuses particularly on import tariffs.

An import tariff, simply described, is a tax. It is a tax or customs duty imposed on goods crossing international boundaries from a country-of-origin to host-country markets (Horst, 1971; Brewer, 1993; Daniels, Radebaugh & Sullivan, 2002; Jeannet & Hennessey, 2004; Griffin & Pustay, 2005). An import tariff is applied either as a specific amount of host-country currency per unit of product imported to a host-country (i.e., a specific tariff) or as a percentage of value of an imported good (i.e., an ad valorem tariff).

Specific Tariff

A nation may levy an import tariff as a specific tariff as a specific amount of host-country currency per unit based either on weight of a product, volume, cubic dimensions, length, height, or other measures decided by the country to which the product is being imported. An example is a nation levying a specific tariff as so many importing-country currency units per pound, or per liter, or per linear foot, or per pair. On importing a liquid product to the United Kingdom, a specific tariff might be £2.00 per liter. On importing lumber, a specific tariff might be £0.85 per board foot of lumber. If footwear, a specific tariff might be expressed at £4.00 per pair of shoes. In each of these examples, the tariff is a specific amount of host-country currency per unit of product.

Specific tariffs often disproportionably restrict importation of inexpensive products as opposed to relatively more expensive products. For example, if the cost of a pair of shoes landed on a dock in a host country is £25/pair, a £4/pair tariff has a greater import restrictive impact than if the landed cost is £150/pair of shoes. A public policy implication for a host-country government to consider is that a specific tariff often restricts products less expensive, rather than those that are more expensive. If the policy goal is to restrict less expensive imports, a specific tariff is appropriate. If this is not a policy goal, a host-country government may want to consider a different approach to tariffs, possibly an ad valorem tariff.

Ad Valorem Tariff

A nation levies an import tariff as an ad valorem tariff on the landed cost of a product - that is, levies on a product's landed CIF basis (Cost, Insurance and Freight) at a port of entry. An example is levying a 60% ad valorem tariff on a product whose landed CIF cost basis (X) in the United Kingdom is £480. That product will have a tariff-imputed landed cost basis of [(X) + 0.60(X)] or [(£480) + 0.60(£480)] or £768.00. Hence, in this example, a product with a CIF landed cost basis of £480 upon entering a host country, leaves the port of entry with a cost basis of £768. At the tariff-imputed landed cost of [(X) + 0.60(X)], such a product may not be competitive in a host-country market, particularly, as in the case of the opening vignette, if host-country consumers are price sensitive.

Compound Tariff

A compound tariff is both ad valorum and specific in its configuration. For example, levying a shipment of imported liquor at a $3.00/liter specific tariff and a 10% ad valorum tariff is a compound tariff. If the shipment contains 10,000 one-liter bottles at a landed CIF cost basis of $25.00/liter, the compound tariff is the specific tariff plus the ad valorum tariff or [(10,000 one-liter bottles x $3.00/liter) + (10,000 one-liter bottles x $25.00/liter x 10%)] = [$30,000 + $25,000] = $55,000 compound tariff.

PURPOSES OF TARIFFS

Among the purposes of tariffs are being protective and/or revenue generative. If a 60% ad valorem tariff has as its purpose to keep a product out of a country, the tariff is a protective tariff. If a tariff's primary purpose is to generate tax revenue for a country, it is a revenue tariff. In many cases, a tariff will have both protective and revenue objectives.

A protective tariff generally is levied at a higher rate than is a revenue tariff. The reason is that a protective tariff is designed to protect a country's domestic products and industries and, therefore, will be of a relatively high magnitude to make prices of imported products noncompetitive against domestic products. An important policy question for government is how high should be a protective tariff? The answer is that it depends whether a host-country government is seeking a partial or a complete restriction of imports of a particular product. The determination of the type of restriction, whether a partial or a complete restriction, often is a function of the amount of pressure brought on a government by domestic industry.

For example, the U.S. steel industry lobbied the U.S. government for a protective tariff against imported steel. The pressure intensified given that 27 U.S. steel manufacturers went bankrupt since 1997, including the third and fourth largest U. S. steel manufacturers (Kahn, 2001; Matthews, 2001a; Matthews 2001b; Berner, 2002; Arndt, 2003). This situation brought pressure from industry on government to enact a protective tariff and to do so at a level approaching a complete restriction of steel imports.

A country generally levies a revenue tariff at a lower rate than a protective tariff. Levying at a lower rate does not keep a product out of a country, but allows entry to apply and collect the tariff. Keeping a tariff relatively low maximizes collection of tax. Government seeks to find a tariff's point of elasticity in order to maximum tax revenue. Too high a revenue tariff will result in loss of tax revenue due to a reduction in imports. Conversely, a revenue tariff set too low also results in loss of tax revenue because the tariff is too low to generate acceptable tax revenues. The policy issue for a government regarding a revenue tariff is to discover the point of elasticity where a tariff is not too high or too low, thereby maximizing revenue.

Whether a tariff is primarily protective or primarily revenue in its objective, its classification may be a single-column tariff or a two-column tariff. Under a single-column tariff schedule, a country levies the same duty on a product no matter its country-of-origin, while a double-column schedule allows differential tariffs rates on imports of the same product from different countries. Countries develop two-column tariff rates through bilateral negotiations. A particularly interesting type of a two-column tariff regime is a preferential tariff in a free trade area, a customs union, or a common market. For example, countries in a common market may reduce tariffs against each other by using a double-column schedule, while maintaining higher tariffs, through a single-column schedule, against countries not members of the common market.

ENABLING LEGISLATION FOR U.S. TARIFFS

The United States Department of Commerce and the U. S. International Trade Commission administer tariffs. Enabling legislation is in the Tariff Act of 1930, particularly in Section 337 prohibiting unfair methods of competition by importers to the United States if the effect of the competition is to injure substantially or to destroy a domestic industry (Keegan & Green, 2000). Other enabling legislation is in the Trade Expansion Act of 1962, the Trade Act of 1974, the Trade and Tariff Act of 1984, the Omnibus Trade and Competitiveness Act of 1988, and the Trade Act of 2002. The Trade Act of 2002 reestablished fast-track authority under which Congress either votes to approve or to disapprove proposed trade agreements without amending them (Czinkota & Ronkainen, 2004). The Trade Act of 2002 also includes (Zoellick, 2002) "a large, immediate downpayment on open trade for the neediest (countries), cutting tariffs to zero for an estimated $20 billion in American imports from the developing world."

The U. S. International Trade Commission (USITC, 2004), created in 1916, is an independent federal agency charged broadly with monitoring international trade and tariffs. Comprised of six Commissioners appointed by the President, the Commission oversees all aspects of international trade policies of the United States, including investigating complaints of unfair trade practices and monitoring the impact of imports on domestic businesses. The Commission holds public hearings, engages in research on trade practices, publishes tariff summaries, and administers the Harmonized System (2004) of three classification codes for goods and services in international trade. The three codes include:

- U. S. Standard Industrial Classification (SIC), a code classifying goods and services.
- United Nation's Standard Industrial Trade Classification (SITC), a code developed by the United Nations for products shipped in international commerce.
- Harmonized System (HS) Commodity Number, a ten-digit code entered on a Shipper's Export Declaration for any shipment greater than US$2500 in value. Also called a Schedule B number (its earlier name), a HS number enables an exporter to identify the type and amount of any tariff levied on a product category in a host country. Another use of a Shipper's Export Declaration with a HS number is to track exports and compile export data.

TARIFFS - CASE EXAMPLES

Four cases elucidate the use of tariffs in global business. In the first case, the U. S. steel industry lobbies for tariff protection against steel imports from other countries. The second case finds the United States applying a tariff against lumber from Canada. In the third case, the United States relaxes tariffs levied against automobiles imported from South Africa. The fourth case involves the U. S. textile industry seeking additional tariff protection. The significance of the first and second cases is that to date these are the only industries (steel and lumber) in which the Bush administration has levied tariffs against imports. The third case demonstrates the impact of a tariff reduction on corporate growth and profits. The final case is about an industry in distress and its need for tariff relief.

Tariff On Steel

With bankruptcy of 27 manufacturers since 1997, including the third and fourth largest manufacturers (Kahn, 2001; Matthews, 2001a; Matthews 2001b; Berner, 2002; Matthews, 2002; Arndt, 2003; Loomis, 2004), the U.S. steel industry reacted by lobbying for a tariff as high as 50% on imported steel. The industry estimated that a 50% tariff would improve industry profits by approximately $10 billion (Kahn, 2001; Matthews, 2001c; Magnusson, 2002a; Czinkota & Ronkainen, 2004). The U. S. International Trade Commission did not support a 50% tariff, but recommended tariffs of 5% to 40% on 16 imported steel product lines (Kahn, 2001; Pearlstein, 2001; Czinkota & Ronkainen, 2004).

While the U. S. International Trade Commission supported a tariff on steel, others argued it is not necessary and would only prolong problems in the industry. Barro (2002) typifies the arguments against steel tariffs in pointing out that "since 1950, Big Steel has been reluctant to make the investments needed to match the new technologies introduced elsewhere. It was slow to replace open-hearth furnaces with basic oxygen furnaces and was late in introducing continuous casting. Big Steel also acquiesced to high wages for its unionized labor force. Hence, the companies have difficulty competing not only with more efficient producers in Asia and Europe but also with technologically advanced U.S. mini-mills."

On March 5, 2002, President Bush, acting on the unanimous recommendation of the U.S. International Trade Commission, authorized a three-year regime of tariffs ranging from 8 to 30% on a variety of imported steel (Allen & Pearlstein, 2002; Magnusson, 2002a; Pearlstein, 2002; Will, 2002; Czinkota & Ronkainen, 2004). These tariffs will impact approximately U.S.$ 8 billion of imported steel originating from Europe, Japan and South Korea or about 10% of the world market for steel (Economist Article, 2002a, 2002b, 2002c).

Arguably, a tariff on imported steel offers protection to the industry and may preserve jobs. Additionally, because steel is a basic industry, national defense considerations arise. So too do domestic political considerations arise. In the muck of politics lies a reality that as many as six seats in the U. S. House of Representatives were from areas in which steel mills might cease operating without the benefit of tariff protection (Blustein, Kessler & Phillips, 2002; Will, 2002). For all of these reasons, the United States levied a tariff on imported steel on March 5, 2002. The steel tariff has benefits and cost, as does any tariff. The public-policy calculus in a tariff decision involves ensuring the benefits outweigh the cost.

In an analysis of the potential cost to consumers of a 20% tariff on imported steel, Hufbauer (2001) found that a 20% tariff on imported steel would cost consumers about $7.0 billion in increased prices over a four-year period. Other economists predict that domestic prices of products containing steel may increase by 6% to 8% in the first year of the tariff (Czinkota & Ronkainen, 2004). The benefits rest largely in the number of jobs saved in the steel industry, which Hufbauer (2001) estimates as approximately 7,300 jobs, at a cost to American consumers of $326,000 for each job saved.

Other important factors in public-policy calculus is an evaluation of potential retaliatory responses by other nations (Economist Article, 2002a; Kantor, 2002, Magnusson, 2002a, 2002b; Powell, 2002) and consideration of the impact of a tariff on a nation's global status (Matthews & King, 2002; Stevenson, 2002; Zoellick 2002). In the case of the steel tariff, the United States expected a retaliatory response from several nations. To offset a retaliatory response, the United States made diplomatic initiatives toward Brazil (Krugman, 2002), Canada (Baglole, 2002), China (Krugman, 2002; Wonacott, 2002), the European Union (Matthews, 2001c; Blustein, 2002; Winestock, 2002), Japan (Krugman, 2002; Zaun, 2002), and South Korea (Krugman, 2002).

Despite ongoing diplomatic initiatives, other nations did not well tolerate the steel tariff, particularly the European Union nations. When the World Trade Organization sided with an EU complaint and ruled the steel tariff illegal, the EU announced plans to impose more than $2 billion of tariffs on U.S. imports unless the steel tariff was rescinded (Becker, 2003a). If the U.S. ignored the WTO ruling and maintained its steel tariff, it would have to accept over $2 billion in European sanctions, in addition to possible sanctions by China, Japan, and South Korea (Becker, 2003b; King & Tejada, 2003).

Organized labor, as might be expected, did not support lifting the steel tariff, no matter the EU objections and the WTO ruling. In a letter to President Bush, AFL-CIO President John J. Sweeney (2003) argued for the tariff as follows: "A report issued by the International Trade Commission in September validates the effectiveness of the tariffs. Bankruptcies and layoffs in the domestic steel industry have slowed. Steel prices have stabilized and many domestic producers are returning to profitability. The steel industry is in the midst of a major consolidation and restructuring. Labor unions and steel companies have negotiated agreements to reduce costs, improve productivity and profitability, and help facilitate industry consolidation. The costs to steel consumers have been largely negligible. Steelworkers and steel companies are doing what you asked them to do in 2002 - make painful decisions to increase their competitiveness. Now is not the time to pull the rug from under their feet, setting back these efforts that have so far been successful. Bowing to international pressure from the World Trade Organization, the European Union, and Japan to end the tariffs would send a disturbing signal that the United States is unwilling to defend its domestic workers and industries besieged by heavily subsidized foreign competitors. America's working families are fighting for their economic survival. Manufacturing employment is at its lowest point in over forty years. I urge you not to alter the steel tariffs. Doing so would only hinder the recovery of the steel industry, which is so vital to our economic future and our national security."

Despite objections by organized labor, President Bush lifted the steel tariff in early December 2003. The administration argued that the tariff achieved its purpose as a temporary trade restriction to assist the steel industry while consolidating in the face of aggressive foreign competition. The EU withdrew its threat of retaliatory tariffs after the announcement of lifting the steel tariff (Koff & Krouse, 2003; Stevenson, 2003).

Tariff on Lumber

Perhaps not as controversial as the steel tariff, another tariff emerged as the result of industry pressure. U.S. timber companies argued that Canada's provincial governments unfairly subsidized logging and production processes, resulting in artificially low prices for exported lumber, with Canadian timber companies allegedly paying as much as 60% less for standing trees than U.S. lumber companies. Because of industry pressure, the U.S. government in August 2001 levied a temporary 19.3% tariff on Canadian softwood lumber, a lumber used primarily in home construction (Crutsinger, 2001). Then, in March 2002, the government announced an intention to increase to a 29% tariff. That tariff adds about $1500 to the construction cost a typical new home (Economist Article, 2002d).

On June 3, 2004, after reviewing lumber shipments between the time of the initial levy and March 31, 2003, the Commerce Department proposed cutting the tariff from its current 27.2% to 13.2%. The decision has no immediate impact because the Commerce Department will not make a final ruling until it completes its final review in December 2004. Canadian officials welcomed relief from what they term punitive duties averaging 27.2%. The Commerce Department emphasized that the recommendation is preliminary and reflect a change in the methodology in setting tariff rates. The Commerce Department still holds that tariffs are necessary to counter Canadian government subsidies of softwood lumber (Editorial, 2004). The Coalition for Fair Lumber Imports commented that the methodology used by Commerce "is way undervaluing timber across Canada" and objects to reducing the tariff rate. The development results from favorable rulings in Canada's legal challenges to the tariff before the WTO and a North American Free Trade Agreement appeal panel (Daly, 2004). The American Homeowners Grassroots Alliance (2004) opposes the lumber tariff and provides opposition information on its website, including its Congressional testimony opposing the tariff.

Tariff on Automobiles

Unlike the case example involving the steel industry, the situation in the automobile industry selected for examination is somewhat different. This case situation involves automobiles imported to the United States from South Africa. These automobiles now enter the U.S. duty-free, under a preferential trade agreement, the African Growth and Opportunity Act of 2001 (AGOA), to stimulate African economies (Itano, 2003).

Bavarian Motor Works (BMW) operates a factory in Rosslyn, South Africa that produces BMW 3 Series automobiles. Itano (2003) reports that of approximately 50,000 BMW 3 Series cars produced each year, 80 percent (40,000 cars/year) are for export, and 25,000 of these cars are destined for the United States. Prior to the 2001 AGOA trade agreement between the U.S. and South Africa, each automobile carried a 2.5% import tariff. The AGOA, in effect until 2008, enables automobiles imported from South Africa to enter the United States duty free.

Since the elimination of tariffs on automobiles from South Africa, BMW-South Africa quadrupled its business, with exports to the United States accounting for half of its business growth. Production at the BMW Rosslyn, South Africa plant in 2002 was 55,600 3 Series automobiles (*BMW Annual Report*, 2002), a significant increase of 43,600 automobiles above the 12,000 automobiles reportedly produced at the plant in 1998 (Itano, 2003). Firms enter host-country markets seeking business growth and profit (Dunning, 1973; Ajami and Ricks, 1981; Dunning, 1993; Gwin and Kehoe, 1999; Kehoe and Whitten, 1999; Zitta and Powers, 2003). BMW is no exception to these desires, with exports to the United States accounting for half of the business growth in its South African plant.

Tariff on Textiles

The textile industry, in a few words, is competitive and is distressed. Consumer prices of apparel products have fallen significantly in recent years. A study by the U. S. Department of Labor found consumer prices of apparel products decreased from a base index of $100 in 1993 to $74 in 2002 (Economist Article, 2003). A study by the consulting firm of A. T. Kearney reports a jacket retailing at $100 in 1992 is $68 in 2003 (Economist Article, 2003). Such retail price erosion obviously impacts negatively the revenue and profit of U. S. based textile firms.

Because of erosion in retail prices, retailers, as a result, demand lower prices from manufacturers, which, in turn, cause manufacturers to consider producing offshore (Ansberry, 2003). Such is the case with U. S. based textile firms, increasingly moving production offshore to low-wage host countries. Producing in a low-wage host country reduces the cost basis of the textile products and, as retail prices erode, enables textile firms to protect profit margins by lowering manufacturing cost. Another reaction to retail price erosion, as well as to an influx of low-cost import clothing, is an emergent increase in alliances and mergers in the textile industry as U.S. firms join forces to compete against low-cost (but often higher quality) imported textiles.

In addition to alliances and mergers, U.S. textile manufacturers are seeking additional tariff protection and import quotas, particularly against textile imports from China, the number one source of imported clothing, and Mexico, the number two source of clothing imports (Rushford, 2003). The American Textile Manufacturers Institute (ATMI, 2003) estimates 2.6 million U.S. manufacturing jobs, including almost 300,000 U.S. textile and apparel jobs, have been lost since January 2001. In July 2003, ATMI estimates 18,200 lost jobs, of which 4,800 were at the Pillowtex plant in North Carolina, the largest single job loss in the state's history. This situation may worsen when textile import quotas expire on December 31, 2004 (WSJ Report, 2003). ATMI predicts that expiration of textile quotas may result in a loss of 630,000 textile jobs by 2006.

ARGUMENTS FOR AND AGAINST TARIFFS

The four case studies presented above embed arguments against and arguments favoring tariffs. Compelling arguments are possible in either direction.

Making an argument for tariffs and accepting that a utopian world of no tariffs is unattainable, the reasons for tariffs are many. The arguments vary depending on the strength of the economies of the countries involved. Is the country a major economic power or a developing nation? The United States may argue, as in the case of the steel industry, that national defense demands the existence of a domestic steel industry. How could the U.S. be dependent on foreign steel for a vital need? This argument may not apply to a developing country struggling to maintain a quality of life for its citizens. That country may impose a tariff on an import that competes with local manufacturers in order to protect jobs, particularly if the local operation has inefficient processes and older production machinery. This machinery may be all that the local company can afford, it is the best they can do and it puts people to work. The local company cannot afford to compete in the global market. Rather, it is providing jobs and products and need protection from larger, well-financed, and technologically advanced global competitors.

An argument against tariffs posits that the world should strive for a true global economy and any country or company should be able to obtain goods and/or services from any available source regardless of country of location. Everything else equal (quality, delivery, etc.), acquisition of good and/or services would be from least-cost locations anywhere in the world. This argument benefits consumers with lower prices and potentially benefits the bottom line of a local company acquiring, manufacturing and selling the final product, for example, the textiles discussed previously. When using tariffs to protect an industry, e.g., steel, there can be a disincentive for a protected industry or company to improve operations, reduce cost and enhance efficiency. As put bluntly by Charles Powell (2002), the steel tariff is 'blatantly protectionist, as well as a setback for free trade and open markets. It won't save inefficient steel producers … will only buy them more time to go on being inefficient." Given continued inefficiencies, savings, as a result, are not available to pass on to consumers and/or improve the bottom line of a company.

FOREIGN TRADE ZONES

In the opening vignette, a firm exports a product to a host-country that promises to be a profitable market for the exporting firm, but it is a price-sensitive market and the product's price, therefore, must be competitive with local products. When the product lands at the port, it receives a tariff of 60% based on its specific product type and country-of-origin locale. The tariff increases the landed cost of the product from (X) in host-country currency to [(X) + 0.60(X)]. At a tariff-imputed landed cost of [(X) + 0.60(X)], the product likely will not be competitive, particularly in the host country's price-sensitive market. What is a manager to do in facing such a situation?

The product is at the port, but with a cost basis of 60% more than anticipated. Among options for management's consideration are either withdraw the product back to its home country, ship the product to another country having no or lower tariffs, or stick it out in the initial host country by increasing marketing expenditures to support the product at its higher price. Likely, the product will remain in the initial host country, particularly if the product enters a Foreign Trade Zone area at the port of entry.

A Foreign Trade Zone (FTZ) is a secure site where goods receive preferential tariff treatment. It may be a site within a port of entry where imports are outside the jurisdiction of the host-country's Customs authority or it may be as large as an entire city, for example Shenzhen, China (FTZRC, 2004; Griffin and Pustay, 2005). Goods in a FTZ remain in international commerce while within the zone or until they depart the zone into the host-country market or exported from the host country to another country.

Using a Foreign Trade Zone provides financial and operating benefits for a firm, especially improved cash flow. This is because of a deferral of customs duties, tariffs, and taxes on products or materials while in a Foreign Trade Zone. In some situations, exporters ship a product unassembled into a host country, assemble into a final product within a FTZ, and thereby avoid a higher tariff than if the product entered the country in final form. To reduce tariffs even more, companies inspect products while in a FTZ and destroy or return any defective products to avoid paying a tariff on defective products. These activities all serve to delay and/or reduce a tariff and thereby improve a firm's cash flow. For other examples of benefits of a FTZ, see the Foreign Trade Zone Resource Center (FTZRC, 2004).

So, should the firm in the opening vignette pay the 60% tariff now or should management delay payment by using a FTZ? If the product enters a FTZ, payment of the tariff upon arrival at the dock is not required. Rather, entering a FTZ make it possible to delay paying the tariff and inspection, further processing, repackaging if necessary, and other activities to make the product ready for sale can be done. Only, when the product exits the FTZ is a tariff paid. The cash flow savings enable a firm to use the monies for marketing the product to enhance a firm's chances of successfully consummating the exchange process.

CONCLUSION

At its core, international business involves exchange. The concept of exchange (Bagozzi, 1975) implies freedom. Individuals have free access to information; products are free to move in a market, even to move freely across international boundaries. Indeed, freedom is at the core of globalization. Managers should be free to source production anywhere in the world in least-cost, high-quality venues and individuals should be free to purchase products from anywhere in the world. However, in reality, freedom in international business is constrained by the policies of governments, policies such as tariffs.

A tariff is a tax. Whether a specific tariff, in which a fixed amount of tax is levied on a product, or an ad valorem tariff, in which the tariff is a percentage of a product's value, a tariff increases the price of a product in host country currency from (X) to [(X) + tariff rate(X)]. Because a tariff yields a higher cost basis for an import, it, in theory, protects domestic industries and home-country jobs, as in the case of the steel tariff. However, as with the steel tariff, a tariff may provoke responses either in the form of an appeal to the World Trade Organization, or bilateral retaliatory tariffs, or a trade war. All of these things inhibit exchange and the free movement of goods in the global arena.

Many problems related to tariffs emerge from political incentive, resulting from addressing concerns of special interests. These concerns often result in protectionist tariffs. Is there possibly a middle ground for tariff legislation wherein a tariff can be set to create revenue, protect local jobs and industries, but not completely shut out foreign competition? Achieving the middle ground requires international open-minded cooperation. Pushing to protectionist extremes causes tariff problems and breakdowns in international trade and comity.

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