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JOURNAL OF INTERNATIONAL BUSINESS RESEARCH

CONTENTS

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ARTICLES

THE IMPACT OF SARBANES-OXLEY ACT ON NON-U.S. ACCOUNTING FIRMS

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ABSTRACT

The Sarbanes-Oxley (Public Company Accounting Reform and Investor Protection) Act of 2002 is the most far reaching legislation to reform American business practices in recent time. This legislation changes the business landscape in the U.S. by creating a new oversight body, the Public Company Accounting Oversight Board, to oversee the corporate governance, accounting and auditing practices of all publicly held companies in the U.S. and to implement regulatory requirements for better corporate governance, accounting, and auditing practices.

Many of these new regulatory changes affect not only U.S. corporations and the U.S. accounting and auditing professions, but also have a far reaching impact on all of the non-U.S. corporations that seek capital in the U.S. security markets as well as those non-U. S. accounting/ auditing firms that service these foreign entities. While the intention of the Sarbanes-Oxley Act is to protect U.S. investors in general and the legitimacy of an U.S. oversight body to regulate publicly held companies in the U.S. is not being challenged, some of the specific requirements within the Act pose challenges for non-U.S. companies that are also subject to their home country's regulatory requirements that may be substantially different or in conflict with the requirements of this new act. Strong opposition also has been expressed by non-U.S. accounting firms that are fearful that implementation of this new Act may place them in a disadvantageous position compared to their U.S. counterparts and change the international market for auditing services. This study reviews the specific requirements of the Sarbanes-Oxley Act that are applicable to non-U.S. accounting firms and provides insight on how these requirements affect the global accounting and audit market.

INTRODUCTION

On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 into law. This Act not only is applicable to all companies listed in the U.S., both domestic and foreign, Section 106 of the Act also subjects any non-U.S. accounting firms who "prepare or furnish" an audit report involving U.S. registrants or any foreign accounting firms whose audit opinion is relied upon by a registered U.S. accounting firm to be subject to the authority of the Act. This new Act not only imposes registration requirements with an U.S. oversight body on foreign accounting/auditing firms, it also redefines many aspects of accounting and auditing practices for foreign accounting firms that may or may not be practically feasible or legally possible in their home countries.

The main areas of the Sarbanes-Oxley Act that affect the accounting profession in general include (1) defining new roles for the corporate audit committee and its relationship with corporate external auditor in that auditors will report to and be overseen by a company's audit committee, not management, and the requirement of audit committees to pre-approve of all services (both audit and non-audit services) provided by its auditor, and (2) auditor independence requirements including audit partner rotation and employment restriction, specification of consulting services that are "unlawful" if provided to a publicly held company by its auditor, as well as (3) the requirement that every audit report attest to the assessment made by management of the company's internal control structures, including a specific notation about any significant defects or material noncompliance found. There are also specific provisions within the Act regarding preservation of audit or review working papers and the requirement of management assessment of internal controls.

As the U.S. accounting profession focuses on adapting to this new era of change, foreign accounting firms have expressed grave concerns that the new U.S. legislation may create an "unlevel playing field" that favors U.S. accounting firms over non-U.S. accounting firms because the non-U.S. firms will now be subject to both their national oversight board as well as U.S. oversight. Currently, the negotiation, debates and discussions are still ongoing between foreign accounting firms and the U.S. Public Company Accounting Oversight Board (PCAOB) in the hope that some relief can be granted in consideration of the differences between the legal and operating environments in the U.S. and the local legal and operating environments of foreign accounting firms. However, foreign regulatory bodies have threatened to retaliate against U.S. audit firms by imposing requirements similar to those of the Sarbanes-Oxley Act (European Report, 2004).

The next section examines the specific requirements of the Sarbanes-Oxley Act that are applicable to foreign accounting firms followed by a discussion of the impact that these new requirements impose on foreign accounting firms and the current state of development of a global co-operative system of accounting/auditing oversight.

SPECIFIC REQUIREMENTS APPLICABLE TO FOREIGN ACCOUNTING FIRMS

The Sarbanes-Oxley Act requirements discussed in this section apply to both domestic (U.S.) and foreign accounting firms. However, complying with these requirements may prove to be especially problematic for some foreign accounting firms.

Registration Requirements

Section 101 of the Sarbanes-Oxley Act created the Public Company Accounting Oversight Board (PCAOB) and gave the PCAOB authority over all U.S. listed companies, including foreign issuers. The PCAOB is appointed and overseen by the SEC and it oversees and investigates the audits and auditors of public companies and has the authority to sanction both firms and individuals for violations of laws, regulations and rules. The PCAOB has the right to issue new auditing standards or adopt auditing standards set by other groups or organizations. And it is empowered to regularly inspect registered accounting firms for potential violations of securities laws, standards, competency, and conduct. Sanctions that the PCAOB can impose include revocation or suspension of an accounting firm's registration, prohibition from auditing public companies, and civil penalties.

Section 102 of the Sarbanes-Oxley Act requires that any public accounting firm prepares or issues an audit report for any U.S. issuer of stock must be registered with the Public Company Accounting Oversight Board (PCAOB) and Section 106 further requires foreign public accounting firms who audit US companies to register with the PCAOB. This requirement covers foreign firms that perform some audit work, such that for a foreign subsidiary of a U.S. company, which is relied on by the primary auditor. Registration is a key to the PCAOB's oversight powers in that registration with the PCAOB opens registering firms to inspections and sanctions by the PCAOB (Illustration 1).

The foreign public accounting firm registered with the PCAOB is assumed to have consented to 1) producing its working papers for the PCAOB or the SEC in connection with any investigation, and 2) subjecting themselves to the jurisdiction of U.S. courts for the purpose of enforcing any request for the production of audit working papers. Illustration 1 shows the possible relationship between the foreign and domestic audit firms with an U.S. company under section 106.

Independence Provisions

The Sarbanes-Oxley Act is based on three fundamental principles of auditor independence: (1) auditors cannot function in the role of management, (2) auditors cannot audit their own work, and (3) auditors cannot serve in an advocacy role for their client. Section 201 of the Act also lists nine non-audit services that impair a foreign or domestic auditor's independence: (1) bookkeeping or other services related to the accounting records or financial statements of the audit, (2) financial information systems design and implementation, (3) appraisal or valuation services, fairness of opinions, or contribution-in-kind reports, (4) actuarial services, (5) internal audit outsourcing services, (6) management functions or human resources, (7) broker or dealer, investment adviser, or investment banking services, (8) legal services, and (9) expert services unrelated to the audit

All bookkeeping services, such as maintaining or preparing the audit client's accounting records, preparing financial statements or the information that forms the basis of financial statements, would impair auditor independence, unless it is reasonable to conclude that the results of the non-audit services will not be subject to audit procedures. These rules also prohibit domestic and foreign auditors from providing any service related to the audit client's information system, but this will not prevent an auditor from working on hardware or software systems that are unrelated to the audit client's financial statements or accounting records as long as those services are pre-approved by the audit committee.

Appraisal and valuation services include any process of valuing assets, both tangible and intangible, or liabilities. Fairness opinions and contribution-in-kind reports are opinions and reports in which the accounting firm provides its opinion on the adequacy of consideration in a transaction. A foreign and domestic auditor also cannot provide any actuarially oriented advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client. However, they may assist a client in understanding the methods, models, assumptions, and inputs used in computing the amount.

The Sarbanes-Oxley rules also prohibit the auditor from providing any internal audit service that has been outsourced by the audit client that relates to internal accounting controls, but the auditor may make recommendations to the audit client for improvements to the internal controls during the conduct of the audit. Further, independence is impaired when auditors seek out prospective candidates for managerial, executive or director positions, act as negotiator on the audit client's behalf, or undertake reference checks of prospective candidates. Also, acting as a broker-dealer, promoter or underwriter, making investment decisions on behalf of the audit client or otherwise having discretionary authority over an audit client's investments, or executing a transaction to buy or sell investments, or having custody of assets of the audit client are prohibited.

Finally, the rules prohibit a domestic and foreign auditor from providing expert opinions or other expert services or legal representation that could be provided by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided. However, providing factual accounts or testimony describing work that they performed will not impair independence, or explaining the positions taken or conclusions reached during the performance of any service by the auditor. The Act also provides that the provision of any non-audit service, including tax services, that is not described as a prohibited service can be provided by the auditor without impairing the auditor's independence only if the service has been pre-approved by the issuer's audit committee.

Section 202 states that a reporting issuer's audit committee must pre-approve allowable services to be provided by the auditor of the issuer's financial statements. The new rules will require the audit committees of U.S.-listed foreign firms to pre-approve all services, and they may establish policies and procedures for pre-approval provided they are consistent with the Act and designed to safeguard the continued independence of the auditor.

Section 203 specifies that the lead and compatible partner, which is defined as a member of the audit engagement team who has the responsibility for decision-making on significant auditing, accounting and reporting matters that effect the financial statements, must be subject to rotation after five years. The rules specify that these partners must be subject to a five-year "time out" period after rotation. Additionally, certain audit partners will be subject to a seven-year rotation requirement with a two-year time out period. An auditor will not be independent if an audit partner receives compensation based on selling services to that client, other than audit, review and attest services, at any point during the engagement period. The rules also state that firms with fewer than five audit clients and fewer than ten partners may be exempt from the partner rotation and compensation provisions with each of the activities subject to a special review by the PCAOB at least every three years.

Reporting Responsibility of Auditor to the Audit Committee

Section 204 of the Act directs the Commission to issue rules requiring timely reporting of specific information by auditors to the audit committee. These rules require foreign auditors to report prior to filing the audit report: (1) all critical accounting policies and practices used by the issuer, (2) all material alternative accounting treatments of financial information within GAAP that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures and the treatment preferred by the auditor, and (3) other material written communications between the auditor and management.

THE IMPACT OF SARBANES-OXLEY ACT ON FOREIGN ACCOUNTING FIRMS

The initial responses by foreign accounting firms to the PCAOB's authority over foreign accounting firms were very negative (illustration 2). As a result, the PCAOB decided to permit foreign accounting firms an additional 90 days (to April 19, 2004) before requiring registration with the PCAOB[1] and decided to allow foreign applicants to withhold information from applications for registration with the PCAOB where disclosure of the information would cause the applicant to violate non-U.S. laws; however, no provision has been granted to foreign public accounting firms exempting them from the registration requirements under section 106 (c) of the Sarbanes-Oxley Act (Evans, 2003).

Many foreign accounting firms view the registration requirement under section 106 as creating unfair advantage for U.S. accounting firms since foreign accounting firms are subject to two layers of professional oversight, domestic and U.S., while U.S. accounting firms are subject to only one layer of professional oversight (U.S.). This complaint is particularly intense from accounting firms within the European Union member states since each EU member state has established or is planning to establish an effective system for the approval, registration and professional oversight of statutory auditors with regard to the single EU capital market from 2005 onwards. The additional administrative and financial burden posed by the Sarbanes-Oxley Act on these foreign accounting firms can be quite enormous[2].

In addition, although the PCAOB allows a foreign applicant to withhold information from its application for registration with the PCAOB where disclosure of the information would cause the applicant to violate non-U.S. laws (Rule 2105, PCAOB), the application must provide a legal opinion that the non-U.S. law would in fact prevent disclosure of required information as well as an explanation of the applicant's efforts to seek consents or waivers to eliminate the conflict and, if applicable, a representation that the applicant was unable to obtain such consents or waivers to eliminate the conflict. The explanation of the applicant's efforts to seek consents or waivers adds no value to investor protection and will result in extremely time-consuming and ineffective attempts to seek consents or waivers, as employees would in many cases refuse to give their consent. Foreign accounting firms also contend that they have to bear the burden of this obligation; most U.S. accounting firms probably will not be affected.

There are also additional concerns over confidentiality and data protection issues relating to the general “duty to co-operate with inspectors” and “… comply with any request … to provide access to, and the ability to copy, any record in the possession, custody, or control of such a firm …” (Rule 4006 of the PCAOB), as well as the provision regarding “Production of audit work papers and other documents” in investigations (Rule 5103). For audit firms operating in legal environments where the confidentiality requirements and data protection legislation may make it difficult to provide all the information which the PCAOB may request, investor confidence and perception of the quality of audits may be eroded.

There are also additional concerns over undue administrative and financial burdens placed on the non-big four accounting firms in their current and future engagement choices. As smaller foreign accounting firms withdraw from and avoid audit engagements to minimize the burden of the Sarbanes-Oxley Act, there will be an increased concentration of audits of publicly listed clients with the "big four" firms. This potential concentration of the international audit market with the big four accounting firms may cause more harm to auditor independence.

INTERNATIONAL HARMONIZATION OF OVERSIGHT SYSTEMS

In response to the Sarbanes-Oxley Act in the U.S., there has been a wave of international initiatives both by national governments and by international accounting professionals to promote accounting and audit reform. For example, in May 2003 the EU Commission launched a communication to reinforce the statutory audit required of the EU public firms and there is a proposal underway to revise the Eighth Directive. Last December, the U.K. government introduced the Companies (Audit, Investigations and Community Enterprise) Bill to the House of Lords with the intention improve the reliability of financial reporting and the independence of auditors, and to strengthen the powers of company investigators. The Japanese Financial Services Agency also has initiated “new comprehensive program for promoting security markets reform” in 2002 (FSA, 2003).

One of the main arguments presented by foreign accounting firms to support their exemption from the Sarbanes-Oxley Act requirements is that there should be a mutual recognition of professional oversight systems. In additional to the mutual respect for each jurisdiction’s sovereignty (FSA, 2003), the differences in the national audit oversight systems due to the historical, cultural and legal differences between the U.S. and other countries need to be respected. This means that if the U.S. were to develop the principles and criteria upon which an equivalence, i.e., mutual recognition of accounting/auditing oversight systems, can be accepted by the U.S, a foreign national audit oversight system can deem to be "equivalent" to the U.S. oversight system even if they are not identical.

In light of the recent global harmonization of the accounting and financial reporting standards, many have argued that this international coordination and reciprocal recognition of regulations for global capital markets would benefit not only the foreign accounting professions but also the global capital markets in general. However, this "mutual co-operation with other high quality regulatory systems that respects the cultural and legal differences of the regulatory regimes that exist around the world" was not supported in a recent PCAOB Briefing Paper on "Oversight of Non-U.S. Public Accounting Firms" (PCAOB Rulemaking Docket Matter No. 013). While the PCAOB announced a co-operative approach to the oversight of non-U.S. public accounting firms and included in its release paper certain criteria intended to be used in its evaluation of the independence and rigor of a particular home country oversight system, the examples of the criteria that may be used to assess the adequacy and integrity of the home country system are still based primarily on the U.S. system for inspections and investigations of U.S. public accounting firms. The FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) explicitly expressed[3] concerns that if the PCAOB largely ignores the established or developing systems for quality assurance in the EU, or rates certain systems as weak because of the way in which they achieve oversight, it is unlikely to contribute to the most effective global oversight and may undermine the perception of audit quality for publicly listed companies in the EU (FEE comment letter to the PCAOB, 2004).

THE SAGA CONTINUES

Since 2002, the number of new foreign listings on U.S. stock exchanges has sharply decreased (illustration 3). Many foreign companies either decided to de-list from the U.S. to avoid being subject to the Act or have decided not to list on the U.S. exchanges citing the compliance costs associated with the Sarbanes-Oxley Act[4]. The SEC intended for the Sarbanes-Oxley Act to be the most comprehensive scheme of revised corporate governance in the history of American business and it certainly has done so with far-reaching impact on both domestic as well as foreign companies. In terms of the accounting and audit markets, the resolve of the U.S. PCAOB to follow a more cooperative approach to oversight of non-US audit firms is still being tested by foreign accounting firms. As the April 2004 registration deadline approaches for foreign accounting firms, the PCAOB will meet again to vote on the proposal to extend the registration deadline for foreign auditors to July 19, 2004. The SEC is under increasing pressure from the EU and other countries to reconsider measures in Sarbanes-Oxley and to explore if there is the basis and a need for exempting foreign audit firms.

Would there be a harmonization of the quality control standards of the international accounting and audit profession, the public oversight systems as well as the corporate governance practices on a global basis? The Sarbanes-Oxley Act certain has an impact far beyond U.S. territories. The U.K., Japan, and the EU, among other countries, have either begun their own legislative processes or have enacted regulatory changes to promote good corporate governance. As accounting and auditing standards become increasingly harmonized to facilitate global capital flows, the Sarbanes-Oxley Act certainly has created a worldwide need for coordination and reciprocal recognition of the equivalence of quality control and public oversight systems and corporate governance so that there can be consistent regulations for global capital markets.

Illustration 1: Section 106 Diagram

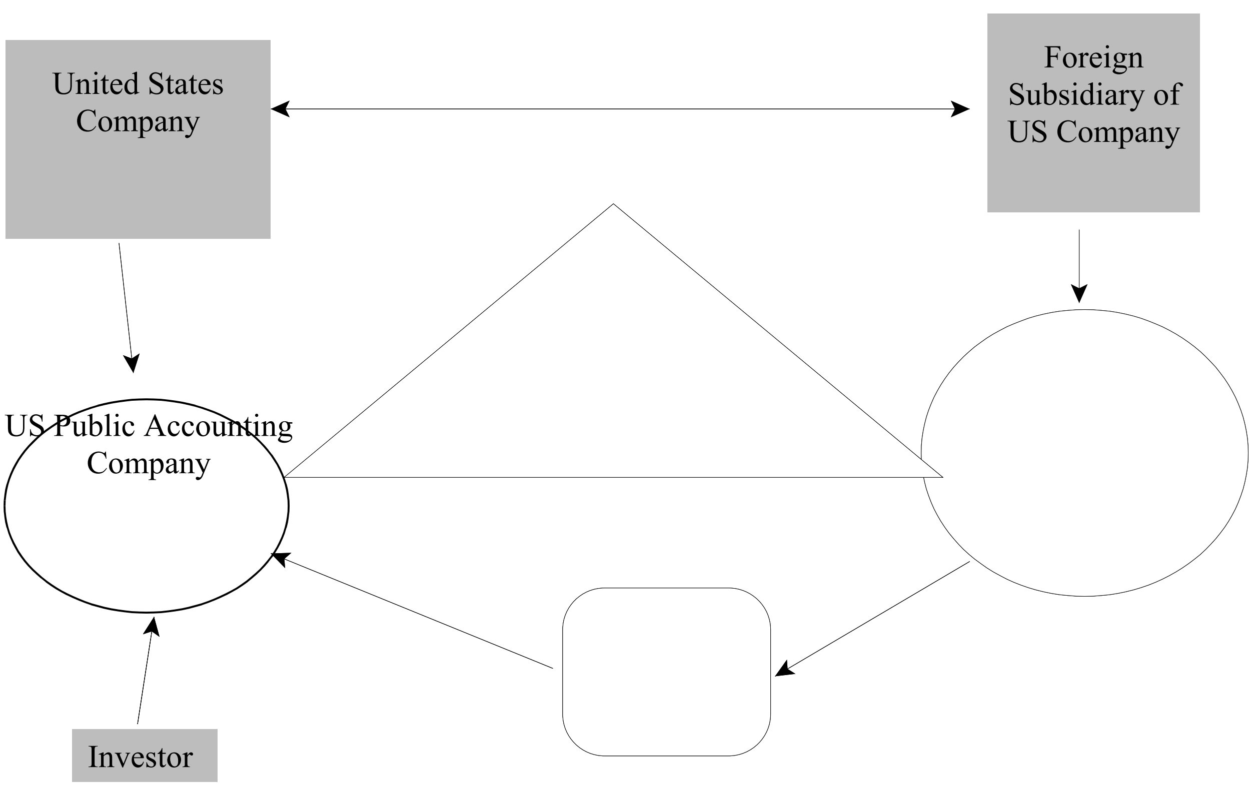


Illustration 2.

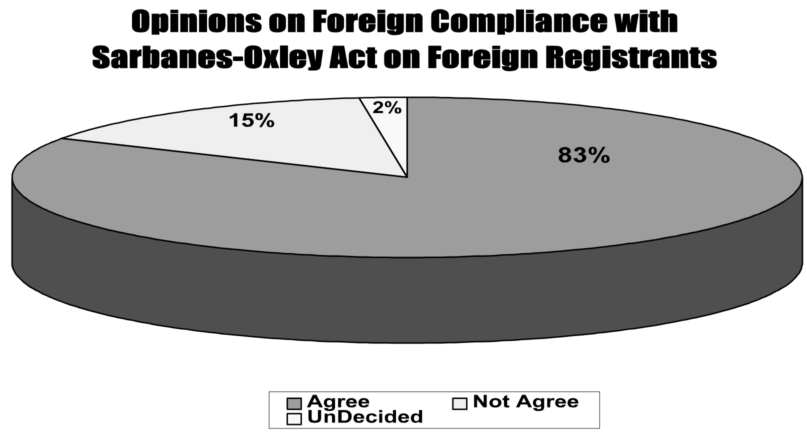
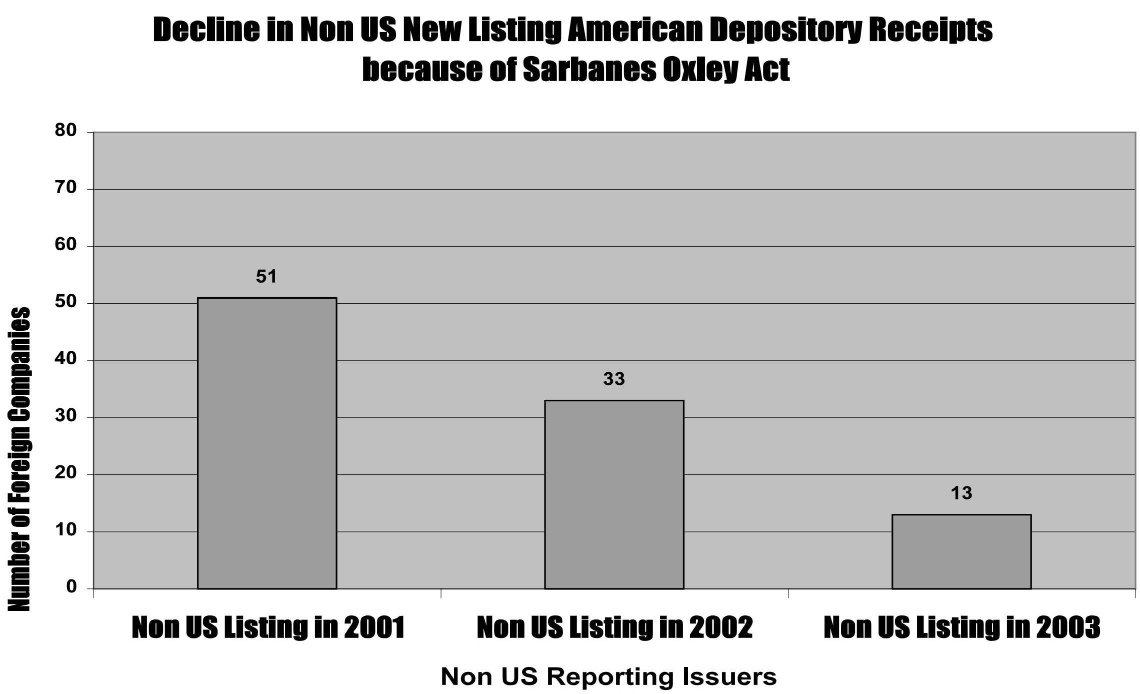


Illustration 3.



ENDNOTES

1. The registration deadline for U.S. audit firms ended Oct. 22 with 598 firms being approved.

2. Comment letter to the SEC from the German Institut der Wirtschaftsprüfer (IDW) which represents the German accountants and Wirtschaftsprüferkammer (WPK) which represents the German auditing profession. File-No. PCAOB 2003-03 PCAOB; Notice of Filing of Proposed Rules Relating to Registration System.

3. The FEE's comment letter, January 2004. Re: PCAOB Rulemaking Docket Matter No. 013 – "Proposed Rules Relating to the Oversight of Non-U.S. Public Accounting Firms".

4. UK's Benfield Group and Daiwa and Fuji Film of Japan decided not to list on US capital markets citing Sarbanes-Oxley as the reason.

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FDI and the Effects on Society

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ABSTRACT

The last decade has seen an explosion in Foreign Direct Investment (FDI) especially in developing countries, where the returns on investment can be higher than in developed countries. Both developing and developed countries have liberalized their policies and introduced new policies to attract FDI inflows. This increase in FDI has had major effects on the social welfare of the citizens of developing host-countries. The purpose of this paper is to examine both the positive and negative effects of FDI inflows to developing countries in areas of politics, society, technology, finance, environment and culture, to determine whether or not FDI contributes to the well-being of society. This paper also provides an overview of the current trends in FDI flows and the relationship between FDI, multinational corporations, and society.

INTRODUCTION

Foreign Direct Investment (FDI) is the single most important instrument for the globalization of the international economy. Defined, FDI is the investment of real assets in a foreign country; it is acquiring assets such as land and equipment in another, host country, but operating the facility from the home country. FDI is viewed by many as necessary to stimulate the economies of both developed and underdeveloped countries. It has even been suggested that FDI will eventually replace official development assistance to underdeveloped countries. Between 1986 and 2000, the average annual growth rate of FDI was 25 percent. More recently after the September 11th terrorist attacks in the U.S., the global economy experienced a decrease in foreign investment flows. Developing countries have been hit the hardest by the decline in FDI as foreign investment is being redirected to more developed countries. In spite of the decline, it is expected that FDI will continue to be the most significant tool for globalization.

It is widely accepted that FDI inflows provide economic benefits such as increased competition, technological spillovers and innovations, and increased employment. Yet the impact of foreign investment extends far beyond economic growth. At times FDI can be a catalyst for change to society as a whole, therefore one must think in terms of economic, political, social, technological, cultural, and environmental factors and examine all the effects of FDI in order to decipher the true long-term impact. As foreign investment and globalization continues to increase, developing countries desperately seeking to attract foreign investment can have undesirable outcomes. In this scenario FDI can have numerous negative effects, such as job loss, human rights abuses, political unrest, financial volatility, environmental degradation, and increased cultural tensions.

The results of FDI on the global economy are complex and unpredictable; they can vary from country to country. This is due in part to the practices that are in place prior to receiving FDI inflows, such as deep-rooted social customs, political practices, laws and regulations. In more developed countries, such as Singapore, China and Ireland, the increase in foreign investment resulted in rapid economic growth and social development. Yet in unstable, underdeveloped countries, the results can be quite different. For the positive effects of FDI to be realized by undeveloped countries, major reforms in domestic policies must also take place.

The purpose of this study is to examine the effects of FDI and to determine whether the benefits of FDI outweigh the costs. Arguments from both sides of the debate will be taken into account when assessing the true impact of FDI.

LITERATURE REVIEW

There is an abundance of literature regarding the impact of FDI on society. Most literature analyzes the relationships between FDI, multinational corporations, and governments. A majority of the literature analyzes one side or the other; however, in order to more accurately measure the situation, a more balanced assessment that examines both sides of the debate is necessary.

Both Kiss (2003) and Hippert (2002), examining FDI from a social standpoint, provide a negative perspective on the impact of FDI in developing countries. Kiss (2003) analyzes the situation in Hungary when the Hungarian government introduced elements of a parliamentary democracy and market economy that eventually led to the social and political exclusion of Hungarian women. The author argues that governments must address gender issues as well as implement official measures and institutional changes to facilitate women's inclusion into production and social systems. Hippert (2002), examines the effect of FDI on women's health. The author asserts that FDI and Multinational Corporations (MNCs) hamper the economic integrity and sovereignty of the developing world and states that it is women who bear the brunt of human rights abuses because of their social positions in developing countries, especially in parts of Mexico and Asia. The author also discusses solutions to these problems that have failed because they have been primarily “top-down approaches,” and proposes that the only plausible solutions are to hold corporations accountable for their employees.

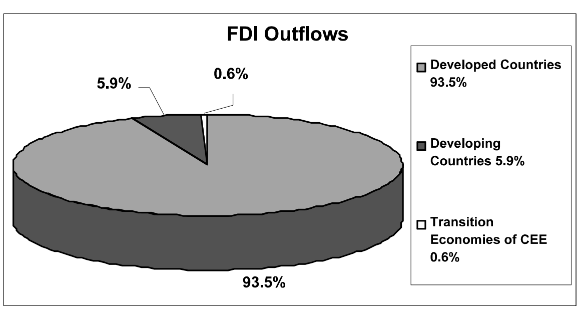
Jones and McNally (1998) provide insight into the environmental degradation that is caused by FDI. The authors consider both sides of the debate on the existence of "pollution havens" and provide reasons why MNCs do not contribute to environmental pollution. The authors also state that in industries that are involved in resource extraction, some evidence suggests that MNCs will relocate to countries where environmental regulations are lax or non-existent. Again in 1998 McNalley, along with Mabey, authored a report on FDI and the environment for the World Wildlife Foundation. The report provides instances of environmental degradation that occurred mostly in extractive industries, along with proposals for reforms to current environmental standards.

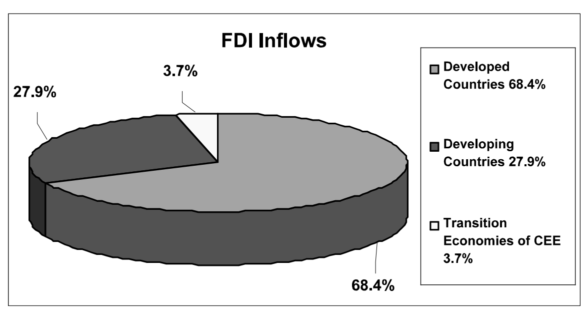
In contrast to the negative view of FDI, Rondinelli (2002) explores the public role and economic power of MNCs and the positive ways in which MNCs can influence governments and provide for the social welfare of host-country citizens. By focusing on their roles as philanthropists and political activists, MNCs provide foreign aid to developing countries, expand international trade and investment, and influence public policy. The author provides several instances in which an MNC stepped in and provided foreign aid to developing countries in order to fill the gap that was created when Official Development Assistance was decreased.

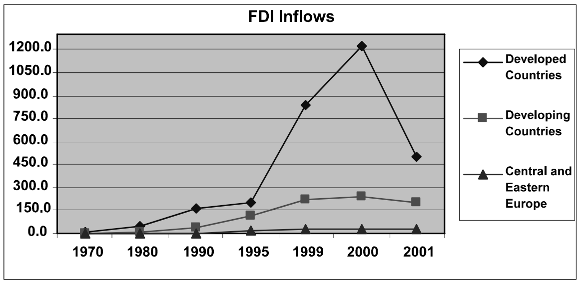
Spar (1999), takes a neutral stance when discussing the complexity of the relationship between foreign direct investment and human rights and the ways in which FDI impacts society both negatively and positively. The author concludes that it is the interaction of governments and MNCs that will lead to economic growth and social prosperity through FDI.

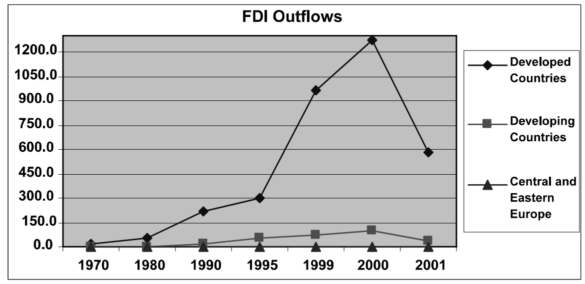
CURRENT TRENDS IN FDI FLOWS

Although in 2001 the global economy experienced a decrease in FDI flows, the magnitude of FDI flows throughout the decade continues to set records. Most FDI flows originate in and are received by developed countries. In 2001, the world total of FDI inflows were $735 billion, while outflows were $620 billion. Of the total inflows and outflows, developed countries received $503 billion and $580 billion respectively, developing countries received $204 billion and $36 billion and the transition economies of Central Eastern Europe received $27 billion and $3 billion. All regions of the world shared in the decline in FDI between 2000 and 2001; however, the decline in FDI flows shrank by 59 percent in developed countries compared to the 14 percent decline in developing countries.







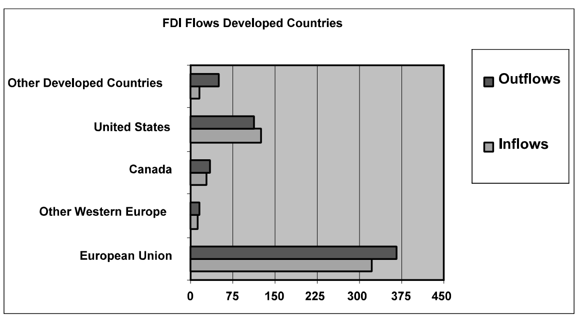


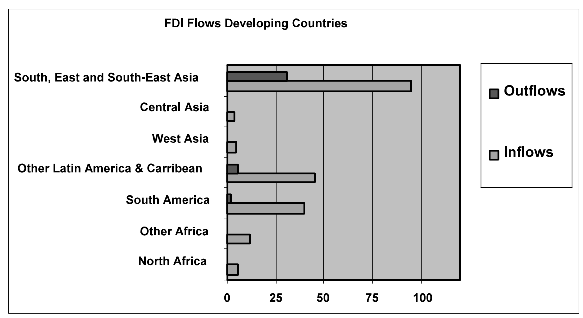
Three main factors have contributed to the increase in FDI over the last decade. The first factor is the increase in global policy changes that are intended to make FDI more favorable. In 2001, 208 changes were made to FDI laws by 71 countries and over 90 percent of these laws are for the purpose of improving the investment climate for FDI. Also in 2001, 97 countries were involved in the establishment of 158 bilateral investment treaties. The second factor affecting the increase in FDI is the rapid increase in technological change. In today's environment, firms are experiencing rising costs and higher risks associated with the increase in technology. In order to remain competitive, it is crucial for firms to expand into international markets. A fall in transportation and communication costs has made it more economical than ever for firms to integrate foreign operations and to focus on increasing the efficiency of operations. The third factor is the ever-increasing global competition for firms, which is actually a result of the previous two factors. The increase in competition forces firms to search for not only more efficient operations and lower costs, but also new markets for consumers and new forms of business arrangements such as strategic alliances and joint ventures. In spite of the recent decline in FDI flows, FDI has proven to be resilient and it is likely that the world economy will continue to expand through globalization (World Investment Report, 2002).

REGIONAL DEVELOPMENTS

Developments in FDI can vary significantly by region and as stated previously, the decline in FDI in 2001 was concentrated in developed regions. The U.S. remained the largest recipient of FDI flows, despite the economic slowdown and the events of September 11th. However, FDI inflows of $124 billion were less than half of what they had been in 2001, while FDI outflows declined by 30 percent to $114 billion. Western Europe also experienced a decline in FDI flows of about 60 percent to $323 billion in inflows and $365 billion in outflows. The main destination for U.S. outward flows was the European Union, and the euro-area as a whole continues to outperform the U.S. in both inflows and outflows. As for other developed countries, Japan continues to suffer from a prolonged recession. Consequently, inflows fell to $6 billion; however, outflows increased to $38 billion. Canada appears have been the most affected by the developments in the US; inflows and outflows fell by 60 percent and 25 percent, respectively.

In developing countries declines in FDI inflows were not as pronounced; however, outflows decreased 14 percent. The economic slowdown in 2001 may have even contributed to the increase in FDI inflows to low-wage economies, as is demonstrated by the increase in FDI from Japan to China and the growth of flows to countries in Central and Eastern Europe, Central Asian, and West Asia. Africa, with its abundance of natural resources, still only receives a small percentage of FDI inflows. However, the sectional composition indicates that Africa as a whole is changing. Inflows are no longer concentrated in oil and petroleum, the services industry is also experiencing a significant increase FDI. In China, FDI inflows actually increased to $46 billion and the East-Asia region remains the largest recipient FDI inflows in the entire region. (World Investment Report, 2002).





MULTINATIONAL CORPORATIONS

A multinational corporation is any firm which takes part in direct investment in foreign countries and controls and manages income generating assets in that country (Stephens, 2002). MNCs are the vehicles for FDI, and as MNCs continue to grow, their influence becomes more pronounced around the world. The debate concerning MNCs centers on their expanding public roles and their influence on both business and public policy. However, as their influence continues to grow, questions arise about their impact on developing countries.

In practice, many MNCs voluntarily adopt the environmental, social, and political practices of the host country; however, if there is an absence of rules and regulations that protect both the environment and the local population of the host country, then there exists great opportunity for profit maximization for the MNC at the expense of the indigenous population. For years, MNCs have been blamed for failing to protect the rights of local populations, for environmental destruction, and in many cases for directly and indirectly participating and collaborating with repressive governments to profit from exploitation (Busse, 2002). Yet MNCs alone cannot be blamed for failing to implement reforms. The extent to which FDI can assist developing countries depends on the interaction of governments and corporations. Because the global economy has seen an increase in FDI that is not extractive resource seeking, there is a larger variety of choices for location in other industries; therefore, countries must compete for FDI inflows. In some cases, where local governments of developing countries face heavy competition for FDI inflows, it is believed by local governments that the positive impact of FDI outweighs the negative impact, and in many cases the negative is a precursor to the positive. This creates a "race to the bottom" where governments seeking to attract foreign capital inflows will reduce barriers and eliminate regulations that were meant to protect the social welfare of its citizens and the environment. In cases such as these, it is believed that the local population employed by MNCs must endure vocational abuses in order for the spillover effects of FDI to be felt by the entire community. In contrast, studies have shown this is not usually the case. Typically the benefits of FDI are short-term with no real long-term sustainable positive impact on the host country. For example, if the FDI is export-oriented and the human base does not provide a natural market for the product, then there is little incentive for MNCs to improve conditions for the indigenous population. Most often the benefits of FDI happen in a trickle-down effect, or spillovers, such as an increase in employee skills, technology, information, and education or training. If the host country is unable to channel the benefits of FDI into domestic, locally owned operations and capital, then there will not be a wide variety of opportunities for entrepreneurship for its citizens (Spar, 1999).

In contrast to the view that MNCs intentionally and unintentionally contribute to human rights abuses, environmental destruction and social instability, many argue that MNCs also act as social philanthropists and political activists. In their expanding roles, many MNCs often work with international agencies and non-governmental organizations to define policy issues, implement codes of self-regulation and compliance, and intervene on social issues. In addition to their public roles, in some developing countries they also provide large amounts of private foreign aid in the form of direct corporate contributions, corporate foundations and personal and family contributions (Rondinelli, 2002).

Obviously MNCs can have substantial positive and negative impacts on host-countries. However, the relationships between MNCs, FDI and society are quite complex and require an in-depth examination of all the negative and positive effects that occur with the increase in FDI.

BENEFITS OF FDI

The benefits of FDI are numerous and in some cases offset the negative impact. FDI inflows can result in technology transfers, human capital formation, international trade integration, an increase in competitive business environments, enterprise development, economic growth, and improved environmental and social conditions (OECD, 2002). FDI appears to have the most significant impact on macroeconomic growth, which is why more and more countries are welcoming all FDI and are now competing for FDI inflows.

> Macroeconomic growth is commonly considered as the most potent source of poverty relief, particularly in the poorest countries. Beyond the initial macroeconomic stimulus from the actual investment, FDI may influence growth by raising total factor productivity in the recipient economy. This works through two channels, namely (i) the spillovers and other externalities vis-à-vis the host country's business sector, and (ii) the direct impact on structural factors in the host economy. (www.cuts.org, p. 3)

To accurately assess the way in which FDI can affect society, one must consider situations in which FDI has transitioned underdeveloped regions into potential global economic competitors.

For example, due in part to their commitment to the World Trade Organization, China increased trade and investment liberalization, and in 2001 China was the largest recipient of FDI inflows. Foreign funds led to a rise in capital formation and consequently an increase in productive capabilities and improved technology. These improvements added three percentage points to its Gross Domestic Product (GDP). China has also become a major world exporter by establishing locally-owned assembly plants to take advantage of inexpensive labor. This has resulted in a boost in China's output base and increased employment. The increase in GDP has provided the government with much needed tax revenues. In many cases developing countries are unable to sustain long-term productivity because earnings are repatriated, although this has not been the result in China. The reinvestment of earnings by foreign firms, which was supplemented by China's high savings rate, has moved China away from being only a low-skilled labor provider, and instead has led to long-term economic gains for the entire region (Asia Monitor, 2002).

MNCs are expanding their roles as social and political activists as well. They are increasingly addressing issues such as corruption, human rights, social and environmental issues. MNCs collaborate with organizations such as the United Nations, the International Labor Organization (ILO), and the Organization for Economic and Community Development (OECD) to implement standards of self-regulation, compliance, and conduct. With regard to environmental standards, many MNCs voluntarily submit their environmental management systems for certification by external auditors. MNCs are also leveraging their influence into roles as international policy makers by lobbying governments to cooperate in multilateral and bilateral trade agreements and government regulations (Rondinelli, 2002). As official development assistance (ODA) to developing countries decreased, foreign investors stepped in to fill the gap in foreign aid. One of the most well-known examples of private foreign aid was Ted Turner's one-billion dollar gift to the United Nations for their social and health programs and his offer of a $35 million gift that would fill the gap in the reduction of financial support from the United States in 2000. Several other foundations and corporations such as Coca-Cola, Finnish Telecommunications, and the Bill and Melinda Gates Foundation have provided developing countries with aid to assist in increasing the social welfare of its citizens through education, health, and the environment (Rondinelli, 2002).

As a further benefit, FDI can lead to technological development in host countries. As long as MNCs incorporate and provide linkages to host country firms and workers, then technological advancement will result in long-term economic growth. Studies have shown that several newly industrialized countries acquired technology from abroad, rather than "re-inventing the wheel." Although FDI is a more expensive way to obtain technology when compared to direct purchasing and licensing, if technology is obtained through FDI, then in reality there is no cost to the host country and in many cases FDI is the only way for a host country to obtain technology. Furthermore, FDI brings with it the skills and knowledge necessary to make technology useful (www.southcentre.org). Through the transfer of technical knowledge, FDI enhances human capital. As MNCs employ local workers, their skills and education levels will increase through training and on the job learning. In addition, as MNCs set up operations in developing countries, local markets that were initially monopolistic will generally become more competitive (www.cuts.org).

NEGATIVE EFFECTS OF FDI

Human Rights Abuses, Discrimination, and Gender Inequality

In countries where the comparative advantage is cheap labor, there is the potential for MNCs, whether directly or indirectly, to commit human rights abuses. This is seen quite often in underdeveloped countries and in countries where there exists either inequalities between men and women or a large discrepancy between the income levels of the poor and the rich. Examples of human rights abuses are violent security measures, discrimination, gender inequality, the failure to provide safe and healthy work environments, the use of sweatshops in manufacturing, and child labor, although this is less typical.

When analyzing the effects of FDI on society, there is distinction between *core labor standards* and *other labor standards*. *Core labor standards* are 1) freedom from forced labor, 2) equal opportunity for employment, 3) the abolition of exploitive forms of labor, and 4) the right to collectively bargain and freedom of association. *Other labor standards* relate to the conditions in the working environment and the labor market, such as health and safety standards, annual leave with pay, and minimum wages; these standards are usually referred to as "acceptable working conditions." While *core labor standards* are commonly, but not always, accepted, *other labor standards* are at the forefront of the debate regarding fundamental workers' rights. The controversy concerning these labor standards, centers on the lack of them in many developing countries (Busse, 2002).

In the age of information technology, the increase in information and access to information has dramatically changed the way businesses operate. This increase in information reveals those corporations that commit human rights abuses. As a result, MNCs whose strategy is reliant on quality and prestige of brand name, have increased their compliance with regulations that are in place to protect core human rights. This does not, however, obligate MNCs to provide the same benefits and protections that are provided to U.S citizens and citizens of more developed countries (Spar, 1999).

Regarding the way that FDI contributes to gender inequality, discrimination and human rights abuses, the case of Hungary provides an example. Hungary emerged into the global economy during the 1980's as "the happiest barrack" of the Soviet Block. The Hungarian economic and social structure during this period was characterized by "relative flexibility and a higher standard of living." (Kiss, 2003, p. 3) After a series of political regime changes during the 1990's, the economic and social situation took a turn for the worse and Hungary suffered a period of recession that peaked in 1994 when the government deficit grew to 7.5 percent of GDP and public-sector debt ratios grew to 85 percent of GDP. Following the decline in economic growth, the socialist-liberal governing coalition introduced a "comprehensive financial adjustment package" (Kiss, 2003, p. 3) aimed at reforming government finances by reducing personnel in the public sector, freezing revenue increases, and cutting back social welfare provisions and publicly subsidized services. During this period of "Hungarian transformation", economic growth was facilitated by dramatic increases in FDI, exports, and privatization that helped reduce foreign debt and the balance of payments. The economic turnaround was deemed one of the most successful in Europe (Kiss, 2003).

The Hungarian government worked hard to attract FDI and foreign investors benefited greatly from the inexpensive labor and investment incentives. By the late 1990's, foreign-owned companies dominated the Hungarian economy; Hungary had the highest ratio of cumulative FDI inflows to nominal GDP in Eastern Europe at 17.8 percent. Yet, this economic growth spurred a drastic decline in social welfare marked by increases in poverty, inequality, and social exclusion. The increase in FDI also caused a major loss in employment as most of the growth was classified as "jobless growth." As FDI by foreign firms began to dominate the economic environment in Hungary, it became difficult for smaller, less efficient, domestic firms to gain strategic advantages, and many were eventually driven out of production and manufacturing industries. The economic recovery of the period did not have trickle-down effects, and at the same time the government deconstructed the social welfare system. Even after FDI inflows increased, the government did little to restore social welfare programs (Kiss, 2003).

Instead of higher incomes and greater consumption for its citizens, which is what theoretically should have followed the increase in FDI, the economic recovery was accompanied by increased unemployment and inactivity for women. Females in many industries were crowded out of the work force by males seeking employment. The losses in employment opportunities forced many women to drop out of the labor force, and they are now finding it difficult to re-enter the labor market. Now considered a "secondary workforce," women often suffer discrimination at the work-place. Those that are unemployed face poverty, a loss of social benefits, and a decline in political representation (Kiss, 2003).

A major concern for many has been the effect of FDI on women's health. In the border region between Mexico and the US, there has been an increase in production facilities for textiles, electronics and garments; these facilities are called *Maquiladoras*. In these factories, women are typically hired for low-paying, labor intensive positions and are often exploited because they are easier to control and because working in *Maquiladoras* is their only option for earning wages. In most regions of Mexico, women are viewed as second-class citizens and are denied many of the basic human rights afforded to women in more developed cultures, it is women who bear the burden of poverty and human rights abuses. Many MNCs that have set up these production facilities, have been accused of exploiting these inequalities by failing to implement rules and regulations concerning basic human rights and for failing to provide the local population the same benefits that are provided to employees in the US. MNCs do not provide safe working environments, and these women are often exposed to dangerous chemicals and forced to work long hours with no breaks. They are also harassed by supervisors and are forced to submit to medical examinations prior to being hired to ensure that they are not pregnant. (Hippert, 2002)

Environmental degradation

Historically, FDI has had a strong relationship with natural resources use and extraction (agriculture, mineral, fuel production). Currently, the debate over environmental pollution has centered on MNCs that have been involved in the exploitation of "pollution havens," which refer to countries with lax environmental regulations that seek to attract FDI by undervaluing their environment. This type of exploitation can lead to high levels of pollution and environmental degradation of the host country (Mabey & McNalley, 1998)

> Environmental degradation reduces the ability of an economy to produce goods and services over time due to the reduction in natural resource inputs such as soil fertility, and ecosystem productivity more generally. About 20 percent of land is suffering from soil degradation, significantly reducing future productivity. The erosion of natural capital in the short term can have long-run impacts, affecting human trends, social and environmental capital shocks that are essential for the balanced sustainable development for any country" (Mabey & McNalley, p. 27).

The mere existence of pollution havens has been thoroughly debated. Currently, there is very little empirical evidence to support the theory that MNCs will relocate to developing countries with less-stringent environmental regulations and many argue that idea of pollution havens is simply just a "popular myth that does not hold in reality." (Stephens, 2002) Supporters of FDI, typically argue that because environmental costs make up a small proportion of total costs, these costs do not influence location decisions. Furthermore, in many cases environmental regulations have little impact on locational decisions when taking into account future increases in environmental regulations and the possibility of the demand by industrialized countries to meet environmental product standards. Although, to date, empirical research cannot measure the impact of FDI on the environment, criticism of the concepts and methods used in these studies suggest that the research investigating the existence of pollution havens is incomplete. The majority of studies examined the effects on an aggregate level and may have possibly left out important variables. Some studies have shown support for the "pollution havens" hypothesis with most evidence relating to the participation in international treaties as a measure for the host-country's environmental standards. In this case, FDI inflows were smaller for countries with higher environmental standards. Although, there is some support for the hypothesis, the support is unsubstantial (Dean, Lovely, & Wang, 2002). Most research suggests that overall MNCs do not invest in developing countries to access lower environmental costs. The reasons for not investing in these countries are threefold. First, many companies cannot afford a tarnished reputation in the global marketplace from environmental and social exploitation. Second, it may be less expensive to apply uniform environmental standards to operations in all foreign countries than to modify standards for specific operations. Last, firms may be obligated to comply with environmental standards used in home-countries (Jones & McNally, 1998).

The debate surrounding the existence of pollutions havens does not trivialize the argument that FDI increases pollution in host-countries. Although, there is little empirical evidence to support the pollution havens theory, there is ample evidence to support the argument that MNCs, once they have established operations in a host-country, do actually contribute to the degradation of the environment. This is especially true for MNCs involved in resource extraction and processing sectors, such as chemicals, minerals, metallurgy, logging, and paper. Over the last 25 years environmental degradation on a global scale has accelerated. In their 1998 report on FDI and the environment, Mabey and McNalley, estimated that global freshwater eco-systems have declined by 50 percent, marine eco-systems deteriorated by 30 percent, forest cover reduced by 10 percent, and global energy has increased by 70 percent causing an increase in greenhouse gas emissions. Although, the evidence of global environmental destruction is undisputable, the relationship between the environment and FDI is less obvious and requires a closer examination on a country by country basis (Mabey & McNally, 1998).

In lower-income developing regions such as Africa, Asia-Pacific and Latin America, which are rich in environmental resources, the impact of FDI on the environment can be devastating. For instance, in Indonesia forest and rivers have been severely polluted and destroyed by mining corporations. Palm oil plantations in Sumatra forced the indigenous community to be driven from parts of their lands. In the Philippines, fourteen rivers become so polluted by copper waste that fish yields were reduced by 50 percent (Jones & McNally, 1998).

The most widely held belief by proponents of FDI flows was that of the “Environmental Kuznets Curve” which asserted that environmental degradation increases up to a certain level of income, at which point it then begins to improve. Yet, there has been little empirical evidence to support this theory and in many cases, it would take years for the average income of a developing country to reach the level at which environmental degradation decreases. If a developing country reaches this point, the effects of degradation will most likely be catastrophic and irreversible (Mabey and McNalley, 1998). Although the benefits of FDI in developing countries can be potentially numerous, in extractive and natural resource based industries the benefits are not as obvious. Most economic theories of sustainability show that unless there are laws and regulations in place to protect and preserve vital ecosystems, FDI and economic growth in general will intensify the present levels of degradation. Furthermore, in the absence of strong regulatory systems, the rents from resource use, that is, payment for the exploitation of their resources, are most often redistributed to less beneficial uses such as funding imports for consumption or investing abroad. In order for the benefits of FDI to be realized in the long-run, rents must be reinvested in efficient enterprises and in long-term productive capital (Mabey & McNalley, 1998).

Financial Volatility

When financial markets are imperfect and underdeveloped, the result is a scarcity of financial resources that prevents MNCs and domestic corporations from undertaking profitable business opportunities. In the wake of the recent debt crisis, ODA flows to developing countries have declined, and banks are providing less credit making it difficult for developing countries to obtain financing. Furthermore, because high investment returns obtained through FDI are based more on interest rate differentials rather than on rudimentary economic variables, investors are finding the problems associated with FDI, which are more difficult to measure, are not always compensated by the high returns (www.cuts.org).

During the 1990's, some economists prescribed to the theory that in a world of free capital movements, the balance of payments of a country are irrelevant because over time the balance of payments will be self-corrected through the savings and investment decisions of individuals and businesses. Based on this theory, all economic agents will attempt to maximize profits and minimize costs; therefore, any government intervention will only lead to distortions that cause adverse affects on the economy and the welfare of its citizens. In reality though, this has not been the case for several developing countries, namely Mexico during the Mexican financial crisis in 1994 and the East Asian crisis that occurred more recently. During the Mexican crisis, foreign investments were being used to finance imported goods for consumers rather than being reinvested in longer-term capital. This caused a massive current account deficit, the eventual devaluation of the Mexican peso, and a financial crisis of enormous proportions. As a result, most economists accept that the balance of payments, at least for developing countries, is a significant factor. In addition to the effects of the balance of payments are the repercussions of financial markets where derivatives have become important financial tools for investors. In the past, investments in longer-term capital, which are relatively immobile, resulted in economic gains. However, with the increase in derivatives and hedging, the distinction between portfolio investment and long-term capital investments has become less clear. As financial markets evolve, investors can now offset the increased volatility associated with FDI with the use of currency hedging or derivatives, which can result in volatility as the buying and selling of currencies by investors puts pressure on spot rates (www.southcentre.org).

Cultural, Political, and Technological Implications

FDI has the potential to cause cultural tension between the home country and the host country. For example, in Asia, where Japan is slowly replacing theU.S.as the leading provider of foreign direct investment in East Asia, cultural tensions that were already in place before the economic boom in East Asia began, have now been aggravated by the Japanese saturation of the East Asian market (Economist, 1993) Although cultural tensions can be fairly benign in more developed countries, in countries with unstable political environments, cultural tensions can have destructive consequences. The most recognized cultural clash has been the rejection of "Americanization" by several middle-eastern societies that occurred before and after the Sept. 11 attacks on the WTC.

Research has shown that FDI can impact the political environment of the host country. Although underdeveloped countries do not receive the majority of FDI flows, in the absence of a stable political environment, which is more typical of an underdeveloped country, the effects on the political structure can be greater than those of more developed countries. Political unrest occurs in several ways. In countries with newly instituted political structures, some people may view foreign investment as an extension of imperialism. In other countries where there exists a considerable discrepancy between the incomes of the poor and the elite, FDI will be viewed as favoring the elite. Local entrepreneurs of underdeveloped countries might view foreign investors as seizing valuable resources that belong to the indigenous population. For MNCs involved in the removal of natural resources, the locals may view the MNC as taking the host country's resources without adequate compensation to the local population. In more traditional cultures, rapid urbanization is seen as a threat to the local culture. In any of these situations, an increase in FDI can lead to political conflict in the host country (Rothgeb, 2002). While FDI can provide much needed technological spillovers, if MNCs fail to create linkages in the local production systems, then FDI will hinder the development of technical skills by local firms and institutions.

PROPOSALS FOR REFORM

When considering the successes of FDI, it appears that with reforms and regulations in place to protect against the negative effects of FDI, the long-term benefits to society can far outweigh the short-term costs. Studies have shown that in absence of favorable conditions in the host country economy, developing countries are less likely to attract foreign investment. In addition, even with increased FDI in a developing country, without an overhaul of a country's legislative, institutional, political, social, and educational framework the spillover effects of FDI are not likely to result in any long-term benefits to the host country. Many proposals for reforms to foreign investment have been recommended. Examples of such include multilateral agreements for corporate conduct, policy frameworks for social and environmental standards, programs for education and workforce training, and improvement of the internal political climate by the host government.

> With most FDI flows originating from OECD countries, developed countries can contribute to advancing this agenda. They can facilitate developing countries access to international markets and technology, and ensure policy coherence for development more generally: use overseas development assistance (ODA) to leverage public/private investment projects and encourage non-OECD countries to integrate further into rules-based international frameworks for investment. (OECD, 2002 p.1)

SUMMARY AND CONCLUSION

A majority of research highlights the negative effects of FDI yet provides researchers with minimal amounts of data concerning FDI's positive contributions to the global economy. Most research has been precautionary at best and generally is necessary to alert governments and business leaders to refrain from accepting any and all flows of FDI, which could potentially beget trouble for future development prospects. When all factors are considered though, it is commonly accepted by researchers and economists that the benefits of FDI far exceed the costs. With the exception of the impact on the environments of developing countries and on financial markets, much of the evidence concerning the effects on workers, the political environment, and cultural relationships is hypothetical and anecdotal at best with only a few instances to validate arguments. Moreover, many of the negative effects are short-term and the standard of living for many developing countries would be worse off without FDI flows. In the age of information technology, it would be a logical assumption and it has even been proven that exploitation of workers and the environment can result in losses of credibility and consumer confidence. For example, companies such as Nike, Toys "R" Us, Avon, and Royal Dutch-Shell have increased their compliance with codes of conduct and have even begun developing preemptive policies (Spar, 1999).

With regard to environmental effects, there is sufficient evidence to conclude that FDI does contribute to environmental degradation. However, environmental degradation is a trend that began with the earliest forms of industrialization and is not partial to developing countries. Pollution will result regardless of location. Many developed countries experience pollution to a degree that has not even reached developing countries. The reasons environmental protectionists have focused their attentions on the impact of FDI on the environments of developing countries is because these countries currently lack the same policies and regulations seen in more developed countries which might protect the environment. Ultimately these regulations are meant to slow the effects of continual resource use and to provide the citizens of host-countries with the same rights afforded more developed countries.

An examination of the current trends in FDI shows that the developing countries receive a disproportionate share of inflows when compared to outflows. The recurring theme throughout this paper concerning the negative effects of FDI is the lack of laws, regulations and policies in developing countries that if in place would otherwise allow countries to channel the spillover effects of FDI in to positive outcomes. In some developing countries that have not reached a certain level of education and infrastructure development and where the markets are also underdeveloped and imperfect, they will be unable to benefit from a foreign presence and the effects of FDI on economic growth will be less benign, yet even in these instances an increase in FDI flows is more beneficial than none at all (cuts.org). The experience of countries in East-Asia shows that developing countries that use FDI purposefully by formulating and implementing national and technological development policies, will be successful in their efforts. MNCs alone cannot solve the problems of poverty, political instability and underdevelopment; these problems stretch far beyond the limited capacity of corporations. Because of this, even a strong combination of FDI and public pressure cannot achieve dramatic results in the reduction of human rights abuses, environmental degradation, political unrest, cultural tensions, and financial volatility. The challenge for governments, business leaders, and advocates is to manage the complex relationships between themselves and to forge an agenda that does not focus only on battling exploitation or limiting the scope of FDI. In the end it remains the responsibility of MNCs and governments of more developed countries, specifically, members of OECD, to assist developing countries in building the infrastructure necessary to reap the benefits of FDI, to continually provide financial assistance in the form of long-term productive capital, and to reinvest profits inward rather than repatriate them.

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BANKING ON SUCCESS IN THE WAR ON TERROR

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ABSTRACT

The world is constantly evolving into a global economy with the help of open financial markets and technology. In synch with this movement, the sophistication of financial crimes is increasing as well. Financial crimes such as money laundering are only a symptom of a more serious underlying criminal activity. Detection of these activities remains difficult and effectiveness of current efforts is difficult to determine at best. This paper examines current anti-money laundering practices.

INTRODUCTION

Money laundering is any activity used to disguise the origin of money that has been gained through illegal activities or events. Before the events of September 11th, many people associated money laundering operations with drug trafficking and illegal gambling outfits. Since the terrorist attack however, the concern over money laundering has turned from tax evaders to terrorist funding. This has prompted strong and immediate action by the United States and a resurgence of support for legislation aimed at finding the sources of "dirty money." However, anti-money laundering initiatives are not local events, as much of the activity involves shuffling funds overseas and offshore. Many countries are actively trying to reduce the risk associated with money laundering. Multilateral efforts are key to reducing the amount of illicit funds passing through the nations' financial sectors. The Financial Action Task Force on money laundering & IMF are only a few of the international organizations working for the cooperative efforts of reducing this illegal activity and therefore disabling the underlying crimes.

Unfortunately, since there are no formal measures to determine the amount of underground transactions, it is difficult to gauge the effectiveness of current anti-laundering practices. Reports are broadcast describing asset freezes on parties believed to be involved in terrorist or other illegal activities. But just how accurate is the financial trail used to asses the guilt of the account holders? The effectiveness of current practices is often questioned. This paper will examine U.S. anti-money laundering practices and also touch on foreign endeavors in this financial war. Special attention will be paid to recent legislation spawned under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot) Act of 2001. Despite concerted efforts in the "war on terror," it may be found that while we can prosecute those who surface in the public eye, it is unlikely that financial initiatives will deter future crimes or debilitate the parties and activities involved.

LITERATURE REVIEW

Two main sources of research material for this paper were the Journal of Money Laundering Control and the Journal of Financial Crime. These two publications offer an array of technical information on actual legislative advisements regarding money laundering as well as some editorial comment on the issues. Aside from the journal articles on the effectiveness of money laundering controls, the direction of future efforts, and Jesse Morgan piece on unilateralism in U.S. policy there appeared to be limited works in this area. Morgan's paper describes US directives through the Clinton and Bush administrations and the scope and limitations of these endeavors. Two other instrumental sources available are the websites of the Financial Action Task Force and the Financial Crimes Enforcement Network. An additional legislative resource on current domestic policy is the National Money Laundering Strategy which the Justice and Treasury Departments are required to publish each year and is available to the public.

DEFINITION AND PRACTICES

The act of money laundering involves processing money gained from illegal activity through various financial networks in order to hide the origin of the money. The money may be moved several times using various transactions to accomplish the transformation from "dirty" money to "clean." The end result is a legitimized sum of money from which portions or the whole amount may be reallocated to the underlying criminal activity. There are three basic steps to this process: placement, layering and integration.

In the placement phase the money is physically introduced into the financial sector. This is the best opportunity for the recognition and tracking of the money. Unfortunately, this opportunity may be ignored. Many banks practice secrecy of customers and provide a haven for those who do not wish to be identified. Even reputable firms who are believed to have moderate anti-money laundering controls often do not realize the intent of the transaction. Even before September 11th, banks in the United States were required to have implemented anti-money laundering programs. However, the protocols of these programs were limited and the scope of practice usually involved only the reporting of cash transactions larger than $10,000.

During layering, the money is transferred, most commonly via electronic transactions to different accounts. It is this process which complicates the ability to trace the money. The money is transferred as different sums and often becomes intertwined with seemingly legitimate accounts both personal and business. While technology has evolved to provide customer convenience in banking, it has also added useful tools for the money launderer. Face to face transactions are no longer necessary and the internet often facilitates transactions without witness.

The third step, integration, involves the re-introduction of the money back into the economy. This can be done in many ways including investment in real estate or business ventures. Often it is desirable to return some amount of the laundered money back to the originating enterprise. Hence, integration may occur using the same institutions as did the placement (Wells, 2003).

Money laundering can occur anywhere but typically placement occurs in areas with weak control measures. "Like water, money launderers follow the path of least resistance" (Baldwin, 2003). However, since there may be many elaborate transactions involved in the layering stage, the territory selected must also have a stable financial system. Surprisingly, there are many areas that fit this profile. Shell banks and offshore financial centers are two popular venues for transactions. Shell banks are companies that have no physical location and therefore limited control over identifying the customer. Another popular way to conduct business is through off-shore financial centers (OFC). An offshore center by the simplest definition is a financial center where most business transactions involve non-residents. Supporting the world's fifth largest financial center the Cayman Islands is a prime example of an OFC with 600 banks and numerous investment houses. OFCs are attractive places to do business because of the combination of close to zero taxes and strict privacy laws favoring account holders and corporate officers (Morgan, 2003). The fall of Enron brought much publicity to the use of offshore financial centers in 2001.

THE USA PATRIOT ACT

US anti-money laundering laws are older and more comprehensive than those of most other countries. The foundations of these laws date back to 1970 with the Bank Secrecy Act, the Money Laundering Control Act in 1986, and the Racketeering Influence and Corrupt Organizations Act (Morgan, 2003). It is illegal in the U.S. to knowingly conduct or attempt to conduct a financial transaction with the proceeds of over 100 types of illegal activities (Silets & Van Cleef, 2003). One of the most basic tenets of the efforts to combat launderers is the requirement placed on institutions to implement an anti-money laundering program.

According to Baldwin, an anti-money laundering program requires at least four things:

1) the development of internal policies, procedures and controls designed to prevent money laundering

2) the formal designation of a compliance officer to oversee and run the program
3) ongoing employee training about the program
4) an independent audit function to test the program (2003)

Laws are currently becoming more stringent, requiring more than a simple anti-money laundering plan on paper. The USA Patriot Act of 2001 has been hailed as the most significant piece of counter-laundering legislation since money laundering became a crime in 1986 (Morgan, 2003). It has added terrorism and a number of new offenses to the previous list of 100 criminal activities. Title III of the Patriot Act is International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. In brief, Title III allows the US Secretary of Treasury to levy measures against foreign financial institutions, regardless of jurisdiction. This provision also prohibits domestic firms from conducting transactions with shell banks and foreign banks that service shell banks. It broadens the definition of a financial institution to include those that may have been exempt from instituting an anti-money laundering program in the past such as broker-dealers (The Law: An Overview, 2003).

The main directive of the new legislation is to 'know your customer.' While a seemingly simple task, the actual process may levee a costly burden on the financial sector. US financial institutions are now expected to identify not only the corporate structure of the foreign banks with which they interact, but also the offshore customers of those banks. These added requirements will increase transactions costs. The act also redefines the culpability of banks in regards to their knowledge of illicit funds. Not only may a bank be prosecuted for knowingly processing illegal funds, they may also be prosecuted for "willful blindness" where the bank simply ignores red flags that would indicate the transaction is suspect (Baldwin, 2003).

The Patriot Act extends the powers of the Financial Crimes Enforcement Network (FinCEN) and the Office of Foreign Assets Control (OFAC). FinCEN is the US representative in the Financial Intelligence Units (FIU) network, a multinational organization developed through the Financial Action Task Force. The agencies in the network use the exchange of information, sharing of expertise, and other forms of cooperation to attack financial crime. FinCEN represents one of the most sophisticated financial intelligence units of the group (International Legal Developments, 2003). FinCEN, given authority by the Treasury Department, is responsible for determining violations of the Bank Secrecy Act and issuing sanctions against those involved in the violations. They also conduct follow up investigations on any Suspicious Transactions Reports in order to trace transactions that are reported as suspicious through the financial organization conducting the transactions. Suspicious Activity Reports that are required to be filed by institutions are another effort of the USA Patriot Act to detect criminal activity.

OFAC is the organization in charge of tracking assets believed to be connected with terrorist or other illegal activities. OFAC has the authority to freeze these tracked assets to prevent further investment in the criminal enterprise. They also maintain an extensive database of suspicious accounts. Professor Barry Rider describes the United States logic regarding the importance of the OFAC by stating, “where criminal conduct involves a continuing criminal enterprise, taking away or otherwise interdicting the proceeds of crime might well prevent the reinvestment of this wealth back into the criminal operation, thus causing serious liquidity problems” (2003). If a financial organization does not comply with anti-money laundering and OFAC directives, consequences can include civil and criminal penalties, as well as in the case of insured depository institutions, loss of insurance coverage (Silets & Van Cleef, 2003).

Although constantly under intense review, support for counter-money laundering efforts continues as proven by the extra $10 million allocation for the Justice and Treasury departments' initiatives present in the 2004 budget that President Bush sent to Congress (Morgan, 2003). As the War on Terror continues it is unlikely that efforts to eliminate funds available to terrorists will slow down in the near future.

KEY PLAYERS

The FATF

The United States isn't the only country concerned with financial crimes. The Financial Action Task Force (FATF) is a global organization designed to fight these crimes. Established in 1989 at the G-7 summit in Paris, membership is currently held by thirty-one countries and two regional organizations. Although performing a critical service, the FATF does not have an unlimited lifespan; its mission is reviewed every five years by the member governments to determine its necessity. The FATF is recognized by governments and international organizations as the world's foremost counter-laundering body, and its policies are viewed as a source of customary international law (Morgan, 2003). The FATF, in an effort to develop guidelines that can be followed universally to help countries' financial systems avoid attracting illicit money, has established a group of 40 recommendations for institutions. Although not legally binding under public international law, the recommendations are followed by many nations voluntarily. These recommendations were drawn up initially in 1990 and revised in 1996. With the attack on America, the focus of the FATF mission has changed slightly. It now recognizes that it isn't only underground drug organizations that must be faced, but also organized crime syndicates and possible threats to national security. In 2001 the FATF met to devise additional recommendations in dealing with terrorist groups. The result was the development of Eight Special Recommendations to be administered with the original Forty Recommendations.

Along with developing and reviewing the Forty Recommendations, the FATF monitors countries and territories to determine which areas pose a threat to international cooperation in the fight against money laundering. There is a set of criteria, consistent with the Forty

Recommendations, that defines what FATF members consider non-cooperative countries and territories (NCCT). NCCT are included in a list published by the FATF. The countries or territories remain on the list until appropriate anti-money laundering efforts are made. The list is updated as needed, most recently with the removal of St. Vincent and the Grenadines in July of 2003. The FATF may also elect to impose counter-measures on non-cooperating areas. Such counter-measures were proposed against the Ukraine in December of 2002, but were lifted due to significant legal reforms in the country at the time.

The FATF's three main objectives are:

a) Spreading the anti-money laundering message to all continents and regions of the globe
b) Monitoring the implementation of the Forty Recommendations in FATF members
c) Reviewing money laundering trends and countermeasures

Several other groups perform duties in their respective regions much like those of the FATF. Some of these organizations are APG (Asia/Pacific Group on Money Laundering), CFATF (Caribbean Financial Action Task Force), ESAAMLG (Eastern and Southern Africa Anti-Money Laundering Group), GAFISUD (Financial Action Task Force for South America), the MONEYVAL Committee of the Council of Europe, and the OGBS (Offshore Group of Banking Supervisors) (www1.oecd.org/fatf/AboutFATF_en.htm). Cooperation by these organizations with the FATF is critical in developing a protected global financial network. But the FATF isn't the only multi-governmental organization that recognizes the need for supervision of the international networks.

The IMF

The International Monetary Fund (IMF) is an important player in the global economy. Through its many roles it is expected to maintain monetary and financial stability across nations. In 1999, the Fund adopted (together with the World Bank) the Financial Sector Assessment Program, a tool used to inquire into the health – and thereby the vulnerability – of a member's financial sector. The Fund in 2000 also began a program to monitor the weaknesses of Offshore Financial Centers. The IMF is active in an Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) front and has recently assumed new and expanded responsibilities in this area. While involvement on this front has been active for less than two years, they have moved rapidly with consequences for the global sector in general and members in particular. The Fund has adopted the FATF 40+8 Recommendations as standards for control. But while the Fund is active in monitoring institutions and issuing assessments, it is not involved in any law enforcement activities related to the prosecution of financial crimes. The Board has remanded that enforcement of laws regarding anti-money laundering and anti-terrorist measures be left to the discretion of the national authorities (Holder, 2003).

Foreign Parties

Perhaps due to the terrorist attack being on US soil, new efforts against terrorism and money laundering in the United States have eclipsed the efforts being undertaken by other nations. But as it is a global financial economy, unilateral efforts to track and trace transactions would be completely worthless. Therefore it is important to discuss a few of the international efforts and the importance of their participation in the success of the "war on terrorism."

In England, the Financial Services Authority is responsible for regulating the financial sector. Before September 11th, financial fraud and money laundering were low priority issues for the organization (Rider, 2003). Since then there have been legislative developments such as the Anti-Terrorism, Crime and Security Act of 2001. With this act the UK defined four main efforts to combat terrorist financing. The activities include: fundraising for organizations, use and possession of terrorist funds, participating in funding arrangements, and money laundering (JOMLC, p2). The Act also provides for extra-territorial jurisdiction, prosecuting those who conduct illegal transactions outside the UK that would have been prosecutable within its boundaries.

Mexico is an important partner to the United States in many markets. Mexico is active in several international organizations, including the FATF. However, their efforts at money laundering control still leave several loopholes that facilitate the transfer of illegal proceeds. Money laundering in Mexico arises mainly from drug trafficking and tax evasion. Their proximity to the United States helps bolster these enterprises. They are in fact one of the top 20 centers of laundered money. The main problem limiting the effectiveness of controls is the slow exchange of information at the national and international levels (Vargas & Backhouse, 2003). In order to help in the coordination of the effort against money laundering, Mexico needs to improve its technologies and information sharing capabilities.

China is fast becoming one of the world's most powerful nations in various markets. Therefore it is just as essential that their financial systems be regulated to control the amount of money laundering and opportunities for financial crimes. Along with the rest of the world China has made new efforts to fight terrorism and ensure worldwide stability since the events of September 11th. In response to the terrorist attack China added a third set of amendments to the Chinese Criminal Law in December 2001. The predicate offenses of money laundering were expanded to cover four kinds of crimes where there were previously only two. Organized crime and terrorism were added to the ranks of smuggling and drug related crime. The punishments for such crimes were increased as well. However, Chinese law too has loopholes that need to be tightened to ensure relatively equal treatment across nations. These weaknesses include expanding the scope of serious crimes covered under this legislation (Ping, 2003).

WILL IT WORK?

There is speculation as to whether US endeavors through the USA Patriot Act, FinCEN and other organizations are actually the most appropriate means to attack money laundering and, therefore, terrorist organizations. Skeptics argue that enforcement efforts aimed at the formal financial sector are the result of flawed logic and will not achieve desired results. Successful interdiction requires a more comprehensive approach that operates on the assumption that most terrorist financing is conducted via hawala-type or underground networks and other informal systems. They stress that to date international organizations and leading states (i.e. the USA) have not succeeded in developing adequate regulatory approaches in this area (International Legal Developments, 2003).

A similar argument claims that US efforts are completely misdirected altogether. Because terrorists with a political objective require funds for a wider agenda, it would be incorrect to assume that the expertise developed in pursuing the proceeds of drug trafficking and serious fraud would be applicable or even relevant to pursuing and interdicting the funds of terrorist organizations (The Law: An Overview,2003).

As with all government initiatives, OFAC itself has come under scrutiny. Claims of success are considered dubious by some. "The OFAC claims that its freeze and blocking order have put Al-Barakaat out of business, and therefore it can no longer serve as a global money transmission network for terrorist groups. Other experts assert, however, that money transmission by al-Qaeda and other terrorist groups take place through other alternative remittance systems, and these systems (including hawala) completely circumvent existing strategies used by financial regulators at present to curtail terrorist financing" (The Law: An Overview, 2003).

There is also concern with regard to the FATF list of non-cooperative countries and territories, described by some as a "name and shame game." Morgan compares this "name and shame" game to that of a similar directive in the War on Drugs. Both appear only as a symbolic persecution of the countries. An example of the ineffectiveness and lack of commitment to these pronouncements is that in 1995 the state department declared that Columbia was uncooperative in the Drug War. However they waived all sanctions against the country for reasons of national interest (2003). Similarly, the FATF and Organization for Economic Cooperation and Development (OECD) often threaten but rarely impose countermeasures against non-cooperators. "Further analysis of recent US actions requires an acknowledgement that the nature and scope of the dirty money threat is murky, while symbolic counter-laundering measures such as the blacklist are experimental and controversial" (Morgan, 2003). Offshore centers believe they are being unfairly targeted. Imposing measures being required by the United States and other groups would seriously restrict their practices and ability to succeed. The UN recognizes that there are legitimate purposes for offshore centers and that they are a part of the global economy (Allen, 2003).

The FATF is also under ridicule for unrealistic expectations. It is feared by foreign nations that foreign banks will be held to a standard which domestic (within the US) financial institutions (or law enforcement) cannot achieve (Preston, 2002). Many of the efforts have prompted countries to adopt anti-money laundering measures to appease the regulatory bodies while the do not have the means of enforcing these measures.

Drafting legislation and expecting that it be universally accepted comes with its own risks. Possible negative responses to legislation need to be considered. Measures imposed by the United States will undoubtedly raise the cost of doing business for foreign financial entities. "If enough financial institutions choose to sever ties with America, America will not only have lost the leverage it had, but it will have lost it at the cost of its diplomatic goodwill and its financial institutions' business relations" (Preston, 2002). The U.S. is a world financial leader and many international transactions depend on the speed and reliable clearing of amounts at US financial institutions. To maintain this position in the global economy any regulatory solution to the problem of money laundering would have to be extremely carefully targeted to avoid slowing transactions and damaging the competitive position of U.S. financial institutions.

Debates regarding US measures ensue but opposing arguments generally fall short, overshadowed by the political power of the US. "These extraterritorial provisions are likely to impose heavy compliance costs on foreign banks that have private banking relationships with US banks. Although this may lead some foreign banks to terminate their relationships with US financial institutions, most sophisticated banking companies need to maintain account relationships with US banks so that they may use the US interbank payment system, and therefore will have to comply with these stricter regulatory requirements" (International Legal Developments, 2003). Rider believes that U.S. measures will become the international norm, like it or not (2003).

LIMITATIONS

Anti-money laundering laws are designed to stop the introduction of dirty money into the financial system from the source. Unfortunately current laws are not designed to detect "clean" money passing through for illegitimate purposes in the future. Terrorist money is often generated through legitimate businesses as opposed to illegal activities such as drug trafficking and only becomes tainted when it is donated to a terrorist organization. Many organized crime ventures participate in the world economy with public businesses. The Al-Qaeda organization operated business such as ostrich farms, shrimp boats and diamond mining (The Law in Context, 2003). It is difficult to track all funds being used for illegal activities. Although intended for terrorism, monies from these legal enterprises do not move around the financial system like dirty money therefore making it even more difficult to detect. It behaves like ordinary money without raising suspicion so it is impossible to identify. This means that the usual range of counter-money laundering techniques and tools are of very limited use (The Law: An Overview, 2003). It has been determined that donations and contributions account for a significant portion of a particular group's funds. Criminal activity may in fact provide a lesser amount of funds than those earned from legitimate business ventures and contributions. "While the giving of property for the purpose of committing criminal acts might effectively criminalize the property in question, it is not in origin necessarily illicit and thus tainted" which makes prosecuting fund sources difficult (The Law: An Overview, 2003).

"On a global scale there is a clear understanding that regulations implemented to counter money laundering activities have not kept pace with the advances of technology and global economic integration, which has understood the weaknesses in legal systems and the failure of international cooperation to convict launderers" (Vargas & Backhouse, 2003).

There is also the possibility that measures are displacing, rather than erasing money laundering because of the limited geographical reach by legal bodies. Even though international collaborations are underway, FATF blacklist pressure may encourage some countries to pass counter-laundering legislation without the financial, technological and human wherewithal needed to implement the changes demanded of them (Morgan, 2003). So while there appears to be great progress on paper, actual improvements are yet to be seen.

International coordination, while striving to combat terrorist funding through money laundering control has also come short for various reasons. One of the main problems is the lack of a single definition for terrorism between countries. Bureaucracies also impede the process of coordinating for a common good. A third factor is the lack of a central database on terrorist financing (The Law in Context, 2003).

Morgan makes a very basic argument against any further legislative moves based on the assumptions that the U.S. has made about the success of anti-money laundering policies. He states, "Despite unfounded estimates that become "facts by reputation" there appears to be no consensus on the actual scope of the laundering problem; this fundamental ignorance undoubtedly impedes counter-laundering policymaking" (2003).

SUMMARY AND CONCLUSION

World institutions recognize the need for monitoring of domestic and international financial markets. While the main concern in the past over the use of offshore centers and hidden accounts was tax evasion, this notion changed with the September 11th terrorist attacks. A review of participants' financial accounts demonstrated the ease with which money can be moved to provide an offender funds to participate in numerous illegal activities. The resulting sentiment was that if suspicious transactions such as overseas transfer had been brought to light sooner, perhaps the events could have been prevented. It was with this notion that the United States rebounded and began attempts to prevent future events by drafting strict anti-money laundering legislation. While this may be an effective means to slow transfers by some organizations for a period of time, it will by no means prevent criminal activity from proceeding. While the global financial market may be a highway for transactions completed with ease because of advanced technology, launderers will continue to succeed by the use of underground markets and other channels without monetary controls.

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APPENDIX I

Current members of the Financial Action Task Force November 2003

1. Argentina	12. Greece	23. Norway
2. Australia	13. Gulf Co-operation Council	24. Portugal
3. Austria	14. Hong Kong, China	25. Russian Federation
4. Belgium	15. Iceland	26. Singapore
5. Brazil	16. Ireland	27. South Africa
6. Canada	17. Italy	28. Spain
7. Denmark	18. Japan	29. Sweden
8. European Commission	19. Luxembourg	30. Switzerland
9. Finland	20. Mexico	31. Turkey
10. France	21. Kingdom of the Netherlands	32. United Kingdom
11. Germany	22. New Zealand	33. United States

APPENDIX II

Non-Cooperative territories as determined by the Financial Action Task Force November 2003

1. Cook Islands	4. Indonesia	7. Nigeria
2. Egypt	5. Myanmar	8. Philippines
3. Guatemala	6. Nauru	9. Ukraine

THE VIETNAMESE MARKET AND THE UNITED STATES: A MATRIX AND HISTORICAL ANALYSIS

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ABSTRACT

This paper examines the Vietnamese market from the U.S. standpoint. Although American presence in Viet Nam dated back to the 60s, such presence had a primary focus on politics rather than economics because of the U.S. containment policy in Asia. U.S.–VN historical relationships were interrupted in 1975 with the withdrawal of American forces and did not resume again until 1995. Although some commercial relationships existed before that date, serious U.S. trade and investment activities in Viet Nam effectively started after 1995. This paper analyzes the nature and scope of business relations between the two nations, emphasizing the special historical circumstance and the fact that the United States has been dealing with an economy in transition led by a Communist state. In addition to the historic determinant, to better understand and to look into the prospects of U.S.–VN business relations, this paper develops a model—an investment potential assessment framework based on the "push" and "pull" analysis drawn from the economic theory of foreign direct investment.

INTRODUCTION

The story of Vietnamese integration into the global market began in 1986, when that nation, under tremendous pressure from low and declining productivity, decided to give up the grand experiment in orthodox socialism with central planning and to move her economy in the direction of the market. The motive and the force that has sustained that historical transformation, also known as *Đ i M i*, or *Renovation*, is the realization of the need to open up the stagnant economy to the outside world. As the result of that integration effort, the movement of exchange of with the rest of the world and the participation of foreign capital and know-how in Viet Nam has accelerated to new heights ever since. Yet, while Viet Nam has developed rather extensive economic ties with Europe and Asia, the participation of North America in the economic reconstruction and expansion of that country has remain relatively modest, at least until quite recently.

This paper examines the nature and prospects for the United States'commercial relations with its former enemy and explore the reasons for America's slow return to the Vietnamese market. The scope of bilateral economic relations, including short-term of service and commodity exchange and long term commitment to a particular markets, i.e., foreign direct investment—FDI, depends importantly on physical factors such as the size of the market and non-physical dimensions such as social capital and the regulatory environment.

For analytical purpose, this paper develops a simple matrix framework for assessing the potential for foreign direct investment. According to this assessment scheme, the "push" and "pull" forces of FDI can be displayed on one dimension, say, on the vertical axis, and the "tangible" and "intangible" factors, on another dimension, namely, the horizontal axis. This matrix will be named Investment Potential Assessment or IPA framework. This paper will argue that the explanation for the acceleration of FDI activities in Viet Nam in the early and mid-90s and the deceleration in the subsequent period can be better understood using the said IPA framework.

But although this matrix is appropriate to analyze U.S.–VN bilateral relationship, to gain a deeper understanding, we need to look more carefully at the special historical circumstance underlying that relationship. This circumstantial specificity would account for the fact that, despite the close encounter between the United States and Viet Nam in contemporary history, there were considerable delays in peaceful economic dialog between the two nations. One of the theses advanced in the paper is that these delays have their root cause in both politics and economics. By examining the latter, it is possible to gain further insights into a specific bilateral exchange process such as that analyzed here, and to offer clues to future developments of that process. Additionally, the experience of U.S.–VN commercial relations can conceivably offer some lessons on bilateral commercial relationships on a global scale.

THE RECORD

Viet Nam's Global Trade Structure

From 1997 to 2003, Viet Nam's exports consists mainly of (in roughly decreasing order of importance) crude oil, garment, footwear, marine products (including frozen items), rice, coffee, and electronics (IMF, 2003). While electronic goods and components accounted for between 3 and 5 percent of total exports, crude oil has the lion's share of Viet Nam's exports during that period. In other words, Viet Nam's exports have been dominated by natural resource commodities, labor intensive products, and agricultural and marine products. The composition of merchandise that Viet Nam have been selling to the world has undergone some subtle but significant changes. For example, the share of marine product exports increased from 8.6 percent in 1997 to 12.1 percent in 2002. The substantial increase in the importance of marine product exports to the United States in recent years accounts for the noted compositional shift. Another small but interesting development in the pattern of Viet Nam's global exports was the large increase in the value (from $63 million in 1997 to $331 million in 2002) and the big increase in share of handicrafts (0.7 to 2 percent). Here again, this latter change in the Viet Nam global trades also finds an echo in the in trade with the United States.

On the import side, the major merchandise groups during 1997-2002, ranked in decreasing order, were roughly as follows: machinery and equipment, petroleum, leather and garment material, steel and iron, fertilizer, and motorcycles (IMF, 2003). The significant changes in the composition of imports occurred in steel and iron (from 4.4 percent to 6.8 percent during 1997-2003), and machinery and equipment (from 15.3 to 19.2).

U.S.–VN Trade Relations

The war with Viet Nam ended in 1975 but animosity between the two former enemies lingered until President Clinton restored normal relations and established diplomatic ties toViet Nam on 11 July 1995 (President Clinton: "This moment offers us the opportunity to bind up our own wounds. They have resisted time for too long."). Viet Nam, in pursuing the agenda of ***Đ i M i*** applied for membership in the World Trade Organization in the same year. Until the U.S. trade embargo against Viet Nam was lifted in February 1994, regular trade relations with Viet Nam was virtually non-existent (1). The said landmarks in U.S.–VN relations took place against the backdrop of a burgeoning economy and impressive growth in foreign trade and investment in that country. At that time, Viet Nam had emerged as one of the most promising markets in Southeast Asia. In fact, according to a 1995 annual survey of investor intentions by *Corporate Location*, Viet Nam ranked 8th (from 23rd previously) in the top thirty investment sites (Corporate Location, 1995). This high ranking put Viet Nam below China but above Korea, the ASEAN countries, the United States, and Japan. But compared with the ASEAN, Viet Nam has remained a very small market. For example, while U.S. total trade, i.e., exports and imports, with ASEAN reached $83.85 billion in 1994, that with Viet Nam was a meager $223.4 billion.

Because of the trade embargo, in value, U.S. trade with Viet Nam was quite negligible up until after 1993. Compared with the pre-1993 period, there was a substantial increase in that volume during 1993-94. With the lifting of the trade embargo in 1994, however, U.S.-VN trade began to increase significantly, and in 1996, U.S. trade with Viet Nam rose to nearly one billion dollars. The Asian financial crisis of 1997 had a depressing effect on that trade, which did not fully recover until 1999 and after. From 2000 to 2003, while the volume of total trade with Viet Nam began to surpass one-billion dollar mark, the U.S. market has absorbed much more Vietnamese commodities than vice versa. Thus, between 2000 and 2001, U.S. imports from Viet Nam increased from $821.3 million to $1,053.2 million, but U.S. exports to Viet Nam only rose from $367.5 million to $460.4 million. Last year marked a high point in U.S.–VN trade relations, again with the United States providing a lucrative market worth $4.55 billion for Vietnamese commodities. Compared to the previous year, the 2003 value shows an increase of over 90 percent. Viet Nam also offered the United States a larger consumer market worth $1.32 billion for American exports.

In short, in sheer volume and compared with the early 90s, bilateral trade between the two nations has shown a healthy and steady growth pattern. Recently, the United States has continued to provide Viet Nam with an increasingly larger market. In fact, in 2002, this country alone absorbed nearly 13 percent of the value of all merchandise that Viet Nam sold to the rest of the world. Yet, the Vietnamese market has also been broadened to take in American goods over time as shown by the recent rise in the value of U.S. exports to Viet Nam, but the share of American merchandise in Viet Nam's total imports has remained around only three percent (Table 1).

Table 1
U.S. Trade with Viet Nam, 1992-2003
(in millions of dollars)

Year	Exports to U.S.	Imports from U.S.	Balance	Total Exports	Total Imports		
	1	2	3	4	5	(1/5)	(2/4)
1992	4.6	0	4.6	n.a.	n.a.	n.a.	n.a.
1993	7	0	7	n.a.	n.a.	n.a.	n.a.
1994	172.9	50.5	122.4	n.a.	n.a.	n.a.	n.a.
1995	252.3	199	53.3	n.a.	n.a.	n.a.	n.a.
1996	616.6	331.8	284.8	7256	11,144	0.085	0.030
1997	286.7	388.4	-101.7	9,185	11,592	0.031	0.034
1998	273.9	554.1	-280.2	9,361	11,500	0.029	0.048
1999	291.5	608.4	-316.9	11,540	11,742	0.025	0.052
2000	367.5	821.3	-453.8	14,449	15,638	0.025	0.053
2001	460.4	1,053.20	-592.8	15,100	15,999	0.030	0.066
2002	580	2394.8	-1814.8	16,530	19,000	0.035	0.126
2003	1,324.40	4554.9	-3230.5	n.a.	n.a.	n.a.	n.a.

Sources: Exports and Imports with U.S. Data: Department of Commerce, U.S. Census Bureau, Foreign Trade Statistics Total Export and Total Import Data: IMF

What has Viet Nam bought from and sold to the United States? To what extent does U.S.–VN trade follows and deviates from the Vietnamese global trade pattern? On the U.S. import side, unlike the pattern of VN global trade analyzed above, the commodity group that the United States has bought the most of from Viet Nam was food and live animal (SITC 1). Accordingly, last year, the United States bought almost one billion dollar's worth of merchandise from Viet Nam in this group, accounting for about one-fifth of total U.S. merchandise imports from Viet Nam. The dominant item in this group in 2003 was marine products: the United States imported nearly half a billion dollars worth of shrimps and prawns. The 2003 imports in this category represent an increase of about 30 percent over the preceding year.

The second largest U.S. import group from Viet Nam last year was garments, the bulk of which was sweater, pullover and similar articles, and other knitted products. This imports had a value of $429.43 million and accounted for 9.4 percent of total U.S. imports from Viet Nam.
The third most import item from Viet Nam was crude minerals (SITC 3), which consisted of petroleum oil and oil from bituminous minerals (U.S.–VN Trade Council, 2004). Another lucrative U.S. market for Vietnamese exports in 2003 was machinery and transport equipment (SITC 7). Most of the Vietnamese exports in this category were associated with U.S. investment in Viet Nam.

As far as the consumer marker for U.S. products is concerned, Viet Nam represents a negligible outlet for the United States. Of the total U.S.–VN trade value of $5,879.3 million, U.S. exports to Viet Nam was only $1,324.44 million, or 22.5 percent of the total. In other words, the Vietnamese market contributed about $3.2 billion to the total U.S. merchandise trade deficit. Here, last year the Vietnamese market absorbed $921.54 million worth of U.S. sales in machinery and transport equipment, representing nearly 70 percent of U.S. exports to Viet Nam (Table 2). The bulk of this U.S. exports to Viet Nam was civilian aircraft ($707,710 million). The other items in this group were materials handling equipment, industrial machines, and measuring/testing/control equipment ($42.5 million).

Table 2: U.S. Trade with Viet Nam, 2003
(By SITC commodity and millions of dollars)

Commodity	Exports	Imports	Exports/Total	Imports/Total
(0) Food and Live Animals	48.28	969	0.036	0.213
(1) Beverages and Tobacco	1.18	2.69	0.001	0.001
(2) Crude Materials, Inedible, Except Fuels	90.62	19.6	0.068	0.004
(3) Mineral Fuels, Lubricants and Related Materials	1.52	283.69	0.001	0.062
(4) Animal and Vegetable Oils, Fats and Waxes	0.2	0	0.000	0
(5) Chemicals and Related Products	108.73	3	0.082	0.001
(6) Manufactured Goods Classified Chiefly by Material	57.42	106.29	0.043	0.023
(7) Machinery and Transport Equipment	921.54	110.86	0.696	0.024
(8) Miscellaneous Manufactured Articles	85.96	3,037.39	0.065	0.667
(9) Commodities and Transactions, N.E.S.	8.98	22.33	0.007	0.005
TOTAL	**1324.44**	**4,554.86**		

Source: Department of Commerce, U.S. Census Bureau, Foreign Trade Statistics.

Next in order of importance in 2003 was chemicals and related products (SITC 5), which valued at $108.73 and accounted for 8.2 percent of U.S. exports to Viet Nam in 2003. The third largest Vietnamese purchase of American goods fell in the broad group of crude and inedible materials except fuels (SITC 2). Viet Nam bought about $91 millions worth of products in this group, with a share of nearly 7 percent of total Vietnamese purchases from the U. S. in 2003.

U.S. Investment in Viet Nam

As of December, 2002, U.S. firms committed over one billion dollars of capital investment in 139 projects in Viet Nam. Out of that capital commitment, only half was disbursed. The dominant form of that investment was wholly-owned, followed by Business Cooperation Contract (BCC) and joint venture. In cumulative terms to December 2003, U.S. capital commitment was valued at $1.134 billion divided into 174 projects. Of that cumulative commitment, $696 million were realized. This investment put the United States at the 13th position, behind the ASEAN countries. The top five investors in Viet Nam in 2003 were Singapore (with $2.977 million in implemented capital), Taiwan, Japan, Korea, and Hong Kong.

Table 3: U.S. Foreign Direct Investment in Viet Nam
(by economic sectors, 2002)

Industry	Number of Projects	Total Investment Capital
Industrial Production	58	358.95 mil USD
Oil and Gas	6	123.80 mil USD
Agriculture and Forestry	13	117.36 mil USD
Culture, Health, and Education	10	103.97 mil USD
Light Industry	21	72.17 mil USD
Construction	9	68.32 mil USD
Finance and Banking	4	65.00 mil USD
Hotel and Tourism	2	52.20 mil USD
Transportation and Telecommunication	8	43.43 mil USD
Food Industry	12	41.85 mil USD
Service	8	26.28 mil USD
Fishery	3	16.20 mil USD
Office and Housing Construction	1	16.00 mil USD
Infrastructure Construction of Industrial Zones and Export Processing Zones	1	5.00 mil USD
Total	**156**	**1,110.53 mil USD**

Sources: Ministry of Planning and Investment, VN: Vietnam: *Committed Progress, Unparalleled Potential.*

In fact, the United States has not played a large role in the Vietnamese direct investment market. From 1998 to 2002, annual capital disbursements by U.S. firms varied between 50 and 80 million dollars. By comparison, the top investor, Singapore spent between 218 and 354 million dollars in Viet Nam annually during the same period. In 2002, compared with the total annual foreign investment (disbursed capital) of $2.8 billion, the U.S. share was a mere 2.5 percent. American investment in Viet Nam has concentrated on industry and construction (64 percent of total investment), followed by services (26%) and agriculture and forestry (10 percent).

DEMOGRAPHICS AND THE ECONOMY

Until 1997, the rapid surge in the flows of FDI into Viet Nam after the 1986 market reform can be explained in terms of her strong demographics, a high rate of economic growth, and solid but untapped natural resources. The evidence can be seen from Table 4. Viet Nam has a big and growing population base. Her population is now over 80 million strong. Besides, Viet Nam is a young and dynamic nation as half of that population is under 25. Moreover, over ten million Vietnamese are between the age of 10 and 14 (U.S. Department of State, 2000; UVDP, 2003). This implies that millions of peoples will enter the labor force every year. Coupled with a high rate of unemployment in the countryside (estimated at 35 percent), a substantial underemployment rate in the cities means that absolute labor costs remains low. Additionally, until the late 90's, when East and Southeast Asia was hit with a grave financial debacle, Viet Nam had been blessed with one of the highest rate of growth in the region and the world. The economy expanded at an average annual rate of about 8 percent before 1997. Indeed, *Đ i M i* has brought about impressive macroeconomics achievements since the early 90s and laid the foundation for further progress (Dollar, 1994; Irving, 1995; Vo, 1994, 97, 2000; 2001). The Vietnamese economy has shown signs of regaining its post-reform dynamism after the slowdown in the late 90s. Last year's real growth rate was around 7 percent. With a stable international financial environment, Viet Nam should represent solid growth potential because of her favorable demographic and resource abundance. The government likes to call the reformed economy a multi-sector economy. Although this is just another name for a market-driven, mixed economy like the ASEAN, there is much truth to that label because Viet Nam is still a young market economy with diverse investment opportunities.

Viet Nam is also abundant in mineral resources with substantial oil reserves. Other mineral such as iron ore, tin, copper, lead, zinc, nickel, manganese are also available. The waterway system also provides opportunity for production of hydropower electricity. Viet Nam also enjoys a favorable geographical location that lies at the crossroad of one of the fastest growing economic region in the world. The extensive seashore also provides excellent sites for port facilities.

Table 4: Viet Nam - Basic Data					
Year	Population	Surface Area (a)	GDP (current $)	Per capita GDP (b)	GDP Growth (%) (b)
1995					n.a.
1996					9.3
1997				361 USD	8.2
1998	76.5 mil (a)	331.7 (000s sq. km)	27.2 bil	359 UDS	5.8
1999				372 USD	4.8
2000				391 USD	6.8
2001	79.5 mil (a)	331.7 (000s sq. km)	32.9 bil	393 USD	6.9
2002	80.5 mil (a)	331.7 (000s sq. km)	35.1 bil	428 USD	7.0

Sources: (a) World Bank Data
(b) IMF, Vietnam Statistical Appendix, December 2003

Today, the tangible factors include improvements in the quality of infrastructure in the major cities such as Hanoi and Ho Chi Minh City.

THE LEGAL AND SOCIAL ENVIRONMENT

Working within a formal contractual framework necessary for an efficient market economy is still a new experience for Viet Nam since the code on foreign investment was not promoted until 1987 (Vo, 1994, 1995, 2001), and laws on private ownership, business contract, and labor were not enacted until the 90s. Yet, despite these late starts, foreign investment laws represent an "attractive package of investment incentives." This code is one of the most liberal FDI codes in the region. Foreign investment in Viet Nam can take different forms such as BCC, joint-venture, wholly-owned, BOT (Build-Operate-Transfer), BTO (Build-Transfer-Operate) and BT (Build-Transfer).

Although bureaucracy still exists, decentralization of application procedure and decision has made the investment environment more efficient. Political stability appears to have a positive impact on Viet Nam's international business relations. Secondly, Viet Nam has made slow but steady progress in the area of building a legal and regulatory framework based on contractual laws. However, despite serious effort at improvement, draft and corruption has remained a serious issue for domestic and foreign business.

Skilled labor may not be very easy to come by in Viet Nam, but the country is known to have a favorable learning curve. Her population is hard working and the entrepreneurial spirit is rather strong. At the present time, the rising costs of labor and the high cost of land may make the Viet

Nam less attractive than a decade or so ago. Other conditions that put Viet Nam at a disadvantage included the high cost of energy. Further, compared with Thailand and China, Viet Nam has a relatively weak network of supporting industries to provide raw materials, sub assemblies, and so on (Business-In-Asia.com, 2004). The main concern for American business in Viet Nam has been in the area of transparency, protection of intellectual property rights, and restriction of e-commerce.

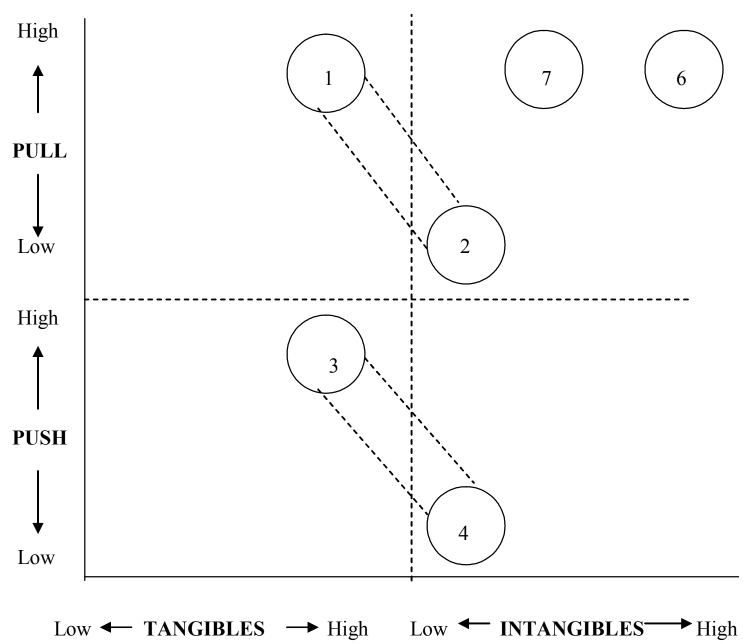
A MATRIX ANALYTICAL FRAMEWORK

The underlying theory of this matrix approach to assessing the potential for foreign business involvement in a host economy is that investor's decision to enter a particular market is shaped some combination of "push" and "pull" forces. The push forces usually come from within the investing company or individuals, but they can also come from the outside environment. Push forces encompass such internal and external factors as company's operation strategy, investment strategy, firm-specific advantages, cash-flow conditions, competition, economic conditions, and so on. The literature on the theory of FDI based on internalization and firm-specific advantages is replete with outstanding contributions (Batra, 1980; Dunning, 1981 & 1992; Hymer, 1976; 1977; Rugman, 1987; Sun, 1998; Vernon, 1979) For example, a company may decide to invest abroad as a part of its aggressive global strategy, the purpose of which may be to seek higher returns or to maintain global market share. Excess cash flows or increase in global demand may provide other incentives to expand beyond the domestic market.

The pull forces are mainly those characteristics of a foreign market that attract investment from multinational enterprises. As such, pull forces are usually location-specific. Factors such as low labor cost, abundant supply of skilled or semi-skill workers, good physical infrastructure, supporting industries, adequate social capital, a strong host economy, and the like are important part of the pull factor. Additionally, host government promotional policies such as the provision of tax holidays, low-interest loans, overhead capital subsidies, and so on can contribute to the magnet that "pulls" capital and technology flows from abroad.

As portrayed in Figure 1, this matrix model features the push and the pull forces on the vertical axis and the tangible factors and intangible factors on the horizontal axis. The "tangibles" consist of macro variables such as the state of the host economy, the size of market, and physical infrastructure. The "intangibles" cover cultural and institutional attributes in the host country such as the legal and regulatory environment, social capital, learning curve, corruption and drafts, and local customs and practices. Naturally, the attributes on the vertical and horizontal axes can possess low or high quality. For example, countries like Singapore, Malaysia may be represented by the combination of No. 3 and No. 6. This means that these particular markets can be assessed as having high on push combined with high on tangibles and high or pull combined with high on intangibles. China can conceivably occupy positions No. 3 and No. 7, because of its new legal and regulatory environment for international business. In other words, markets characterized by a combination that lies in the Southwest – Northeast direction, e.g., No. 3 and No. 6, suggest that they have great potential in attracting FDI. One important point to consider is that sometimes, a high in tangibles may more than compensate for relatively low ranking on intangibles such as the legal environment.

Figure 1
An Investment Potential Assessment Framework



Then, using similar standards, it is fair to argue that Viet Nam occupies a combination of No. 1 and No. 2 or a combination of No. 3 and No. 4. In either situation, a combination that lies in the Northwest – Southeast direction like that of Viet Nam suggests that the potential for foreign investment is limited. In the case of U.S.–VN commercial relations, the weak ranking of the United States compared with the strong investments position (as measured by the capital invested) of other regional countries can be explained partly in terms of the potential assessment matrix and partly in terms of delays in establishing normal relations with Viet Nam. The latter is a political matter as one now learns that both nations missed early opportunities to establish diplomatic ties. We now have solid evidence that the major stumbling block in post-1975 efforts to re-establish normal relations was the issue of war reparations that the Vietnamese side had required (Tran Quang Co, 2004).

Beyond that, the following points about U.S.–VN commercial relations should be noted. First, Viet Nam shares with her Asian neighbors a traditional Confucian ethic and a system of business connections built largely on family and human relationships as opposed to arm's length dealings. This affinity has played a role in the early introduction and the sustained high intensity of FDI activities in Viet Nam from the ASEAN, Koreas, and Taiwan. On the other hand, the United States has a different management style that is built on laws and arm's length principles. Secondly, this paper argues that U.S. ambivalent attitude toward the Vietnamese market can be explained in terms of a human and regulatory environment that spells greater risks. Finally, as noted, there is the factor of historical delays as stated earlier. The conclusion that the U.S. position in Viet Nam in the mid 90s can be portrayed by combination No. 3 and No 4 in Figure 1 in based on the fact that the "push" force was strong at that time. The United States had a strong economy at that time and corporate profits were favorable. These factors tend to encourage capital to seek new investment outlets.

CONCLUDING THOUGHTS

Given the dominant position of the United States in the global economy, chances are that bilateral U.S.–VN commercial will in the long run have the effect of changing the institutions and the modal of operation of the smaller country, Viet Nam. Until such a substantial change occurs, perhaps it is fair to predict that while trade relations will continue to expand, the Vietnamese market will not be a major focus of American foreign investment. Based upon the investment potential assessment model developed here, China will continue to be a more attractive alternative for U.S. multinational enterprises. From the Vietnamese perspective, the colossal economy to the North, namely China, will represent the main rival for Viet Nam in attracting U.S. capital and know-how.

On the other hand, like China, Viet Nam's future membership in the WTO will mean that that nation has to open its economy even more for foreign business. Hence, with that membership development, which probably will not take much longer to happen, the business environment in Viet Nam will become more conducive to American ventures. At that point, the Vietnamese market, because of its untapped resources, will have a chance of become an attractive alternative vis-à-vis the Chinese market.

On the trade front, the record of the first few years of the bilateral trade agreement can be justifiably qualified as a success. The surge in the trade volume attests to that. On the other hand, it is quite conceivable that dispute will continue to flare, especially where Viet Nam enjoys a comparative advantage. Low labor costs are expected to give the Vietnamese a competitive edge in fisheries, and this will lead to friction with the southern states in United States. The Vietnamese government has said that it does not subsidize its shrimp industry. It appears that U.S. domestic shrimp producers have not been able to meet U.S. market demand. Thus, it is doubtful that dumping, it customarily mean, is the real issue as U.S. fishermen have claimed. In that case, trade protection can only decrease consumers' welfare.

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WAL-MART'S LEARNING CURVE IN THE GERMAN MARKET

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ABSTRACT

Entering the German market would present Wal-Mart with many obstacles to overcome. When Wal-Mart decided to do business in Germany the company had to adhere to the many rules and regulations surrounding German businesses. According to German law, selling merchandise below cost is illegal. The sixth amendment of the Act against Restrictions of Competition (ARC) is a ban on undertakings with superior market power offering goods or services below their cost price without justification. This action limited the effectiveness of Wal-Mart's low cost leader strategy. Another German restriction requires stores to limit their amount of operational hours. German shopping hours are strictly regulated under Paragraph 3 of the BGBI (B9 – 74/00, Seite 875). No German stores are allowed to be open 24 hours a day, nor are they allowed to be open on Sundays and must close by 4 P.M. on Saturdays. In response, Wal-Mart began to open its stores earlier to avoid violating any regulations. The response from consumers was positive resulting in increased business. Another barrier to Wal-Mart was the limitation placed on the number of sales it could have in a single year. According to German law, sales are only permitted during a uniform two-week period twice a year. Wal-Mart is looking forward to changing the laws in the German lower house to allow them to offer the two for one deal popular in the United States. The final barrier to Wal-Mart is the law concerning the German workforce. Article 2 of Convention 87 states that German workers have the right to organize. About 25 percent of Wal-Mart's 18,000 workers in Germany are organized in the union called the Uni Commerce affiliate ver.di (Vereinte Dienstleistungsgesellschaft). Wal-Mart traditionally rejects trade unions so they could keep wages and labor costs down. If however the company signs the collective agreement, stating that Wal-Mart workers can unionized, it will show the company cares about the improvement of the relationship with their workforce, equal opportunity, and non-discrimination.

Retailing is, by its nature, a dynamic industry. There have been an almost overwhelming number of changes during the past 50 years. Today's consumer will demand more for less from the shopping experience: more quality, choice, consistency, convenience, and service, for less money, time, effort, and risk. Another major factor in the changing consumer atmosphere is the changing German demographic. Due to the shrinking younger population, older consumers dominate the market. This will drastically affect Wal-Mart's marketing approach to the German people. Today

the German people are looking for more convenience and comfort. As life styles are becoming busier, the time devoted to household shopping and meal preparation is shrinking. Wal-Mart will have to adapt to these changes and offer a variety of healthy, prepared meals evidenced by the organic market increase 20 % from 2000 to 2001. Most importantly, however, consumers in the German market want to indulge themselves with small pleasures and personal rewards. Wal-Mart will have to continue to find new ways to keep the German consumer excited and interested in Wal-Mart's products.

WAL-MART STRATEGIC GOALS

To complete the advancement and domination of Wal-Mart in domestic and foreign markets, the company has outlined a four-point plan of marketing and logistical strategies. The first of these strategies is simply to dominate the retail market by positioning itself as a low cost leader in retail merchandising. Using its vast volume-buying resources Wal-Mart is in an enviable position to drive competition revenues down by offering its customers an immense variety of quality merchandise. Another important strategic objective of the Wal-Mart Company is to grow through US and International expansion. Wal-Mart has been a success in the US market and has now focused its resources on the expansion and growth of its stores in international markets. The international retailer currently operates in eight countries around the world. International success is derived from first buying out the industry leader in a particular company, thus eliminating its closest competition and gaining an easy entrance into the market through an established chain. After the takeover, Wal-Mart converts the stores, as well as the consumers, to Wal-Mart with quality products and dedication to customer satisfaction. An aggressive marketing campaign is then launched to expose the public to the Wal-Mart brand through television and other advertising mediums. Finally, Wal-Mart's focus is to offer the consumer more than retail merchandise. The company now offers its consumers a variety of services and goods ranging from pharmaceutical supplies to fully stocked grocery areas and countless other services to ensure that the consumer can fully participate in the one-stop-shop atmosphere that was the founding principle of Wal-Mart. (Staying on Top of the Fortune 500)

WAL-MART'S ATTRACTION TO INTERNATIONAL TRADE

International activities started in Mexico. Sam's Clubs were only the beginning. Soon to follow, Wal-Mart formed a joint venture with CIFRA, Mexico's largest retailer. After this successful introduction of the stores in a foreign market, Wal-Mart International decided to venture into Canada. The entry into the Canadian market was achieved by purchasing Woolco and its 122 stores. Subsequently, expansion continued into Latin America, particularly in the largest and most developed markets of Brazil and Argentina. (DSN Retailing Today: The Division that Defines the Future, 2003)

As of November 30, 1998, the International Division operated a total of 630 units in Argentina (13), Brazil (13), Canada (152), Germany (21), Mexico (410), and Puerto Rico (14). The Division also had joint venture agreements in China (3), and Korea (4). However, the Division has continued to grow extensively in 1999 with the purchase of 74 Interspar hypermarket stores, owned by the German Spar Handels AG, for $ 1.7 billion demonstrating their determination and commitment to international growth in the German market. This gave Wal-Mart a total of 95 stores in Germany. (walmartstores.com) The company went on to acquire 229 stores of the British Asda group, a supermarket chain (DSN Retailing Today: The Division that Defines the Future, 2003)

WAL-MART'S ENTRY INTO THE GERMAN MARKET

As in most of the countries around the world, the once popular mom-and-pop stores were rapidly losing ground to big retailers. Germany was no exception. Germans, who were once anxious to preserve the Old World traditions of small family-owned shops, could now be seen crowding into the stores of major supermarket chains. A major reason for the gain in popularity of supermarkets over village shopkeepers is, because of size, they can offer lower prices to the consumers. Wal-Mart recognized the change in German shopping behavior represented future opportunities for the company. Thus, they began searching for a way to enter the German market (Schmid, 2003a).

Acquisition of Wertkauf

When Wal-Mart Stores, Inc. announced in the beginning of 1998 its acquisition of 21 stores in the Wertkauf hypermarket chain from the *Mann* family of Germany; the impact was immediately felt on both sides of the Atlantic. (International Contact) For Wal-Mart, the deal allowed them to gain their foothold in the European market. For the Manns, it was evidence that their hard work had paid off. Through the years, the company had focused on establishing a strong reputation for providing quality service to its customers.

Although both parties agreed not to make the financial terms of the acquisition public, it is known that Wertkauf's annual sales are approximately DM 2.5 billion. (International Contact) According to *Bob Martin*, the company had been seeking the right opportunity to establish itself in Europe, and particularly in Germany, which is the single largest base for retailing on the continent followed by the United Kingdom and France. The one-stop shopping Wertkauf hypermarket stores sell what is described by Wal-Mart as a "broad assortment of high-quality general merchandise and food," and are similar in format to Wal-Mart Supercenters in the U.S. "Wertkauf matched the criteria necessary for the successful introduction of the Wal-Mart concept into the German market," offered *Martin*. "The 4,900 Wertkauf associates have provided quality service to German customers for many years and have built a strong reputation. They are the foundation of the business, and Wal-

Mart will count on them to help us earn the respect and confidence of the German people". (Die Zeit)

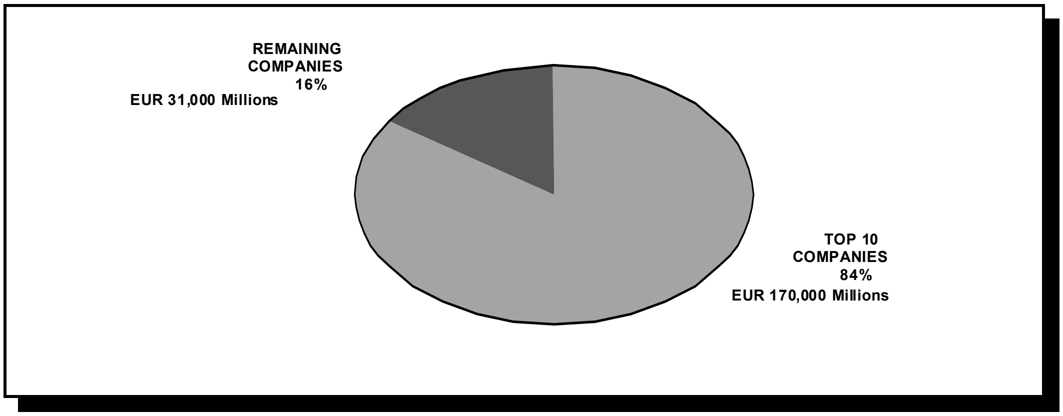
Acquisition of Interspar

Not even a year had passed when Wal-Mart announced a second acquisition in Germany. This time they had purchased 74 Interspar hypermarkets from Spar Handels AG. The deal was made public on December 9th 1998, and the purchase price was DM 1.1 billion. While the Wertkauf stores that were purchase the previous year are located primarily in southern Germany around Frankfurt, the Interspar stores could be found in metropolitan areas such as Hannover, Hamburg, Cologne, and Munich. The annual sales for the 74 stores are estimated to be DM 2.6 billion. (International Contact) As a result of the purchase of the Interspar chain, Wal-Mart's market share increased to 2.4% of the German retail market. Before the Interspar acquisition their market share was a mere 1.1 percent. This is small compared to three of Wal-Mart's German competitors, Rewe, Edeka and Aldi, who control more than half of market for food in Germany. (Status Quo)

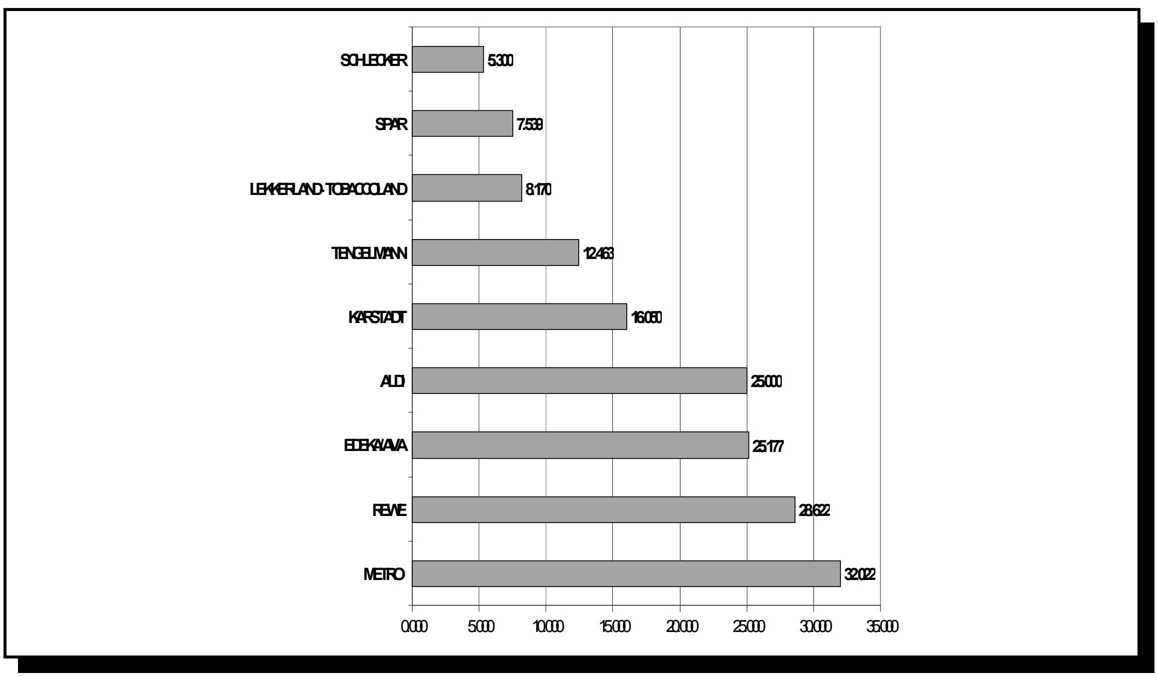
THE GERMAN FOOD RETAIL SECTOR

Germany has experienced low economic growth and this has led to relatively low growth rates in food prices in nominal terms and falling prices in real terms. On average, food prices increased by less than 1%. Despite a strong increase in employment and noticeable decline in unemployment, private consumption was disappointing, partly owing to high oil prices. Against this backdrop and, in part, reflecting it in the growth of discounters, price competition in food retailing has been very intense. The German food retailing market is not only highly advanced in terms of logistics, marketing, pricing and merchandising but is also one of the most concentrated in Europe. Germany's ten largest grocers dominate 84 % of the market with combined sales of EUR 170 billion. (Status Quo)

The top 30 players achieved combined sales of EUR 198 billion, thus capturing 98% of the national market. This means that the remaining 90 grocers account for only 2% of the national market or EUR 4 billion. (mm-eurodata.com) The German market has made considerable movement towards the "one-stop shopping" concept with several large multiple retail chains dominating to the detriment of the independent retailer. (Status Quo) German retail sales climbed a nominal 1.6 percent in 2002 (ananova.com), advancing from EUR 134 billion to EUR 201 billion. Adjusted for inflation, this represents an increase of 3.7 percent. (mm-eurodata.com) Having led a shift from the high street to out-of-town stores, the large retailers are now tackling the less profitable parts of the retail chain in order to increase their market dominance. This includes the opening of both convenience stores, in an effort to get a bigger slice of the local shopping basket sales, and a return to mid-size supermarkets in town centers. (Status Quo)



Total Turnover 2002 in German Retail Market (Euro Millions)



Top 10 German Retailers by Total Turnover 2002 (Euro Millions)

PROBLEMS AND SOLUTIONS

Wal-Mart has come across many differences in terms of business practices and cultures. These have presented barriers of varying degrees of difficulty and may be seen as being potential hurdles to be overcome, but they are not the same in the different countries that the company has entered. For example in the United Kingdom there has been a much simpler integration as the social culture and economic structure of the country is more similar to that of the United States. This was not the case when Wal-Mart decided to enter the German market. There were different ways in which the county's laws and culture impacted the company in terms of regulations, labor difference, and the German customer base.

German Regulations

There were many new laws and regulations concerning business that Wal-Mart had to conform to before successfully entering the market. These "barriers to entry" included transforming one of the founding Wal-Mart's principles of selling below cost, store operation regulations, and how business was conducted in terms of sales offered to the public. Adherence to German business regulations proved to be pivotal to the success of the company. (businessweek.com)

Selling below Cost

The German Federal Cartel Office ordered Wal-Mart to increase its price to meet German regulations. The sixth amendment of the Act against Restrictions of Competition (ARC), known as Gesetz gegen Wettbewerbsbeschraenkung or GWB, in Section 20 (4) 2 (bundeskartellamt.de), is a ban on undertakings with superior market power offering goods or services below their cost price unless there is an objective justification for this. The Cartel Office has carried out several preliminary investigations on the basis of this provision and has prohibited undertakings from selling below cost price in prohibition proceedings. The Cartel Office has also established principles for interpreting this provision in order to make its practice in this area transparent and to provide additional legal security for the undertakings concerned. In its decision of September 1, 2000, (Kartellverwaltungssache), the Cartel Office prohibited the Wal-Mart company from selling certain basic foods such as milk, butter, sugar, flour, rice and vegetable fat below their respective cost prices. The Cartel Office established that owing to their size, market share and resources, Wal-Mart has superior market power over the independent grocers that are the small and medium-sized competitors. Wal-Mart had been selling between five and ten items below cost price since the end of June 2000. The manufacturers' selling prices, as confirmed by the suppliers, including all the price reductions, discounts and other price-related terms relating to the items in question, were decisive factors in determining the cost prices. In this case, Wal-Mart was also not selling below cost price as their prices were meant from the very start to run over long periods and lasted for more than two months. Selling these products below cost cannot be objectively justified either. They were not perishable goods, and Wal-Mart cannot claim that it had matched their rivals' prices. Wal-Mart has not put forward any other reasons that could objectively justify their action. Wal-Mart took the lead by cutting prices in mid-June, not only legally undercutting the sales prices of its competitors but also illegally undercutting its own cost prices. (freshfields.com)

The Cartel Office will continue to maintain effective competition for the benefit of consumers. A precondition for this is the existence of competitive structures, which are not determined by market power alone. Small and medium-sized undertakings also have to face the challenge of competition. However, they must not be squeezed out of the market through unfair pricing strategies by large enterprises with superior market power if they would be able to operate efficiently under fair competition. In introducing the new Section 20 (4) 2 into the ARC, the lawmaker assumed that certain legal terms such as "cost price" would be defined in more detail through administrative practice and decision-making. In spite of the small number of proceedings carried out so far and a lack of court rulings in this respect, the Cartel Office has decided to start defining such terms by establishing principles for interpreting this provision, thereby at the same time contributing to greater legal clarity and security. In addition, the Cartel Office assumes that the preliminary effect of the principles of interpretation will be to combat unfair price-setting practices intended to squeeze competitors out of the market, independently of individual proceedings carried out by the Cartel Office. The principles of interpretation are tailored to the trade sector in accordance with the meaning and purpose of Section 20 (4) 2 of the ARC. In the manufacturing and service sectors the general rules on the abusive setting of prices through sales below cost price deriving from court decisions will continue to apply. The principles of interpretation establish that the Cartel Office includes all the price-effective conditions that arise from supply contracts in the cost price, taking the manufacturer's invoice price as its starting point. These include annual discounts but also product-related additional agreements concluded during the year. The Cartel Office assumes that all the conditions agreed between the supplier and the buyer in principle serve to sell the product and are thus product-related. In addition to directly-assignable deductions, such as cash discounts and rebates, further conditions may be considered, such as annual bonuses, allowances for advertising costs and sales promotion cost, even if these are contracted only for a particular product, temporary sales operations or particular distribution channels. This is intended to prevent any inappropriate manipulation of the selling price. The publication states that beginning to charge lower competitive prices may be a justification for sales below cost price. This does not apply, however, if the illegality of such competitive prices is evident or has been established by an authority or a court. The Cartel Office accepts as justification neither undercutting competitive prices nor "overshooting the euro" in the price reaction through covering an excessive regional area or going beyond the product group in question. This limitation prevents a downward price spiral as a result of unfair practices. Sales below cost price may be justified when an undertaking enters a market for the first time. However, when a firm changes hands or when a merger is involved this is not considered to be a "new entry". (bundeskartellamt.de/13 and bundeskartellamt.de/25)

Store Hours Regulations

German shopping hours are strictly regulated under Paragraph 3 of the BGBI (Bundesgesetzblatt, Band 1, Seite 875). No store is allowed to be open 24 hours a day, nor are they allowed to be open on Sundays in accord with Germany's Sabbath laws. On Saturdays, stores must close by 4 P.M. (bundesrecht.juris.de) Nonetheless, Wal-Mart has begun to open its stores earlier and thus has managed to avoid violating any regulations restricting stores from remaining open beyond a certain time of the day. Soon after Wal-Mart acquired the Wertkauf stores, it began to open at 7 A.M. This received excellent customer response and resulted in increased business. Most large retail stores in Germany open at 9 A.M. and close at 8.30 P.M. during the week. (Schmid, John)

Limitation of Sales

Also the limitation of sales has to be considered in the German market. Any type of sale, such as clearance or end of the season, is illegal in Germany except during uniform two-week periods twice a year. (Schmid, John) There has been a light at the end of the tunnel with the recent lightening of the competition laws there have been fears of the outbreak of a "price war". For a discount store such as Wal-Mart this may be seen as the signaling of an ability to compete in its traditional way, returning the core competencies of the company. Here it can be seen that with the German lower house changing laws, which have been in place since the 1930's, there will be the overturning of laws that have prevented the two-for-one offers that are popular in the United States, as well as taking away the seasonal limits that are placed on the special offers. This may ease the situation from Wal-Mart, but they still face many challenges to establish themselves and gain the market position they desire in Germany. (vz.nrw.de)

German Workforce

Additionally, Wal-Mart must face another major operating complexity with Germany's unionized workforce. About 25 percent of Wal-Mart's 18,000 workers in Germany are organized in Uni Commerce affiliate ver.di (Vereinte Dienstleistungsgesellschaft). (Wal-Mart in Deutschland) The labor unions in Germany are extremely powerful and managed regionally. Every region has a local chairperson whose negotiating powers include determination of working conditions and work schedules. (Verdi.de) Because the world's largest retailer is anti- Union in the United States, Wal-Mart has failed with any type of Union. Wal-Mart believed the Union will caused them to loose profit. When Wal-Mart came to Germany the Union hoped that Wal-Mart could adapt to the way they do business. Wal-Mart's approach was to reject trade unions so they could keep wages and labor costs down. By not being a member of the Union, Wal-Mart is not obligated to pay six weeks of vacation for employees who worked at least 15 hours a week, nor are they obligated to pay medical and social benefits. (union-network.org) For Wal-Mart to grow in Germany understanding collective bargaining and the regulations is a must. This is represented by the I.L.O (International Labor Organization). The I.L.O's declaration framework is based on these fundamental principles and rights in the workplace.

Fundamental Principles of the I.L.O

"**Principle 1** support and respect the protection of international human rights within their sphere of influence; and

Principle 2: make sure their own corporations are not complicit in human rights abuses.

Labor

Principle 3: freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labor;

Principle 5: the effective abolition of child labor; and

Principle 6: the elimination of discrimination in respect to employment and occupation.

Environment

Principle 7: support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies." (union-network.org/ p. 2)

Rights in the Workplace

Article 2 of Convention 87 defines the basic right for any worker to organize:

> "Workers and employers, without distinction whatsoever, shall have the right to establish and, subject only to the rules of the organization concerned, to join organizations of their own choosing without previous authorization."

In Article 11, the governments of member countries are given the obligation to ensure that the right to organize is respected:

> "Each Member of the International Labor Organization for which this Convention is in force undertakes to take all necessary and appropriate measures to ensure that workers and employers may exercise freely the right to organize."

Convention 98 gives further support for the right to organize by forbidding employers to interfere: Article 2 states:

1. Workers' and employers' organizations shall enjoy adequate protection against any acts of interference by each other or each other's agents or members in their establishment, functioning or administration.
2. In particular, acts which are designed to promote the establishment of workers' organizations under the domination of employers or employers' organizations, or to support workers' organizations by financial or other means, with the object of placing such organizations under the control of employers or employers' organizations, shall be deemed to constitute acts of interference within the meaning of this Article." (union-network.org/ p. 5)

This framework will give everyone an opportunity to grow. If Wal-Mart signs the collective agreement for commerce it will show that the company cares about the improvement of the relationship with their workforce and the respect of equal opportunity, and non-discrimination, health and the environment. This will enhance Wal-Mart's relationship with the community and society in Germany, as well as in other countries. (union-network.org)

Understanding the Consumer Trends

Retailing is, by its nature, a dynamic industry. We have seen an almost overwhelming number of changes during the past 50 years, from the satisfaction of the basic needs to a “multi-optional” consumer. Every decade in the last 50 years was concerned with a different attitude and, therefore, faced with a different consumer pattern. In the 50’s the only concern of the consumers were the satisfaction of the basic needs. Because of the Second World War there was a tremendous backlog on supply and demand. Therefore, the 60’s and 70’s became a time for economic growth and high consumption. The so-called “affluent society” was born. The consumer of the 80’s and 90’s looked for the pursuit of pleasure and the principle of everything that is good in life. This new consumer type is also called “hybrid customer”. Consumers’ expectations are getting higher. Today’s consumer will demand more for less from the shopping experience: more quality, choice, consistency, convenience, and service, for less money, time, effort, and risk. If anything, the forces of change are picking up speed. Doing business in the future will be markedly different from doing business in the past. The next ten years will undoubtedly hold even more changes than the last decade. Therefore, Wal-Mart has to understand the trend of the German consumers and meet their prospective to survive and prosper in the future. (Status Quo p. 23 ff)

A Changing Population

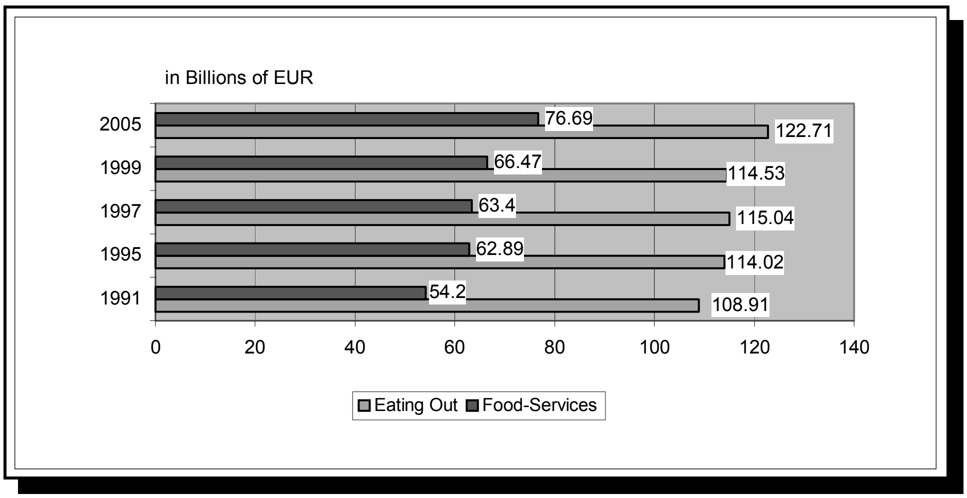
One of the factors Wal-Mart must study is the demographics. The changing of the population is one of the major factors in understanding the consumer. Germany is faced with the oldest changes by a society in peacetime. Due to the fact that the younger population is shrinking and the older population is increasing. This shift in age composition is dramatic, unprecedented, and caused by a sharp decline in births some years ago, and it has dramatic implications for Wal-Mart. (Status Quo p. 8)

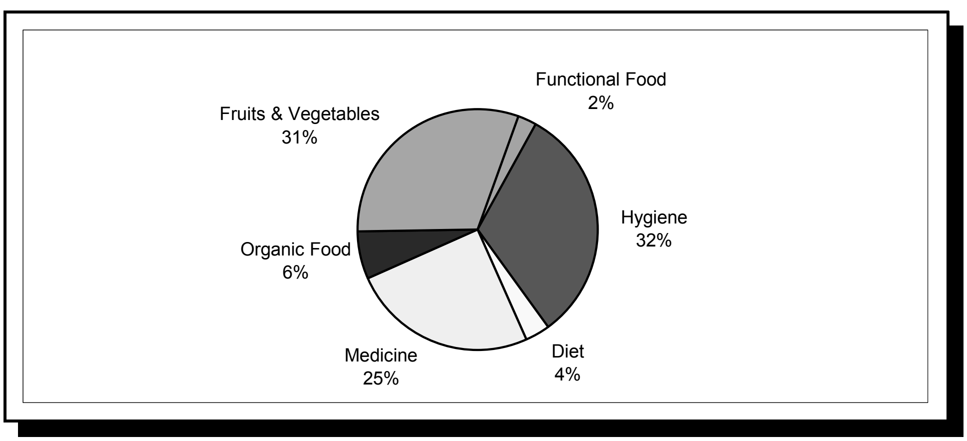
There has been a dramatic decline for items such as toys, games, and some segments of the apparel and footwear market. Therefore Wal-Mart can reconfigure the usage of space in their stores and also concentrate on less youth-oriented, less style-oriented, and more practical marketing campaigns. The middle age population will have a need for such products as cosmetics, skin care, hair coloring, and other youth-inducing products. Also the sales of leisure and entertainment products will rise. The older population will put emphasis on improving the quality of homes in which they plan to retire. Furthermore, the number of households in Germany will rise considerably, even with a shrinking growth of population. That is because the number of people living alone will increase substantially, as people marry later. (Status Quo p. 8)

A Changing Consumer Lifestyle

Another major change Wal-Mart has to consider in order to meet customer needs is the changing consumer lifestyle, which in turn is affecting the consumer behavior. In a time-constrained world, consumers are looking for more convenience and comfort. Lifestyles are busy and getting busier. The time devoted to household shopping and meal preparation is shrinking. For example, the preparation for a warm meal had declined from 30 minutes in 1974 to just 5 minutes in 2000. The German population is changing their eating habits, from cooking in the house to more service-oriented meals. In the last years the money being spent away from home has risen dramatically and will continue to climb, as is evident from the following chart. (Status Quo p. 25)

Consumers will become increasingly reliant on immediate consumption options. Many households will no longer shop only once a week. Their planning horizon will be a meal at a time. They will replace the regular, weekly, shopping trip with shorter, more frequent, fill-in shopping forays. They will eat out, take out, and buy prepared food more often. Therefore, convenience to the consumer is best described as easy-to-buy, easy-to-select, easy-to-decide, easy-to-prepare, and easy-to-locate. Additionally, wellness is another key word of the new consumer trend. Healthy eating is a growing trait, as is the popularity of organic and functional food. Sales of health and beauty aids are growing in double digits. Also nutrient and organic products are increasing in demand. With the recent academic "mad cow disease" (MKS), the demand of organic food has further increased. The current organic market is worth 3.83 billion Euros and reached a growth rate of 20% in only one year, being between the years of 2000 to 2001. Also, functional products are increasing in popularity. Functional food has an added ingredient that supports one or more of your body's function. Forecasters have seen the world-market change from 30.68 billion Euros in 1998 to 51.13 billion Euro in 2004, which indicates a market growth of 62 percent. (Status Quo p. 26)





Market Volume for Food-Services and Eating-Out Consumer

The new consumer also likes to indulge themselves with small pleasures and personal rewards. They are looking for something that makes them feels good and appreciated. All of the above attitudinal trends will influence shoppers as they enter the store. Therefore, for Wal-Mart to be successful in Germany they need to stay focused on the customer, as indicated earlier, with the realization of new consumer trends. Wal-Mart continually has to change in order to meet customer needs. This shows that the consumer wants more comfort, convenience, wellness and indulgences. First of all Wal-Mart has to rethink the way their merchandise is offered to the customer. They need to be more innovative with each and every store and the consumer buying behavior within a given store. Making the store more personal, with every item within the store more relevant to the consumer. This will have an exponential impact on the merchandise assortment in the store. Due to the increasing demand of convenience, Wal-Mart must focus on adding value to the food shopping experience by offering busy consumers meal solutions that will sell the meal not the ingredients. (Status Quo p. 25) This will shift space allocation away from commodity packaged goods aisles toward a larger section of fresh, fresh prepared, takeout, and eat-in options. Therefore the consumer will be able to shop for their needs and not have to wander through the store on a "discovery mission" to find items they want to buy.

In addition to being more convenient to the consumer, Wal-Mart has to do a better job in grouping products together. The most important element of affinity merchandising is grouping together products that solve a customer's need, regardless of who owns that category. Understanding and merchandising to this exploding consumer need will be a very profitable strategy for Wal-Mart in the future.

Wellness is one of the other growing assortment trends. As seen earlier, wellness comes in many categories. One of the wellness categories is focused on "getting well" and "staying well" is yet another. Wal-Mart will have to increase the space they dedicate to products that will make sick consumers feel better, and healthy consumers feel great. Also, selling health and body maintenance will reset Wal-Mart in the traditional health and beauty, vitamins and nutritional categories.

In addition, consumer indulgence is one of the dominant traits that Wal-Mart must address in the future, because of the increasing population of "boomers". This consumer class believes it deserves the "niceties life has to offer." They're not looking for toilet paper and dishwashing soap. To meet the consumer needs this also means that Wal-Mart must provide a broader section of unique products such as special perfumes, relaxation equipment, cosmetics, plus thousands of other items that meet the fancy of impulsive consumers.

CONCLUSION

Wal-Mart is the largest retail store in the United States with 4,414 retail facilities globally. The company's relationship with its customers, as well as its employees, is highly stressed. The company maintains Sam Walton's philosophy that the customer is always right. Upon entering the

German market, Wal-Mart has been faced with great difficulty. The primary problems that the company has had to attempt to overcome are heavy legislation and limited space. While dealing with these obstacles however, Wal-Mart has continued to maintain its consistency in terms of its strategy of its fundamental retail concept, and its goal to get worldwide customers to recognize Wal-Mart in association with these concepts. Always the low prices and satisfaction are guaranteed.

Wal-Mart stands for low prices, and the price still drives the majority of consumer buying decisions. However, with the time pressures and the continued complexity of life decisions, price-based value equations are beginning to be questioned in the eyes and mind of the consumer. Consumers are beginning to look for convenience as the new value equation and are willing to pay for it. The reality is that consumers always did and always will want a bargain, but the good price at Wal-Mart will have to be accompanied, as indicated earlier, with convenience and simplicity. These concepts are solutions that are all significantly new in driving consumers reasons for shopping one retailer over another.

The problems of Wal-Mart in Germany can be seen as wide-ranging. Some solutions to consider include the need for the company to implement their strategy in the best possible way, especially in regards to public relations. Many Germans see Wal-Mart as a bully and a tyrant. Therefore, Wal-Mart has to adopt a friendlier corporate attitude among the German public. If Wal-Mart changes its image, it will not only remain the largest retail chain in the world, it could become one of the most popular stores in history.

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CONSUMERISM: STATISTICAL ESTIMATION OF NIGERIA MEAT DEMAND

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ABSTRACT

This study estimates the responsiveness of demand for meat to variations in prices and incomes on the basis of food demand data for the time period between 1980 to 2002 using an Almost Ideal Demand System (AIDS) model. These findings are reasonable given the position that beef holds as the dominant and traditional meat in Nigeria. These elasticities also imply that beef and chicken are luxury goods, while other fish and demersal fish are normal goods for Nigeria households consistent with the findings of previous studies. With the exception of some cross-price elasticities, the majority of the price elasticities exhibit the expected signs and magnitudes. This indicates that demand for beef and other meat in Nigeria is very price elastic. In general, the results suggest that own-prices as well as incomes are the predominant factors determining consumer choice and meat consumption patterns in Nigeria rather than relative prices.

INTRODUCTION

Before the 1970's oil boom, agricultural exports were the backbone of the Nigerian economy with livestock products accounting for a significant share of exports. During this period, the country had a well-developed domestic agricultural market. However, despite this sound potential for growth in the domestic market, Nigeria is currently witnessing a drastic decline in agricultural production, especially in livestock and meat sectors of the industry. This decline in agricultural production coincides with the nation's oil boom.

Furthermore, Nigeria has enjoyed yearly economic growth (GDP) of 10.8 percent in real terms between 1980 and 1987 as a result of export earnings from petroleum. Real per capita income rose at 60 percent per year during this period. However, the decline in the world oil prices experienced in 1987, combined with the reduction in world market prices of agricultural products in 1995 brought an end to country's economics growth and real per capita income. Between 1989 and 1997 real per capita income dropped at a rate of 7.8 percent per year.

During this period, the federal government of Nigeria maintained a trade policy dominated by quantitative restrictions and price controls on food items. In January 1990, a tax was imposed on meat imports, ostensibly to raise government revenues and stimulate domestic meat production. The abrupt drop in meat imports, coupled with inadequate domestic supply pushed up price of meat and thus depressed domestic demand. For example, per capita meat consumption that had risen from 12.05 kg in 1981 to 13.8 kg in 1986 dropped to 11.6 kg in 1992. Also meat prices rose by 70 percent from 1987 to 1999, resulting in a decline in Nigerian per capita meat consumption from 10.5 kilograms of meat per year in 1987 to 9.4 kilograms per year in 1999 (*FGS*, 1999)[1]. Although the federal government of Nigeria has designed various programs to help stabilize meat prices and consumption, the country is still experiencing meat shortage and price fluctuations.

The purpose of this study is to understand the source of the change and fluctuation in meat consumption in Nigeria. In order to determine the cost or likely success of the various government programs, this research paper will examine the responsiveness of demand for meat to variations in prices and incomes on the basis of food demand data for the time period between 1980 to 1999. Additionally, it will also assist in formulating recommendations for policies with the potential to create more stable meat consumption and prices for the nation. In order to understand the source of the decline and instability in consumption and to determine whether the shock is from changing incomes or from changing prices, this paper will determine whether demand for meat is price-elastic on the basis of food demand data during the time period studied from 1980-2001.

World demand for meat has risen sharply during the last few decades. The key reasons for these increases in meat demand are increasing population, improving technology and increasing incomes. However, despite this overall improvement in technologies and incomes, per capita consumption of meat has lagged especially in the less-developed countries of the world because protein is the most costly food item.

The early empirical studies of demand were characterized by the extensive use of single equation methods centered on the measurement of elasticities since they are easily understood and conveniently dimensionless. Hence, demand could be directly measured as the parameters of a regression equation linear in the logarithms of purchase, outlay and prices.

Agricultural economists have long been interested in the proper measurement and interpretation of elasticities and flexibilities among endogenous variables in systems of simultaneous equations. Elasticities are vital parameters in developing models for policy analysis, have been used in applied models frequently based on subjective judgment, but not supported by quantitative and empirical evidence (Mdafri and Brorsen, 1993). Adegeye (1988) estimated price elasticities of demand for beef, poultry, and fish products, such as freshwater fish. Unfortunately, he adopted provincial elasticities and failed to aggregate based on the most recent policy analysis. It is well known that partial measures, commonly used in a single-equation context are not valid for obtaining elasticities among endogenous variables in a system framework because indirect effects are not accounted for by standard partial measures. This applies to elasticities with respect to exogenous variables but does not apply to structural elasticities.

THE ALMOST IDEAL DEMAND SYSTEM

Following the important paper by Diewert (1971), several demand system estimation models, known as "flexible functional form", have been developed. The basic method is to approximate the direct utility function, indirect utility function or the cost function by some specific functional form. One of these approaches is Christensen et al's (1975) indirect translog model

$$U = \alpha_0 + \sum \alpha_k \log(P_k / X) + \tfrac{1}{2} \sum_k \sum_j \beta_{kj} \log(P_k / X) \log(P_j / X), \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(1)}$$

where k, j are goods. The demand function from equation (1) is complicated and clumsy to estimate while the direct translog model is usually estimated under the practically nonsensical assumption that, for all goods, prices are determined by quantities rather than the other way round.

Deaton and Muellbauer (1980) started not from an arbitrary preference ordering, but from a specific class of preferences, by which the theorems of Muellbauer (1975, 1976) permit exact aggregation over consumers: the representation of market demands as if they were the outcome of decisions by a rational representative consumer. They proposed that the cost or expenditure function, which defines the minimum expenditure necessary to attain a specific utility level, can be used to represent consumer preferences, known as the price-generalized logarithmic (PIGLOG) class,

$$\log c(u, P) = (1 - u) \log\{a(p)\} + \log\{b(P)\}. \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(2)}$$

With some exceptions, u lies between 0 (subsistence) and 1 (bliss) so that the positive linearly homogeneous function $a(P)$ and $b(P)$ can be regarded as the costs of subsistence and bliss, respectively. Next they take specific functional forms for log $a(P)$ and log $b(P)$

$$\log a(P) = \alpha_0 + \sum \alpha_k \log P_k + \tfrac{1}{2} \sum_k \sum_j \gamma^{*}_{kj} \log P_k \log P_j, \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(3)}$$

$$\log b(P) = \log a(P) + \beta_0 \prod_k P_k^{\beta_k} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(4)}$$

After the selection of a specific functional form, the cost function in the AIDS model can be written as

$$\log c(u, P) = \alpha_0 + \sum \alpha_k \log P_k + \tfrac{1}{2} \sum_k \sum_j \gamma^{*}_{kj} \log P_k \log P_j + \beta_0 \prod_k P_k^{\beta_k} \quad \ldots\ldots \text{(5)}$$

The demand functions can be derived directly from equation (2). It is a fundamental property of the cost function that its price derivatives are the quantities demanded $\partial c(u, P)/\partial P_i = q_i$: Multiplying both sides by $P_i/c(u,P)$ we find:

$$\frac{\partial \log c(u,P)}{\partial \log P_i} = \frac{p_i q_i}{c(u,P)} = w_i, \quad \ldots\ldots (6)$$

where w_i is the budget share of good i. Hence, logarithmic differentiation of equation (5) gives the budget shares as a function of prices and utility,

$$w_i = \alpha_0 + \sum_j \gamma_{ij} \log P_j + \beta_i u \beta_0 \prod_k P_k^{\beta_k}, \quad \ldots\ldots (7)$$

where

$$\gamma_{ij} = \tfrac{1}{2}\left(\gamma_{ij}^{*} + \gamma_{ji}^{*}\right), \quad \ldots\ldots (8)$$

for a utility-maximizing consumer, total expenditure X is equal to $c(u, P)$ and this equality can be inverted to give u as a function of P and X, the indirect utility function. Solving equation (5) and (7) and eliminating u, we obtain the budget shares as a function of P and X. These are AIDS demand functions in budget share form:

$$w_i = \alpha_i + \sum_j \gamma_{ij} \log P_j + \beta_i \log\{X/P\}, \quad \ldots\ldots (9)$$

where w_i is the expenditure share of commodity i, P_j is the commodity price, X is the total expenditure of the selected goods, and P is overall price index, which is defined by

$$\log P = \alpha_0 + \sum_k \alpha_k \log P_k + \tfrac{1}{2} \sum_k \sum_j \gamma_{kj} \log P_k \log P_j, \quad \ldots\ldots (10)$$

By taking three sets of restrictions on the parameters of the AIDS equation (7),

$$\sum_{i=1}^{n} \alpha_i = 1, \quad \sum_{i=1}^{n} \gamma_{ij} = 0, \quad \sum_{i=1}^{n} \beta_i = 0, \quad \sum \gamma_{ij} = 0, \quad \gamma_{ij} = \gamma_{ji}. \quad \ldots\ldots (11)$$

Provided equation (11) holds, equation (9) represents a system of demand functions which add up to total expenditure $\sum w_i = 1$ are homogenous of degree zero in prices and total expenditure taken together, which satisfy Slutsky symmetry. When there is no change in relative price and X/P the budget shares are constants. Changes in relative prices take effect through γ_{ij}. Changes in expenditure operate through the β_i coefficients, which are summed to zero and are positive for luxuries and negative for necessities (Deaton and Muellbauer, 1980).

An important feature of the AIDS model is that the expenditure levels are allowed to impact the distribution of shares. It is of flexible functional form, allowing testing of theoretical restrictions on demand equations. The AIDS model in share form for a group of n commodities can be written as

$$w_i = \alpha_i + \sum_j \gamma_{ij} \ln P_j + \beta_i \ln(X/P), \qquad i = 1, 2, \ldots, n \ldots\ldots\ldots\ldots\ldots (12)$$

where w_i is market share, X is total expenditure, $i = j$, is the number of products in the demand system, and P_j is the price of product j in the system. α_i, γ_{ij}, and β_i are parameters. $\ln P$ is defined as:

$$\log P = \alpha_0 + \sum_k \alpha_k \ln P_k + \tfrac{1}{2} \sum_k \sum_j \gamma_{kj} \ln P_k \ln P_j . \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (13)$$

In practice, equation (12) is difficult to estimate because of its nonlinearity. A common alternative is to estimate a linear approximation version of the AIDS model. That is, instead of estimating the complete AIDS model in equation (12), its linear approximation is employed by replacing $\ln P$ with $\ln P^*$, where $\ln P^*$ is the Stone's Index defined as:

$$\ln P = \sum_i w_i \ln P_i, \qquad i = 1, 2, \ldots, n. \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (14)$$

therefore, (13) becomes:

$$w_i = \alpha_i + \sum_j \gamma_{ij} \ln P_j + \beta_i \ln\{X/P\}. \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (15)$$

Marshallian and Hicksian measures of elasticities may be computed from the estimated coefficients of the AIDS model as follows:

$$\varepsilon_{ii} = -1 + \gamma_{ij} / w_i - \beta_i , \ldots\ldots\ldots\ldots\ldots\ldots \text{(16)}$$

$$\varepsilon_{ij} = \gamma_{ij} / w_i - \beta_i \left(w_j / w_i \right), \ldots\ldots\ldots\ldots\ldots\ldots \text{(17)}$$

$$s_{ii} = -1 + \gamma_{ii} / w_i + w_i , \ldots\ldots\ldots\ldots\ldots\ldots \text{(18)}$$

$$s_{ij} = \gamma_{ij} / w_i + w_j , \ldots\ldots\ldots\ldots\ldots\ldots \text{(19)}$$

where ε and s denote Marshallian and Hicksian elasticities respectively. The expenditure elasticities can be obtained from the estimated coefficients as well:

$$\eta_i = 1 + \beta_i / w_i \ . \ldots\ldots\ldots\ldots\ldots\ldots \text{(20)}$$

In the case of Nigeria, the meat demand system to be estimated includes beef, pork, chicken, and fish. Furthermore, time trends in a more appropriate manner would be incorporated into the model more appropriately by interacting each variable in the model with time period variable (Pollak and Wales, 1981).

DATA ESTIMATION AND PROCEDURE

Very few demand meat estimates have been obtained for Nigeria, the earliest dating back to 1965. One reason is the absence of adequate data in terms of both quality and duration of the time period covered. The official source of data on meat and fish in Nigeria is the Statistics Division of the Ministry of Livestock, Fisheries and Animal Industrial, which publishes information on herd inventories and livestock slaughtered numbers. Divisional data are aggregated first into provincial and then national data, and later reported by Nigeria Federal office of Statistics, Economic and Social Statistics in Lagos. Data were obtained from the Nigeria Federal Office of Statistics, Economic and Social Statistics (Lagos: FOS, various years) and the Central Bank of Nigeria. The data are Nigerian time series data on meats and fish categories from 1980 to 2002. The price data are in index form and are constructed so that 1990 = 100 (Base year).

All prices are the retail level and all quantities are per capita and based on retail cuts. Disposable income per capita will be used in the estimation to determine the income effect on meat consumption. Time series data were obtained for meat consumption of meats (demand for all meats), the price level (price index), disposable income per capita, and expenditures on meat products.

RESULTS AND ANALYSIS OF THE AIDS FOR NIGERIA MEAT DEMAND SYSTEMS

Parameter estimates for Nigeria meat demand system were obtained using the Deaton-Muellbauer iterative procedure. Most of the parameter estimates were significant at the 10 and 15 percent level of significance (Table 1.1). The principal goal of the study, however, was to estimate Nigerian demand elasticities for beef, chicken, demersal fish, and freshwater fish and analyze the effects of expenditures on household meat consumption behavior in Nigerian. Thus, the Marshallian and Hicksian elasticities are reported in Table 1.2 and Table 1.3 respectively with all expenditure elasticities having positive signs as expected. However, the magnitudes of these elasticities are different for the six commodities. The expenditure elasticities for chicken, freshwater fish, and demersal fish are greater than one, implying that they are luxury goods. However, demersal fish has the greatest expenditure elasticity of 2.389 compared with other meat products. This suggests that demand for demersal fish would increase greatly when per capita expenditure rises. The magnitudes of expenditure elasticities for beef and other meat are similar, although they are relatively lower compared to those of demersal fish and freshwater fish. These findings are reasonable given the position that beef holds as the dominant and traditional meat in the diet for most Nigerians. These elasticities also imply that beef and chicken are luxury goods, while other fish and demersal fish are normal goods for Nigeria households consistent with the findings of previous studies.

With the exception of some cross-price elasticities, the majority of the price elasticities exhibit the expected signs and magnitudes. Uncompensated own-price elasticities presented in Table 1.2 have negative signs in accordance with economic theory. However, the magnitudes of own-price elasticities of demand vary for different types of meat. Own-price elasticities for beef are much higher than those for other meats and less than one. This indicates that demand for beef and other meat Nigeria is very price elastic.

The magnitudes of own-price elasticities for beef and chicken meat consumption are between -0.224 and -0.118 respectively for the Marshallian elasticities illustrated in Table 1.2 and –1.632 and –0.411 for Hicksian elasticities illustrated in Table 1.3. Furthermore, some of the cross-price elasticities have negative signs, but the magnitudes are very small. In general, the results suggest that own-prices as well as incomes are the predominant factors determining consumer choice and meat consumption patterns in Nigeria rather than relative prices.

The results of this estimation broadly coincide within the range of income elasticities (0.57 - 1.0) and price elasticities (0.34 - 1.04) in South Korea and Japan from previous studies such as Hayes et al., (1990) and Hayes et al. (1991). The Hayes et al. studies were based on 1961-1987 and 1947-1978 average data in South Korea and Japan respectively and also employed an LA/AIDS model. Therefore, it appears that meat demand and consumption in Nigeria in the past decade may, in part, be comparable to that in South Korea and Japan during 1960s and 1970s.

CONCLUSION

Nigeria is not only one of the largest meat producing countries in Africa but also one of the largest meat consumers in this region of the world. The empirical results of this study suggest several points of interest for researchers, policy makers, planners and traders with involvement in Nigerian food production and marketing. First, expenditure elasticities for demersal fish and freshwater fish are highly elastic suggesting that Nigeria households will consume more demersal fish and freshwater fish as incomes increase. In terms of beef, the expenditure elasticity is also highly elastic, implying that Nigeria consumers with low incomes will increase their consumption of beef as their incomes rise. Second, own-price elasticities of all meat items are fairly elastic. This suggests that any changes in meat prices could bring about a significant shift in meat consumption patterns. Third, given the emergence of large unemployment in Nigeria, a major challenge confronting the government is how to design appropriate policies for the relative enhancement of low-income groups. Identifying elasticities for different income groups would enable Nigerian decision-makers to gauge more precisely the impact of their policies on various income groups, and more effectively design policies targeted at low-income groups.

The strength of this study relative to previous meat demand studies in Nigeria and other West African countries is the use of observations pertaining to expenditure share rather than average income estimates for the population as a whole. Further partitioning of income groups with time series data of greater duration and incorporating socio-demographic variables would enhance the accuracy of results. Caution should be taken, however, when interpreting those empirical results because the statistical information on consumption data in Nigeria is rather scarce, incomplete and controversial. The described data problems limit strong interpretation of empirical findings. Nevertheless, this study opens up discussion on the important issue of consumption patterns for different meat and fish products in Nigeria. Further studies will enhance the potency of these preliminary findings.

Table 1. 0: Comparison of Price and Income Elasticities for Beef in Nigeria, by Various Authors

Author	Product	Type of Model	Price	Income
Adegeye (1988)	Beef	Linear Log-linear	-2.367 -2.675	0.470 0.457
Tambi (1991)	Beef	3SLS	-0.411	0.596
Present Study	Beef	Double-log	-0.118	0.327b

[a] Three-stage least squares. [b] Expenditure elasticity.

Table 1. 1: Parameter Estimates For Nigeria Meat and Fish Demand System Using an Almost Ideal Demand System Model, 1980-2002

Dependent Variables
(The budget share of per capita wheat import of:)

Independent Variables	Beef	Chicken	Other Meat	Demersal Fish	Freshwater Fish	Other Fish	Expenditure	R^2
Beef	0.163** (0.048)	-0.1704** (0.031)	0.062** (0.001)	-0.050** (0.001)	-0.057* (0.014)	0.080** (0.010)	0.143* (0.041)	0.91
Chicken	-0.111* (0.023)	0.133* (0.022)	0.084* (0.050)	0.133* (0.022)	-0.042* (0.031)	-0.079* (0.004)	0.025* (0.009)	0.842
Other Meat	0.007** (0.001)	-0.112* (0.010)	0.081* (0.009)	-0.023** (0.001)	-0.024** (0.001)	0.029 (0.003)	0.021* (0.005)	0.851
Demersal Fish	0.007* (0.001)	-0.005** (0.011)	-0.062* (0.019)	0.050* (0.015)	-0.057* (0.007)	0.077** (0.004)	0.262** (0.018)	0.956
Freshwater Fish	0.163* (0.018)	-0.171* (0.032)	0.012** (0.008)	-0.036* (0.001)	-0.422* (0.012)	0.072* (0.005)	0.143** (0.019)	0.947
Other Fish	0.007* (0.001)	-0.480* (0.029)	0.062** (0.011)	-0.006* (0.001)	-0.011* (0.002)	0.047* (0.009)	0.016** (0.007)	0.957

Note: The numbers in parenthesis are standard errors.
Single (*) and double asterisks (**) denote significance at the 15% and 10% level, respectively.

Table 1. 2: Marshallian Elasticities for Meat and Fish in Nigeria Using an Almost Ideal Demand System, 1980-2002

Commodity	Beef	Chicken	Other Meat	Demersal Fish	Freshwater Fish	Other Fish	Expenditure
Beef	-0.224** (0.061)	-0.093** (0.051)	-0.112** (0.006)	0.213** (0.021)	-0.911** (0.083)	0.388** (0.019)	1.255** (0.079)
Chicken	-0.189* (0.089)	-0.118* (0.081)	-0.103** (0.041)	-0.342* (0.037)	-0.623** (0.117)	0.102* (0.021)	0.407* (0.014)
Other Meat	-0.111** (0.008)	-0.814* (0.102)	-0.069* (0.013)	-0.012** (0.001)	-0.581** (0.011)	0.671** (0.087)	0.793** (0.084)
Demersal Fish	-0.295** (0.016)	0.413* (0.052)	-0.151* (0.032)	-0.438* (0.046)	0.924* (0.163)	-0.734* (0.053)	1.569* (0.051)
Freshwater Fish	0.126* (0.071)	-0.452 (0.097)	-0.173* (0.011)	-0.011* (0.045)	-0.163** (0.105)	0.181* (0.075)	0.235* (0.011)
Other Fish	-0.071** (0.003)	-0.032* (0.001)	0.525** (0.086)	-0.219** (0.015)	-0.201** (0.041)	-0.419* (0.021)	0.141* (0.091)

Note: The numbers in parenthesis are standard errors.
Single (*) and double asterisks (**) denote significance at the 15% and 10% level, respectively

Table 1. 3: Hicksian Elasticities for Meat and Fish in Nigeria Using an Almost Ideal Demand System, 1980-2002

Commodity	Beef	Chicken	Other Meat	Demersal Fish	Freshwater Fish	Other Fish
Beef	-1.632** (0.012)	-0.233* (0.011)	0.151** (0.023)	0.421** (0.062)	-0.891** (0.025)	0.087* (0.001)
Chicken	-0.221* (0.062)	-0.411** (0.047)	0.201* (0.019)	-0.178* (0.015)	-0.941* (0.054)	-0.911* (0.013)
Other Meat	0.241* (0.010)	-0.341** (0.107)	-0.012** (0.005)	-0.116* (0.011)	-0.321* (0.017)	-0.221** (0.042)
Demersal Fish	-0.192** (0.022)	0.821** (0.016)	-0.215** (0.021)	-0.321* (0.061)	0.054 (0.001)	-0.307* (0.001)
Freshwater Fish	0.121* (0.011)	-0.106* (0.021)	-0.271* (0.001)	-0.117* (0.064)	-0.551* (0.003)	0.052** (0.001)
Other Fish	-0.090* (0.001)	-0.161* (0.011)	0.511** (0.026)	-0.371* (0.001)	-0.851** (0.073)	-0.101** (0.091)

Note: The numbers in parenthesis are standard errors.
Single (*) and double asterisks (**) denote significance at the 15% and 10% level, respectively.

ENDNOTES

[1] Nigeria, Federal Office of Statistics. *Economic and Social Statistics Bulletins* (Special Series) (January 1999).

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POWER DISTANCE AND INDIVIDUALISM AS CULTURAL DETERMINANTS OF ETHICAL JUDGMENTS

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ABSTRACT

The effects of power distance and individualism on perceptions of ethical intention were examined using data from New Zealand European and Malaysian Chinese commerce students. The aim was to assess the attitudes of these commerce students towards ethical problems presented in a set of business scenarios. Ethical judgments of both samples were not found to differ significantly across four of the five ethical dilemmas tested. However, New Zealand students considered environmental protection a significantly more important issue than their Chinese counterparts did. Results of the study raise concerns with regard to the interpretation of past findings involving different nationalities and ethnic groups, and argue for the inclusion of other independent measures to assess the cultural characteristics of these samples. Possible problems with the use of Hofstede's (1980) cultural typology are also identified and discussed.

INTRODUCTION

Today's university students will be tomorrow's business managers. As such, they will have a profound impact on both the everyday practice of and the principles governing business. Recognition of this truth by scholars may explain, in part, the proliferation of research regarding the ethical development of university students in general, and business students in particular, over the past 15-20 years. For example, Borkowski and Ugras (1998) uncovered 56 empirical studies concerning the ethical behavior of U.S. business students to include in their meta-analysis – and their review of the literature was restricted to the ten-year period of 1985-1994.

More recently, the increasing globalization of business has inspired a number of cross-cultural studies that have examined the ethical beliefs and decision making of business students in different cultures (e.g., Davis, Johnson, & Ohmer, 1998; Grunbaum, 1997; Nyaw & Ng, 1994; Priem, Worrell, Walters, & Coalter, 1998). Some studies have found meaningful cultural effects. Swinyard, DeLong, and Cheng (1989), for example, found noteworthy differences between the moral decision-making of U.S. and Singaporean business students. More recently, Brody, Coulter, and Mihalek (1998) found significant differences between the ethical perceptions of U.S. and Japanese accounting students to whistle-blowing. Since the subjects had yet to receive any formal workplace training, the authors concluded that the observed differences in ethical perceptions were due to cultural differences.

Other studies, however, do not support the view that culture influences ethical beliefs and decision making. For example, Preble and Reichel (1988), in their study of Israeli and U.S. management students' attitudes towards business ethics, found both groups held relatively high moral standards. More recently, Allmon, Chen, Pritchett, and Forest (1997) found significant agreement with the way Australian, Taiwanese and U.S. students perceive ethical/unethical behavior, suggesting a universality of business ethical perceptions.

Attention has also been given to cross-cultural aspects of ethical standards. Theorists have long suggested that countries with different cultures and values have different perceptions as to what constitutes ethical or unethical behavior (Ferrell & Gresham, 1985; Hunt & Vitell, 1986; Bartels, 1967; McClelland, 1961; England, 1975). However, cross-cultural studies that have examined the ethical standards of business students in different cultures have yielded conflicting results. While some researchers do find ethical standards to vary significantly across different cultures (Tsalikis & LaTour, 1995; Tsalikis & Nwachukwu, 1991; White & Rhodeback, 1992), others have found little disparity (Lysonski & Gaidis, 1991; Whipple & Swords, 1992).

Typically, researchers have relied on nationality as a surrogate for culture, rather than explore more detailed cultural characteristics of respondents in trying to account for differences/similarities in ethical beliefs (McDonald, 2000). A nation (i.e., a people inhabiting a country under the same government), however, may contain several cultures. In the Asia Pacific Region, for example, Malaysia is comprised of three principle ethnic groupings, these being Malays, Chinese, and Indians, while people of European, Maori and Pacific Island descent form the dominant ethnic groups in New Zealand. Such a level of analysis will be necessary if we are to account for the contradictory results regarding the direction and degree of variation in ethicality across cultures.

The difficulty of defining, examining and understanding either culture or ethics as individual topics in their own right or in relationship to management practices, has been recognized as one of the leading concerns inhibiting effective investigation of organizational behavior in a multi-cultural context (e.g., Hofstede, 1980; Keida & Bhagat, 1988; Krober & Kluckhohn, 1952). Specifically, there is a lack of a systematic effort to standardize the cultural characteristics of respondents from different nationalities to account for differences and similarities in ethical beliefs. Most studies attribute measured ethicality to a wider and more abstract set of environmental influences. In light of the above issues, this study aims to investigate the relationship between perceived ethicality and cultural dimensions in an effort to clarify the equivocal findings of previous cross-cultural studies on ethical standards among business students.

CULTURE AND ETHICS

Greater understanding of the impact of culture on ethical judgments requires selection of samples based on similar underlying cultural dimensions. In this study, culture is operationalized via two of Hofstede's (1980) four cultural dimensions, power distance and individualism. According to Hofstede (1980), power distance is the degree to which an individual respects authority or the extent to which less powerful individuals in society willingly accept inequality in power distribution. Individualism is the extent to which the individual places his or her own interests, as opposed to the benefits of the in-group (e.g., family, clan, and organization), as the primary concern. Placing the power distance index on the x-axis and the individualism index on the y-axis, Hofstede (1980) created a matrix with four quadrants to help identify different clusters of countries based on various combinations of these two dimensions.

If culture is an important determinant of ethical judgments, one would expect to find evidence of greater ethical differences between countries with more disparate cultures (other things being equal). Hofstede's framework provides a basis for selecting such countries. Given that New Zealand and Malaysia are at almost opposite ends of the two dimensions of power distance and individualism (see Table 1), they form an ideal pair for comparison of ethical standards.

Table 1: Ranking (and scores) of New Zealand and Malaysia on Two Cultural Dimensions

Country	Power Distance	Individualism
Malaysia	1 (104)	36 (26)
New Zealand	50 (22)	6 (79)

Ranking: 1 = Most inherent; 53 = Least inherent

Numbers in parentheses represent actual indices calculated

Source: Hofstede & Bond (1988)

Power Distance and Ethicality

Organizations in high power distance countries are typically characterized by a sense of caution and a lack of trust amongst peers and across the hierarchies (Hofstede, 1980). Such a society seems to accept that those in authority are endowed with wealth and prestige, and these managers are "expected" to maintain or otherwise accrue their power, thereby prompting avenues for unethical behaviors to achieve such aims (Shaffer & O'Hara, 1995). On the other hand, the subordinates' devotion and compliance towards the leaders in these organizations are so deeply rooted in their cultural beliefs that subordinates typically look upon their superiors as role models. They may therefore condone questionable practices of their superiors so long as these actions do not adversely affect the employees' well-being. In the same way, subordinates tend to accept the questionable practices of their managers, the managers, in turn, may condone the actions of their superiors, resulting in a firm that accepts certain controversial practices as justifiable. For example, purchasing executives may tend to accept bribery as a common practice if their managers tend to pay little "tributes" to the credit staff of a supplier firm in order to receive "special" credit terms. These managers, in turn, may have inherited the notion from their superiors who exercise such misdoing on a wider scale. These superiors, in time would most likely "adjust" their attitudes in favor of such questionable actions by relaxing the boundaries of the ethical code enforced upon their subordinates. It would not be surprising if managers even encouraged junior executives to adopt such practices if they proved to be a quicker and more efficient method of "getting things done".

However, such tolerance may snowball into increasingly unethical behaviors over time. This is supported in Newstrom and Ruch's (1975) survey involving managers enrolled in a professional development course. The authors believe that people, who frequently engage in questionable practices of a minor nature, are more likely to engage in transgressions of a more serious nature over time.

On the other hand, people in low power distance countries are characterized by equality of relationships. Individuals here "look more to both their peers and informal norms than to their superiors and formal norms, for guidance on appropriate behavior" (Vitell, Nwachukwu, & Barnes, 1993: 756). Such relationships make it possible to question and challenge the doubtful practices of others in the organization. Hence, it may reasonably be suggested that respondents from high power distance countries, when confronted with a practical business ethical dilemma (such as those presented in previous studies) would tend to be more tolerant of such unethical behaviors than would their counterparts in low power distance countries.

Individualism and Ethicality

To examine the relationship between individualism and ethicality, it is important to examine how an individualist feels towards unethical behaviors. According to a number of authors, individualists place emphasis on self-sufficiency, individual initiative, individual achievement, and control (Hofstede, 1980; Shaffer & O'Hara, 1995; Roth, 1995). The dimension typifies a culture where people derive esteem from their own achievements (Morris, Davis, & Allen, 1993). As such, it would be logical to assume that individualists, when confronted with a questionable issue, are likely to be more critical and would dare to challenge practices that run counter to their principles, than the collectivists. They may be more apprehensive of being victimized by corporate politics or immoral decisions, and would generally take steps to protect and dissociate themselves from unethical deeds. This is explicitly expressed via their ethical ratings.

Collectivists, on the other hand, accept group-based rewards, and readily contribute towards attaining common objectives. Hence, group excellence becomes the responsibility of each individual member (Early, 1994; Morris et. al., 1993). The notion of group welfare may logically entail maintaining a secure and stable relationship amongst its members. As opposed to the individualists (who would place priority on their own well being), the collectivists are generally protective towards colleagues in the organization. With the focus on group cohesiveness and harmony as prime motivating forces, these subjects may display higher levels of tolerance for questionable practices of peers and superiors. This may explain the less ethical ratings of Taiwanese and Hong Kong subjects involved in previous studies (White and Rhodeback, 1992; Armstrong and Sweeney, 1994).

In view of this, it may reasonably be suggested that respondents from low individualistic countries, when confronted with a practical ethical dilemma, would tend to be more tolerant of unethical behaviors, than would those from highly individualistic countries. The burden of group success and the desire for harmony are reflected in their ethical ratings. These ratings would tend to reflect more tolerance for unethical behaviors compared with those from highly individualistic countries, when judging similar ethical dilemmas.

Since Malaysia and New Zealand are categorized under the "large power distance/low individualism" and "small power distance/high individualism" categories, respectively (see Table 1), it is hypothesized that:

Hypothesis 1: *Respondents from Malaysia, when confronted with a practical ethical dilemma, will be more tolerant of unethical behaviors than their counterparts in New Zealand.*

METHODS

A survey questionnaire design was used to collect data from two New Zealand universities. Eleven hundred questionnaires were distributed and 335 completed questionnaires were collected, yielding a response rate of just over 30 percent. However, only 242 responses were suitable for the purpose of this study. Ninety completed questionnaires were excluded from the analysis based on the nationality or ethnicity of the respondent, and another two were rejected because of incomplete responses. Useable responses from 75 Malaysian Chinese (MC) and 168 New Zealand European (NZE) students remained. Despite minor demographic differences between samples from the two universities, results of t-tests indicated that these differences did not produce any significant effect on the responses of the two cultural groupings. Data from both sources were thus combined for subsequent analysis.

The questionnaire consisted of three sections. The first part measured the cultural dimensions of individualism and power distance using scales adapted from the Global Leadership and Organizational Behavior Effectiveness Project (House et. al., 1999). This study, initiated by Professor Robert House and his colleagues, involves a leadership study currently being carried out in over 60 different countries. A measure of the masculinity-femininity dimension from the study was also included, as a means of identifying possible sample differences. The power distance, individualism, and masculinity scales consisted of 5, 12 and 3 items, respectively.

In the second section, respondents were asked to determine the ethicality of ten vignettes representing the five business ethical categories used by Becker and Fritzsche (1987) - 'personal integrity' (PI), 'coercion and control' (CAC), 'paternalism' (P), 'physical environment' (PE) and 'conflict of interest' (COI). These ethical categories were selected from a number of sources, including two books dealing with business ethics (Barry, 1979; Beauchamp and Bowie, 1978), and issues addressed at the Summer Issues in the Management of Public and Private Institutions sponsored by the Society for Values in Higher Education (Becker and Fritzsche, 1987). Five of these business vignettes were taken directly from Becker and Fritzsche (1987). The other five (one for each ethical category) were set in a university context; these scenarios were included for a separate study assessing the effect of context on ethical judgments. Respondents were asked to rate the likelihood that they will commit the unethical actions depicted in the scenarios on an 11-point scale ranging from *definitely would not take action* (0) to *definitely would take action* (10).

The last section contained questions on basic demographic details. These included items relating to length of residence in New Zealand or Malaysia, age, sex, and full/part-time work experience.

RESULTS

Demographic and Cultural Characteristics

The demographic and cultural characteristics of the two samples are summarized in Table 2. The NZE sample had, on average, six months more experience in tertiary study, and had significantly higher full-time and part-time work experiences than the MC sample. The scores on the power distance dimension for MC and NZE students are consistent with Hofstede's findings, although the magnitude of the difference is less than anticipated (see Table 3). Contrary to Hofstede's findings, no significant difference was found with regards to the individualism scales across the samples.

Table 2: Demographics of NZE vs. MC Samples

Demographics	NZE	MC
Sample Size	168	75
Age	21.87	21.79
Full-Time Work Experience	1.62	0.59*
Part-Time Work Experience	3.93	0.70**
Tertiary Level	2.81	2.23**

*p < .05 **p < .01

Table 3: Scores on the Cultural Dimensions - NZE vs. MC		
Cultural Dimensions	NZE	MC
Masculinity	10.39	11.50**
Individualism	32.57	34.61
Power Distance	10.68	13.83**
**p < .01		

Mean Ratings on the Ethical Scenarios

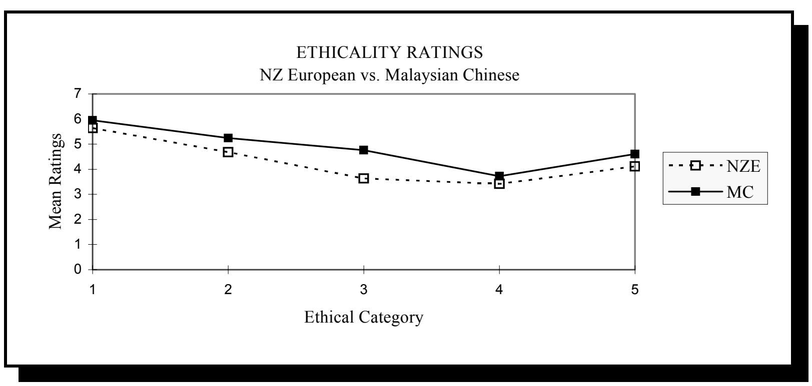
A five-by-two within subject repeated measures (MANOVA) design was used, i.e., five ethical categories by two contexts. The university context was not utilized in this study, however. Results of the MANOVA analysis showed main effects of ethnicity (F=10.08, p<0.05), context (F=104.52, p<0.01) and ethical category (F=11.12, p<0.01), and an interaction effect between ethical category and context (F=31.99, p<0.01). A series of one-way ANOVAs (applying the Bonferroni correction factor for the level of significance) was subsequently applied across each pair of samples, and results of the analysis are presented in Table 4.

Table 4: Mean Ratings of NZE vs. MC samples		
Ethical Category	Business Scenarios	
	NZE	MC
1. (CAC)	5.64	5.95
2. (COI)	4.68	5.24
3. (PE)	3.63	4.76*
4. (P)	3.42	3.72
5. (PI)	4.11	4.6
**p* < .05		

Both samples are least likely to commit the unethical practice that may compromise or harm public interest (paternalism). New Zealanders are next least likely to engage in unethical actions associated with the physical environment category, followed by the personal integrity category. The order of intention was reversed in the case of the Malaysians. Probable reasons why New Zealanders attached greater importance to environmental issues are discussed in a later section. Both samples also expressed unwillingness to approve shipment of any orders that did not meet standard safety requirements. Ratings for this ethical category were close to the mid-point of the scale, suggesting that respondents may be making decisions at close margins to acceptance. A possible reason for this is that respondents were confronted with two clearly undesirable choices - either risking public safety or facing a plant closure. The concern for public safety was given a slightly higher priority in this case. The New Zealand sample was next less likely to engage in unethical actions associated with conflict of interest, whereas the Malaysian sample indicated a greater willingness (i.e., with ratings higher than "five-point" mark) to profit from the organization. On the last issue involving coercion and control, both samples expressed willingness to engage in bribery to gain access to international trade.

Table 4 indicates that only one out of the five scenarios tested was found to be statistically different in ratings. Therefore, our hypothesis that Malaysians would show less ethical behavioral intentions than New Zealanders cannot be supported. However, findings indicated a pattern in the relative ethicality ratings of the New Zealand and Malaysian samples. The former provided aggregate ratings that were more ethical than those provided by their Malaysian counterparts were for all the vignettes. Although only one vignette was found to be statistically different, Figure 1 shows a consistent pattern in the ethical standards of the two samples. The Malaysian sample appeared to be less ethical than the New Zealand counterparts were when determining ethical behavior in moral dilemmas in the business context. The overall pattern gives support to the existence of disparity in the direction stipulated in our hypothesis.

FIGURE 1
Mean Ratings of New Zealand and Malaysian Samples



Effects of Demographic and Cultural Variables

Two scenarios that elicited statistically different ratings emerged from the "physical environment" ethical category. The proportion of variance (associated with disparity in ratings) accounted for by ethnicity could not be determined at this stage. Moderating effects of other factors such as demographic and cultural differences are likely to contribute to the observed disparity. To determine the effects of these variables, partial correlation analysis is used.

Recall in Tables 3 and 4, the New Zealand and Malaysian samples were found to significantly differ in terms of part and full-time work experiences, tertiary level, masculinity, and power distance scales. A series of partial correlation tests was subsequently applied between ethical ratings for the physical environment scenario and each of these variables (including ethnicity) while controlling for possible multicollinearity effects amongst other variables concerned. The results are summarized in Table 5.

Table 5: Partial Correlation Coefficients

Source of Variation	(PE)
Ethnicity	0.16*
Full-Time Work Experience	-0.20**
Part-Time Work Experience	0.04
Tertiary Level	0.07
Masculinity	-0.02
Power Distance	0.10
*$p < .05$	

Table 5 indicates that ethnicity and full-time work experience were significant factors in explaining the variance associated with disparity in ratings across PE. Both variables contribute (independently and significantly) to explaining the variance in ethical judgment involving environmental issues in the business setting. The finding is consistent with previous research that has found similar relationships between ethical judgment and work experience (Purcell, 1977; Arlow & Ulrich, 1980; Stevens, Harris, & Williamson, 1993; Stevens, 1984; Norris & Gifford, 1988).

DISCUSSION

Perceived Ethicality and Cultural Dimensions

Our samples did not reflect the degree of difference suggested by Hofstede's original findings. Although significant differences were found between MC and NZE on two of the three cultural dimensions tested, the absolute differences were not large. However, we found a consistent (albeit insignificant) pattern in the ethical differences across the samples. These respondents did not exhibit the expected extreme disparity along the power distance and individualism measures, and therefore the failure to reach statistical significance is not surprising. Possible reasons why the New Zealand and Malaysian samples did not exhibit the disparate cultural characteristics expected are discussed below.

Firstly, Hofstede's (1980) initial work was done more than fifteen years ago. A considerable amount of acculturation throughout the years would inevitably have diffused the authenticity of any culture. Countries such as Malaysia, Hong Kong and Singapore, for example, have experienced tremendous Western influences over the last decade. Increases in Western subsidiaries and foreign investment, greater exposure to Western media (e.g., TV programs, films, fashion, and magazines), growth in tourism relations with Western countries, and the gradual acceptance of English as the working language, are evidence that Western cultures have increasingly manifested themselves in these countries.

Secondly, Hofstede's original work used nationality as the unit of analysis and did not take into account the diversity of ethnic differences within each nationality. An aggregate sample based on country of origin was used as the selection criteria. Cultural composition within the same country is likely to produce a profound effect on ethical perceptions.

Another possible explanation for the inconsistency in the cultural characteristics of the MC and NZE samples may in part be due to the effects of situational ethnicity. The Malaysian students may have adopted a "when in Rome do as the Romans do" attitude, and adapted to the presiding norms of their host country. Simply stated, individuals may "switch" between two cultural identities (original and host country), being prompted by situational cues to employ different sets of evaluation criteria when assessing a particular situation (Cox, Lobel, & McLeod, 1991). Malaysian students studying in New Zealand universities tend to adopt local norms consistent with lower power distance (such as use of lecturers' first names in contexts where this would be unacceptable in Malaysian institutions).

To test the effects of situational ethnicity, we have subsequently administered the questionnaire to 22 Malaysian Chinese students studying in Malaysia. These students were enrolled in a Commerce degree program taught by one of the universities through which the primary sample was collected. Results of one-way ANOVA analysis indicated that the Chinese sample in New Zealand scored significantly higher than its counterpart in Malaysia on all three cultural dimensions: individualism (34.61 vs. 28.63, $p<0.01$), masculinity (11.51 vs. 10.18, $p<0.05$) and power distance (13.83 vs. 8.14, $p<0.001$). The concept of situational ethnicity suggests that administering questionnaires to Malaysian Chinese in New Zealand lecture theatres may have cued the students to respond in a manner more consistent with the (Western) norms of the university. That is, we would expect Malaysian Chinese students studying in New Zealand to score higher on the individualism and lower on the power distance scales. However, while the Malaysian Chinese students were rated higher on individualism, there was a corresponding increase in the power distance and masculinity measurements (contrary to Hofstede's original findings). Hence, there is no conclusive evidence to support a situational ethnicity effect.

Lastly, there may be problems associated with the scales adopted for measuring these cultural dimensions. The scales used in this survey, though validated, were not the same ones employed in Hofstede's earlier studies.

All the past cross-cultural studies reviewed were conducted on the general assumption that samples from different backgrounds will exhibit distinct cultural characteristics. Most of them assumed that nationality or country of residence reflected the sample's cultural orientation. Independent measurement of the cultural characteristics was not carried out in these studies. Findings in Table 3 demonstrate that this assumption may no longer be valid. Studies that found little disparity in ethical judgments across two distinct cultures may in fact have utilized samples that (unknowingly) possessed similar cultural traits. Hence, caution must be exercised in the generalization of such cross-cultural findings.

Attitudes towards Environmental Issue

Findings in Table 4 indicated significant differences in ethical perceptions of New Zealand and Malaysian students towards environmental issues. A probable reason why New Zealanders expressed greater concern in environmental issues may be related to the intensive efforts being channeled into promoting environmental awareness in the last few decades. New Zealand's commitment to environmental protection is evidenced by its being one of the pioneer countries to implement a comprehensive statute (the Resource Management Act 1991), which is primarily concerned with impact of industry activities on the environment. New Zealand resources are now effectively managed under a single piece of legislation under the direct control of the central government, which has absolute authority over matters concerning the physical environment. This government protection reflects the strong affection for the natural environment held by most New Zealanders. Hence, it is not surprising that pollution of the country's resources is being increasingly viewed as an undesirable act that may jeopardize the clean and green image New Zealand portrays, an image that is considered critical for its success as an exporter of agricultural and horticultural products to international markets.

Malaysia, which enjoys large reserves of tin, rubber and palm oil resources is fast becoming a developed country, and is currently shifting its focus towards industrialization. However, Malaysia's commitment to environmental issues in the last few decades has raised doubts amongst environmental lobbyists. In Vatikiotis' (1992) article entitled "Environment: Malaysia -Plenty of laws, but little action," Malaysia's efforts to preserve the environment are described as seriously hampered by the lack of coordination and support between the federal and state government. He states:

Much of the environmental legislation, however, is only passed at the federal level. This means that state governments can ignore the legislation, and the federal government can claim it cannot be implemented without the cooperation of the state governments. (Vatikiotis, 1992: 32)

Such political factors may offer a possible reason why relatively less attention has been channeled into environmental issues in Malaysia in recent years. The concern over environmental issues was not prominently expressed in the responses of the Malaysian students.

Directions for Future Research

Firstly, future cross-cultural studies should rely on past findings only as a basis for selecting different ethnic backgrounds. Some form of "confirmation check" should be incorporated to authenticate the cultural characteristics of the samples. Researchers should acknowledge the fallacy of attaching a common set of cultural characteristics to every ethnicity within the same country (e.g., assuming that Malaysian Chinese and Malaysian Malays hold similar cultural beliefs). Without such initial assessment, the researcher runs the risk of utilizing samples from diverse backgrounds that, unknowingly, behave in the same manner thereby undermining the reliability of such cross-cultural comparisons.

Secondly, recall that the scenario involving environmental issues elicited significantly different reactions from Malaysian and New Zealand students. Such a disparity suggests that different emphasis was being placed on environmental ethics by the sample, and highlights an interesting avenue for further research. Countries are currently at different stages of their development regarding environmental issues. Differences in government policies towards economic growth may determine how resources of societies are allocated, and this may have serious implications on a nation's attitudes towards environmental issues. The economics perspective offers just one of the numerous ways in which environmental ethics of a nation may be shaped. The issue may also be examined at an organizational level in a multinational context, or even at a managerial level. On a wider scale, an organization's attitudes towards environmental issues may depend on the nature of the industry, organizational culture and scope of trade. At a micro level, an individual's impression of the environment may be shaped through a combination of psychological and behavioral factors. The scope for future research in this area is considerable.

Though the research is able to account for some of the variations in ethical differences at this point, the study does not provide much indication about the types of ethical situations in which students are more likely to engage in unethical practices. Ethical judgment, however, has been found to vary across ethical categories. The empirical link between cultural dimensions and the various ethical categories raises another critical issue that has yet to be investigated. The relationship would provide a basis for predicting the ethical categories, which would evoke substantial reaction from respondents (e.g., scenarios involving physical environment elicited significantly different reactions from MC and NZE). Regrouping and tabulating responses from earlier studies into broad categories may accomplish this. In this manner, the types of ethical situations that raised considerable concerns amongst respondents may be analyzed. Knowing how people from different backgrounds may react to certain ethical situations would have important managerial implications for training and management of staff in multinational organizations.

It is important to recognize that the sample size in this study was small and hence general conclusions need to be made carefully. Furthermore, all findings of this study are based on reported intentions, which may not be a true indication of behavior in actual situations. Although this study has focused on only one link between the cultural environment and ethical behavior, we acknowledge the importance of other (possibly more important) influencing factors. However, outcomes of this study should help us better understand the determinants of ethical intentions, which are important precursors to actual behaviors.

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STRATEGIES FOR SUCCESSFUL REPATRIATION

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ABSTRACT

U.S. multinational corporations (MNC) primarily send their best employees on international assignments to grow new markets, maintain existing operations (Windham, 1999), or develop high potential employees who can both contribute to company strategy and craft a global view of the corporation's business (Derr & Oddou, 1991). Over a twenty year period researchers have consistently reported MNC problems with retaining returning employees, especially the high costs of international assignments associated with low retention rates of repatriates. The purpose of this examination is to present strategies for addressing the repatriate attrition problem. The two objectives for this paper are (1) to compile and categorize strategies from corporate and employee perspectives, and (2) to summarize researchers' theories and relate them to actual practice. This approach allows MNC human resources and other executives to customize practices to fit corporate strategic objectives and alleviate low repatriate retention rates.

INTRODUCTION

Multinational corporations (MNC) report problems with retaining employees who are returning to the home company and country from international assignments. These problems apparently arise because human resources departments poorly execute the repatriation process and fail to satisfactorily incorporate employees into the company upon their repatriation. The problems have recurred over a twenty year period with no appreciable change (Goss & Tucker, 2003).

This is an important matter. Over the past thirty years, the business world has expanded operations to a global scale. The trend is expected to continue into the future (Derr & Oddou, 1991), and MNC will require more expatriate employees ("How to Assist," 2001). Management will experience pressure to earn a greater return on investment from the cost of the expatriate assignments.

Companies place employees in foreign assignments for periods of time generally ranging from 3 months to 3 years. These assignments are costly to the corporations, and the investment in individual employees is high (Black & Gregersen, 1999). The problem that many multinational corporations face is the failure to retain employees for more than two years after they return to the home office.

A corporation usually sends employees to an expatriate assignment to develop new markets, to maintain existing operations (Windham, 1999), or to develop high potential employees who can both contribute to the company strategy and develop a global view of the corporation's business (Derr &

Oddou, 1991). These employees are involved in the long term global strategy of a company (since they can be available for potential additional international assignments) and for the benefit of the company over the long term. Retaining their services is of great importance.

Problems arise, however, from poor execution of the process by human resources departments and failure to satisfactorily incorporate employees into the company upon their repatriation to the home country. The result is that employees suffer from reverse culture shock while resettling their families. In addition they are dismayed to find that they are not offered a position where they can use the knowledge and contacts gained while on the assignment (Black & Gregersen, 1999). Their dissatisfaction prompts repatriated employees to seek either another foreign assignment or a position where they can use their foreign training and experience. (Ferrar & Hug, 2001; Forster, 1997).

PURPOSE

The purpose of this examination is to review the literature over the past 20 years, identifying strategies for addressing the attrition problem. The two objectives for this paper are (1) to compile and categorize strategies from corporate and employee perspectives, and (2) to summarize researchers' theories and relate them to actual practice.

CORPORATE PERSPECTIVE

The corporate goal is to secure an acceptable return on investment while implementing the company's global strategy. The company's return on investment tends to increase if the company can retain the employees and utilize the experience and knowledge they have gained.

Costs escalate when attrition rates are high. The loss of experienced employees after international assignments results in high training costs for replacements and the loss of return on investment in salaries and benefits paid to the employees while on the assignment (Black & Gregersen, 1999). Global surveys show this to be a growing problem. Companies experiencing more frequent employer changes because of international assignments increased from 20 percent in 1999 to 24 percent in 2001 (Windham, 1996-2001).

The high cost of assignments and the low returns have prompted management and human resources professionals to consider various options for reducing the cost of the international assignments, such as altering the structure and terms of assignments and revising their repatriation policy and practice. The Global survey in 2001 reported that 59 percent of the respondents were seeking alternatives to long term assignments because of the costs involved (Windham, 1996-2001).

Some employers have conducted methodical reviews of all aspects of the company's expatriate program in order to generate a more acceptable return on their investment ("How to Assist," 2001). An example is a review of the structure of assignments. Different methods carry different levels and types of costs. Companies have several options: long term (12 months or more), short term (up to 12 months), commuter, frequent flyers (regular visits to the foreign operation), and virtual (the employees manage their responsibilities remotely from the home country with occasional trips abroad) ("Managing," 2002).

A second example addresses repatriate policy and practice. The Global survey (2001) reported that respondents with programs in place to improve corporate return on investment reviewed their policy and practices and chose to use various recommended methods: better candidate selection, career planning and skill use, communication of objectives, assignment preparation, and program monitoring (Windham, 1996-2001). Career planning, skill use, communication, and assignment preparation are discussed in the next section of this paper.

Black and Gregersen (1999) asserted that successful repatriating companies view foreign assignments over the long term and expect expatriates to generate new knowledge or to acquire leadership skills. They have three common characteristics:

♦	Focusing on knowledge creation and global leadership development
♦	Assigning overseas posts to people whose technical skills are matched or exceeded by their cross cultural skills and,
♦	Ending the expatriate assignment with a deliberate repatriation process.

Derr and Oddou (1991) also identified characteristics and practices of several companies that are recognized in the industry as having successful programs for international assignments. This success is evidenced by their low 5 to 10 percent turnover rate of employees returning from assignments. These companies have three characteristics in common:

♦	International assignments are developmental.
♦	The assignments are part of the path leading to top management positions.
♦	The firms' competitive advantage and ability to sustain growth are partly a function of their international know-how.

It is important to note that these studies share common themes: the importance of employee development, the selection process, and a repatriation process.

Stroh (1995) added that a successful company demonstrates positive corporate values related to the importance of an international assignment. Recommendations include making use of the first hand experience of the returning employees:

♦	Ask them to assist in formulation of international assignment policy (Stroh, 1995).
♦	Ask them to help inform and create policies related to the expatriate experience to develop policy based on practical experience.

♦	Ask them to assist in developing strategies to attract and retain a diverse domestic workforce since they have first hand experience with and an appreciation for diversity. (Stroh, 1995)
♦	Ask them to serve as mentors for new expatriates (Harvey & Wiese 1998)

Nokia uses international assignments to generate knowledge. The company has a decentralized research and development (R&D) function, 36 centers in 11 countries. Senior executives form teams to generate new ideas and bring these people together in an R&D center for assignments of up to 2 years. Nokia is gaining global market share by rapidly turning new ideas into successful commercial products (Black & Gregersen, 1999).

THEORETICAL EMPLOYEE PERSPECTIVE

Best practice recommendations evolve from a theoretical foundation. If company human resources policy makers know the underlying reasons for successful programs, they can develop policies and practices that successfully mesh company strategy with retention of employees who are the keys to implementation.

In this paper we first discuss the theoretical foundation and present examples of company programs that have successfully retained internationally trained employees upon their return to the home company.

Why do returning employees find it so difficult to adjust to the home company and home country? The difficulty is manifested in resignations by the employees, discontent, and negative effects to the company's international programs. The literature presents generalizations (theories) about human behavior as it relates to international assignments. The theories interrelate and form a cohesive perspective to understand discontent, lack of commitment to the home company, disconnection with home operations, and a long period of adjustment.

We discuss four of these theories, all reflected in recommendations, which provide a basis for proactive program development. The theories are the expectation, reentry systems, equity, and W-curve theories. Each recognizes a facet of the experience of returning after a long absence to one's home country and company.

Expectation Theory

Expectation theory addresses the effectiveness of open and honest communication with the employees. Topics include jobs they can expect on return to the home office as well as the more common psychological and financial transitions. The expectancy value model (Furnham, 1988, as cited in Martin & Harrell, 1996) suggests that the assigned employees have expectations about their eventual return to the home office. Martin and Harrell (1996) asserted that this theory explains much of the employees' dissatisfaction upon return to their home countries. They explain that fulfilled expectations lead to positive evaluation of the repatriation experience, whereas unfulfilled expectations lead to negative evaluation and poor readjustment (Martin & Harrell, 1996).

The expectancy violation theory (Burgoon, 1992, as cited in Martin & Harrell, 1996) states that unfulfilled expectations can be violated either positively or negatively. If things turn out worse than expected, the employees tend to evaluate the experience negatively, while if things turn out better than expected, they evaluate the experience positively. Therefore, Martin and Harrell concluded that it is better to over prepare the employee and set up realistic (probable or worst case) expectations. (Martin & Harrell, 1996). Black (1992) surveyed 174 employees from four MNC and reached the same conclusion. The levels of repatriation general adjustment, from highest to lowest, occurred with over-met expectations, met expectations, and under-met expectations (Black, 1992).

Several recommended strategies emerged from surveys related to this theory: predeparture training, a realistic job preview, and bringing employee expectations in line with company perspective. Carol Jones, of Deloitte & Touche LLP, emphasized "expectation management," which requires the human resources department to be as open and honest as possible with the employees, both at departure and return (Poe, 2000).

The following three surveys illustrate the point that surveys across different employee groups yield similar results. Stroh's research related the degree of commitment to the degree the company met expectations of repatriates.

Job performance standards: Employees exhibited more commitment to organizations when individuals and firms held similar job performance expectations.
Interpersonal relationships at work: Only 23 percent of returning employees experienced positive surprise when their interpersonal relationships at work were better than they expected.
Job discretion: Commitment to the local work unit was highest if returning employees found they had more job discretion than they expected. Fifty-three percent were negatively surprised. They seemed to expect to hold a similar-level position upon return compared with significant levels of responsibility and discretion on the international assignment (Stroh et al., 2000).

A second survey by Derr and Oddou (1991) queried 135 repatriates with overseas assignment durations of one or more years. These were high performing employees; their job performance ratings were outstanding to good, with 65 percent in the outstanding to excellent range. The study compared expectations before the assignment with results after the assignment.

Their expectation level before the assignment was high: 70 percent said the assignment was presented as a definite career opportunity, and 83 percent said they interpreted the offer as a career move that would enhance their career opportunities. Only 30 percent had a clear idea of a career path after the assignment.

The response to their return was quite different from their stated expectations:

Career considerations: Some were told they had six months to try to find a place in the organization, and three left immediately. Of the returning employees, 23 percent were promoted and 18 percent were demoted. The returning employees reported that 54 percent had a specific job waiting for them while less than half (46 percent) indicated they had been consulted before returning about the type of assignment they would like.Perhaps the most telling result is that 87 percent stated the expatriation had helped broaden their personal perspective more than it had helped develop their career.
Job Discretion: Most of the employees who received assignments (60 percent) reported less job discretion or a position with less potential impact on the company (Derr & Oddou, 1991).

A third survey by CIGNA, National Foreign Trade Council, and WorldatWork ("Employers," 2001) illustrates the point that employers should be aware of expatriate expectations and provide the support that the employees expect.

According to the CIGNA survey results, two distinct viewpoints of these assignments existed between the corporate human resource executives and the employees who completed the work assignments. For example, the two top ranking reasons for employers to expatriate were specific projects and foreign operations management. Employees, on the other hand, responded to the same question with totally different responses: personal excitement and resume enhancement.

Expectation theory (Stroh et al., 2000) predicts that this causes negative reactions from the employees when they realize that their expectations will not be met.

Reentry Systems Theory

Reentry systems theory, according to Martin and Harrell (1996), concentrates on the importance of communication and contact with the employees before, during and after the assignment. The returning employee learns to adapt through the cycle of stress-adaptation-growth through communication with others in the reentry environment, just as she had adapted on her international assignment.

One indication of noncompliance (maintaining contact) with this suggestion is the result from the Global survey (2001) which reported 42 percent of the surveyed companies had intranet sites with no expatriate section and 91 percent had intranet sites within the company (Windham, 1996-2001). The NFTC survey (2000) found that two-thirds of the responding companies had an intranet, but only 20 percent had an expatriate section. This was alarming since 92 percent of the expatriates said the Internet was critically important to them, and they used it daily ("Employers," 2001). Communication "allows the expatriate to feel a close bond with headquarters regardless of geographical distance" (Czinkota et al., 1989).

Adler's (1981) study pointed out the importance of communicating organizational changes to employees during the international assignments. Referring to expectation theory, employees "who were kept informed regularly while overseas had fewer re-entry surprises and fewer unmet expectations" (p.

350). This contact connected the employee to home office changes (positive and negative) and even negative news, such as reorganizations and lost contracts, thus preventing reentry surprises.

Baughn's study (1991) supports these findings. The study included 226 employees of five multinational firms who had returned to the home company in the U.S. within the previous five years. He found that contact, mentorship, and repatriation support all related to "socialization" upon return. They were "significant predictors." Adler's study (1981) concluded "that the more surprised returnees are by negative changes, the less effective they are on the job" (page 350).

Harvey and Wiese (1998) proposed a mentoring model to provide social support and to manage expectations by communication. The model approaches the reentry problem in three phases:

Before expatriation
Affirm the organization's commitment. Provide an "anchor" by discussing organization, personnel, and strategic domestic situations. This affirmation begins before expatriation and continues during and after the assignment.
Create a formal communication channel. Mentors and key individuals provide updates to the employee on changes in organization, personnel, and strategic operations in the home country.
Define the role of the mentor during the assignment.
Discuss advanced planning for return to the home country.
During expatriation
Continue the mentor relationship with headquarters.
Establish a mentor at the foreign location.
After expatriation
Facilitate finding a new position in the home company at least six months prior to return.
Provide updates on company changes (power base and relationships among key managers) six to nine months before return.
Provide updates on the community.
Encourage the repatriate to participate in a mentoring program with new expatriate employees.

Examples of Best Practice

Medtronic provides mentors at the vice-presidential level. The mentor helps to set career goals and places the repatriated employee in a job upon return to the home office. The two maintain communication through e-mail, telephone calls, and visits (Klaff, 2002).

Cendant keeps its employees connected through "team huddles." These are groups of employees who work on a particular client. It may be a virtual team, with some members at the home office and some located internationally, but the team is required to keep in touch. The company achieves two goals. It keeps its international assignees in touch and maintains a truly multicultural global work-force team (Poe, 2000).

Equity Theory

Equity theory ties closely with expectation and reentry systems theories. It relates to employee motivation and commitment to the company (Robbins, 2001). Procedural justice refers to the perceived fairness of the process used to determine the distribution of rewards and tends to affect an "employee's organizational commitment, trust in the boss, and intention to quit" (Robbins, 2001, page 170; Stroh, 1995).

Equity theory helps to explain the degree of commitment that returning employees give to the company. If the employees perceive that the company is not treating them fairly in light of their international experience, they tend to feel less committed and are willing to leave the company to work for another. Robbins suggested that company managers should heighten the perception of fairness by openly sharing information on how decisions are made and following consistent and unbiased procedures (Robbins, 2001).

Ericson (1999) concluded that aligning international assignments with employee career paths reduced the effect of the equity/inequity phenomenon. He attempted to predict repatriate turnover as a test of equity theory. The repatriate's perception of equity was positive if company management became actively involved in planning for the employee's next assignment upon return. The international assignment became a stepping stone in a career path. Secondly, management could encourage the positive equity perception by placing the returning employee in a position that utilized the experience and knowledge gained on the assignment (Ericson, 1999). The employees perceived acknowledgement of their experiences and achievements and were more likely to endure the transition from international employee to working within the domestic organization.

Examples of Best Practice

Monsanto starts thinking about the next assignments for returning employees three to six months before they return. First, they (two employees ranked above the employee, with international experience) assess the skills the expatriate has gained and review potential job openings within Monsanto. The expatriate writes a self-assessment and describes his/her career goals. The three people then meet and decide which of the available jobs best fit the expatriate's capabilities and the organization's needs. In the six years since this program's initiation Monsanto dramatically reduced the turnover rate of returning employees. The employees feel treated fairly even if they don't get the job of first choice (Black & Gregersen, 1999).

Honda starts the assignment with clear strategic objectives. Six months before the employee returns, the company starts an active matchmaking process to locate a suitable job for that person. A debriefing interview is conducted upon return to capture lessons learned from the assignment. This is an integrated approach. Turnover rate is less than 5 percent. Its expatriates consistently attain the key strategic objectives established at the beginning of each assignment (Black & Gregersen, 1999).

Royal Dutch Shell has one of the world's largest expatriate workforces. The company enlists resource planners to track workers abroad. Expatriates normally know what their next assignment will be some 3-6 months before they move, and nearly 100 percent of expatriates begin each return assignment with a clear job description. Management returns high potential expatriates to the home office every third assignment to raise their visibility among senior executives. Technical mentors stay abreast of the expatriates' skill levels and arrange for upgrades at RD's training center (Barbian, 2002).

Deloitte & Touche managers discuss, before the employees go abroad, the job each of the company's 200 expatriate employees will take after returning. The employee signs a written commitment letter, which includes a job guarantee at the end of the assignment (Klaff, 2002).

W-Curve Theory

W-Curve theory describes the reentry adjustment, often called reverse culture shock (Czinkota et al., 1989). It emphasizes the common process of initial euphoria, irritation and hostility with cultural differences, adjustment, and reentry to the home country (Martin & Harrell, 1996).

The W-curve is actually two U-curves. The first U-curve occurs when the employee enters the new country for the international assignment. The second U-curve occurs upon return to the home country. The pattern is the same. The reverse culture shock on return is intensified because the employee does not anticipate company, community, and cultural changes during the absence. There are also cases when "reentry may cause a reverse culture shock [if the] adjustment phase [to the foreign location] has been successful, and the return home is not desired" (Czinkota et al., 1989). Adler (1981) noted that the reentry phase is slightly more difficult than the adjustment phase because of employee expectations. Anderson's (1999) survey of ten organizations in Australia yielded this representative comment from a respondent: "…emotions and feelings associated with culture shock and reverse culture shock need to be known, confronted and helped through if one is to remain effective (p. 15)."

Gail (1996) studied the W-curve and ways to decrease its effect. He concluded that repatriation training reduces the turnover of repatriated executives because they are taught to expect a transition period. His study showed that the mere presence of a repatriation program has more effect on reducing turnover than the contents of the repatriation programs (Gail, 1996). This is an interesting finding. It seems that the attention alone assures returning employees that the company notes their contribution and special circumstance.

Harvey (1989) conducted a study of 175 corporations. He identified four negative elements of reentry: career issues, financial pressures, family problems, and psychological stress. Most of the companies that provided repatriation training covered career path counseling, assistance with relocation, and financial assistance. The softer elements such as family problems and psychological stress were not generally addressed.

Example of Best Practice

Unocal offers all expatriates and their families a day long debriefing program upon return. It focuses on common repatriation difficulties. The company shows videos of past expatriates and families describing difficulties. Then the session turns to live discussions and suggestions on how to cope (Black & Gregersen, 1999).

Summary of Theories

Researchers combined the four theories (expectation theory, reentry systems theory, equity theory, and W-Curve theory) with survey results to propose recommendations for improving the systematic processes and procedures that human resource departments should use in companies with international assignees. The recommendations fall into six categories (Table 1).

Table 1: Summary of Recommendations for Successful Repatriation

1	Provide predeparture training: set realistic goals (Forster, 1997)
2. .	Address the culture shock phenomenon (Czinkota et al., 1989) Provide training relating to the process of reentry (Martin & Harrell, 1996). Address financial issues (Martin & Harrell, 1996)
3	Offer a realistic return job preview (Stroh, 1995)
4	Bring employee motivations in line with company perspective (Stroh, 1995)
5	Mentor (Harvey & Wiese, 1998)
6	Provide career planning well before the employees arrive back at the parent organization; identify possible ways to use their new skills (Stroh, 1995)

CONCLUSIONS AND RECOMMENDATIONS

Management of MNC face challenges in successfully retaining returning employees from international assignments. This paper focuses on corporate and employee perspectives in alleviating the high cost of global programs and low retention rates of returning employees.

At the corporate level, management is responsible for corporate global strategy and can proactively review practices and policies to determine which require change in order to meet objectives. The cost of international strategy is a prime concern. Adjustments to practices related to the selection, development, and repatriation of employees are necessary if the costs associated with attrition are the source of lost return on investment.

This paper highlights four theories - expectation theory, reentry systems theory, equity theory, and W-curve theory - to explain the interaction of company actions with employee expectations, cultural transitions, and level of commitment to the home organization. If the employees know what to expect upon their return to the company, they cope better with the reentry transition. Their commitment to the home organization is strongest if they perceive that company management is implementing a career plan that utilizes the experience and knowledge gained during the international assignment. The company, while always keeping their global strategy in mind, can build a strong bond through contact before, during, and after the assignment.

Multinational corporations that want to compete globally and build a pool of international management expertise are advised to incorporate appropriate features to their management of repatriates. The best performing companies are reaping the benefits of decreasing employee turnover through their success in the global arena. Our findings clearly indicate that companies have plenty of guidance from researchers and actual best practices to implement a successful global strategy. International assignments should be development tools to build the ranks of experienced international managers.

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