as a supranational governing body may have peaked in importance. The recent formation of the Pacific Alliance among Chile, Colombia, Mexico, and Peru has the potential of returning Latin America to the "open regionalism" which led to the founding of the Mercosur Accord in 1991. This time, the founding members of the Pacific Alliance are free-market oriented, relatively fast growing economies which have embraced globalization. The Pacific Alliance is trying to resolve the difficulties of the spaghetti bowl of regional trade agreements by agreeing on rules of origin, border procedures, and harmonization of trading rules without WTO involvement.

Questions for Discussion

1. *How might the creation of yet another regional alliance threaten the WTO?*
2. *What does the "spaghetti bowl" of regional trade agreements mean for the notion of free trade?*
3. *Should free trade be the goal of international business?*
4. *What are the potential benefits and pitfalls of a free trade regime with or without the WTO?*

Case Study 6.1

Structural Adjustments in Masawa

Masawa is a small country located in southwestern Africa, with an area of 240,000 square miles and a population of about 60 million. The northern and western parts of the country are hilly terrain, while the southern and eastern areas are plains. Masawa has substantial natural resources: mineral deposits of manganese, copper, and tin in the northern hill areas and large tropical forests in the southeastern parts of the country. The eastern part has most of the cultivated land, and agricultural production, especially cereal crops, is concentrated there. There are some cocoa plantations in the western part of the country; cocoa is an important commercial crop. The main exports of Masawa are copper, tin, and cocoa. Manganese deposits are too small to be commercially viable for export.

The country attained its independence from colonial rule in 1961 and since then has seen a few political upheavals. Emorgue Watiza, a leader of the country's freedom movement, was the first president. He ruled Masawa for six years before being ousted by the military, which installed General Ramaza, who was assassinated in 1974 and replaced by another military ruler, Colonel Waniki. Colonel Waniki instituted a series of political reforms, and after twenty-one years of power, handed over the reins of government to Dr. Sabankwa, the winner of the country's first democratic election. Dr. Sabankwa brought excellent credentials to the presidency. He holds a PhD in political science and government from the University of Paris and had been active in the movement for restoration of democracy in Masawa. He enjoyed the almost total loyalty of his tribe, the Waldesi, which is the largest tribe in the country, constituting 30 percent of the population. Besides the Waldesi, Masawa also has three other major and sixteen minor tribes. The three other major tribes are the Mokoti (18 percent), Lemata (15 percent), and Simoki (11 percent). The remaining 27 percent of the population is made up of members of the smaller tribes, none of which individually constitutes more than 5 percent of the population.

Dr. Sabankwa enjoyed considerable support from the Simoki and several minor tribes at the time of his election. After more than fifteen years in office, however, that support has eroded, and rumblings of discontent have been heard, even from Sabankwa's own Waldesi tribespeople, especially those living in urban areas. Much of the discontent is clearly the result of the economic difficulties the country is facing, which have led to considerable difficulties for both the urban and rural populations. Reactions, however, tend to be more pronounced in the densely populated and politically conscious urban areas.

Most of Masawa's economic difficulties began before the election of Dr. Sabankwa. The country had little in the way of industrial or technological development when it attained independence, and the annual per capita GNP was $160. Much of the agriculture was conducted along primitive lines and was largely dependent on seasonal rainfall, which tended to be erratic. In the initial years of independence, Masawa's rulers sought to adopt a centralized planning approach to economic development, assigning a key role to the government in nearly all aspects of economic activity. The public sector accounts for 90 percent of industrial production, and all key infrastructure projects are run by government agencies. Masawa has a large number of highly paid civil servants who administer the wide range of economic and other controls imposed by the government. Although private enterprise is officially permitted, there are a number of bureaucratic disincentives for entrepreneurship. A typical new venture in the private sector needs separate approvals from thirty-two different government agencies and departments.

As in many other countries of the developing world, the state-owned industrial enterprises of Masawa have had losses for a variety of reasons, including inefficient management, overstaffing, administered prices of products, and outmoded technology. The government has guaranteed most of the debt taken on by the enterprises and has had to resort to substantial deficit financing to make good on these obligations.

(continued)

Case Study 6.1 *(continued)*

The government of Masawa has faced a major budget deficit every year for the past eleven years; for several reasons, the deficit has become a permanent feature of the government's finances. Government expenditures have been rising rapidly in five areas: defense, oil imports, administrative expenses of the government, subsidies to industrial enterprises, and price subsidies for essential consumption items, especially food. On the other side, revenues have been stagnant, principally because of the absence of strong measures to secure better tax compliance by the vast majority of taxpayers. The government has, therefore, resorted to large-scale deficit financing, which has pushed the inflation rate progressively higher every year. In 2011, Masawa experienced 93 percent inflation, and there were indications that this number would increase by another 40 percent in 2012.

Imports have been increasing steadily over the past seven years, while exports are stagnant, because the world market for Masawa's principal exports continues to be sluggish. The exchange rate of Masawa is overvalued by about 70 percent, and there is a large premium on the black market for foreign currencies. The country has suffered considerable flight of capital as wealthy industrialists lost faith in the political and economic stability of Masawa.

The external debt of Masawa, largely to official creditors, is well above the level considered dangerous for sustaining the debt-service schedule. The country has no access to the international capital market, having defaulted on the amortization of earlier loans, taken primarily by state-owned corporations. Foreign exchange reserves are at a dangerously low level and are sufficient to finance only two weeks of imports.

Dr. Sabankwa calls a meeting of his cabinet to discuss the question of accepting an International Monetary Fund structural adjustment loan in order to tide the country over the immediate problems on the balance of payments front and to improve future prospects. The finance minister briefs Dr. Sabankwa and the cabinet ministers on the pertinent issues.

The IMF is willing to extend a $3 billion loan to Masawa under its structural adjustment lending program, but it wants Masawa to draw up a set of concrete economic measures to restructure the economy. Although several measures have been recommended by the IMF, five are the most important:

1. The government should initiate a phased reduction of official subsidies on food.
2. Masawa should devalue the exchange rate by 40 percent.
3. The government should take steps toward privatizing state-owned enterprises.

4. The level of imports should be reduced.
5. The government should reduce its administrative expenses by cutting the government staff and salaries.

While these measures seem sensible and useful, effective implementation of them would create many practical difficulties. First, cutting food subsidies would be an extremely unpopular measure that might spark civil disturbances, especially in the urban areas. Those most affected would be the urban poor, who are already under great economic hardship. Devaluing the exchange rate also has ominous implications. Politically, it might be viewed as a weakening of the economy, providing another reason for opposition groups to attack the government's handling of the economic situation. Further, the costs of imports would rise and contribute to an increase in the already high inflation rate. Privatization would also be difficult, since there are few people in Masawa with the managerial or technical expertise to take over the operations of these enterprises. Further, there is bound to be strong opposition from the trade unions to any move for privatization.

Reducing the level of imports would be a feasible option, but it would hurt the growth rate considerably, because imports of essential industrial equipment and machinery would have to be curtailed. A very large cut in imports might not even be possible because of the inelastic level of defense and oil imports. Reducing government staffing may create ill feelings in a crucial time.

Dr. Sabankwa fears that these steps, if implemented, would generate political unrest that would lead to the fall of his government. As he mulls over these issues, he wonders whether a compromise solution can be found.

Discussion Questions

1. What would be your position if you were a member of Dr. Sabankwa's cabinet?
2. Should Dr. Sabankwa accept the IMF plan as it exists or should he insist on some modification? If modification is needed, what changes should he suggest? What arguments can Dr. Sabankwa make to convince IMF officials to agree to these modifications in the structural adjustment plan?

CHAPTER 7

Analyzing National Economies

"There is no substitute for knowledge."
—W. Edwards Deming

CHAPTER OBJECTIVES

This chapter will:

- Describe the importance of national economic analysis and identify the major indicators used in this analysis
- Describe the sources of data and research tools that can be incorporated in national economic analysis
- Discuss the results of analysis as inputs to developing an international marketing strategy

While W. Edwards Deming was a noted quality expert, the quote at the beginning of this chapter still serves as an important introductory statement for international business. Whether the aspiring international business is large, midsize, or small, the analysis done before venturing into foreign markets is crucial for success. Sometimes equally important is the level of ongoing analysis that is undertaken once the international venture has commenced. The analysis of national economies is an ongoing process; the nimble business is one that can respond to changes on the ground in all of its markets of operation. In order to respond in a timely manner, a solid foundation of understanding of the various markets is vital.