

The Study Program

Classes:

International Business Management	Winter	4 Sws = 6 Credits
International Corporate Governance	Winter	2 Sws = 3 Credits
International Financial Management	Summer	2 Sws = 3 Credits
Western European Business	Summer	2 Sws = 3 Credits

Seminars:

International Business Research	Winter	2 Sws = 8 Credits
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Various classes and seminars offered by Professor Backhaus, but also other colleagues.

Western European Business: Syllabus Summer 2009

Time: Tuesday 12:15 – 13:45, J 2
Wednesday 16:15 – 17:45, J 2

Text: Reading Package

Date Topic

14.04. Political Economy Foundations
15.04. Historical Precursors; European Reconstruction
15.04. The beginnings of the EU (18:15 – 19:45; J 2)
21.04. Theory of Supranationalism; European Community Law
22.04. EU Institution, Decision-making, and Lobbying
28.04. European Economic Integration
29.04. European Monetary Integration
05.05. European Social Integration
12.05. EU Enlargement and the Constitutional Question
13.05. EU Competition Policy & Privatization
19.05. Case Study
20.05. Case Study
26.05. Examination (F1, Fürstenberghaus)

Vorlesung Western European Business

INTRODUCTION: WESTERN EUROPEAN BUSINESS

Course Objective:

Study the European Business Environment:

Legal, Cultural, Role of government

Central: Political and Economic Integration of Europe

Hence: study political mechanism of economic integration

Beneficial: know some European history!

The History of Migration in Europe; Rise (and Demise) of the Nation State

Context: An economic theory of political regimes

Understand history in a more analytical context.

Review of 'Institutionalized Corruption'

Economic Analysis of Anarchy and Dictatorship.

A Theory of Gangs; Equilibrium in an Warlord Economy

Predatory Hierarchies

Equilibrium within and among nations.

Efficient rent-seeking in dictatorial regimes.

Corruption Pyramids

Methods of rent-seeking in different political regimes.

Attitudes towards international economic activity in democracies.

Context

Classification of Economic Theories

- Constitutional Economics: Functioning Property Rights
- Constitutional Politics: Politically motivated redistribution in a constitutional setting
- Non-Constitutional Politics: The Jungle

Questions:

- What kind of social structures emerge in the absence of Law?
- What relationship exists between combat activity and economic output?
- How do nations emerge?
- What is the relation between rent-seeking and Politics?
- How does "Corruption" fit into this analysis?

Economic Theories of Conflict and Dictatorship

Conflict Equilibria

		Combat Decisiveness	
		Low	High
Resources	Equal	Cooperation	Constant War
	Unequal	Paradox of Power	Slavery

Dictatorship Equilibria

Strong dictator

Few soldiers

No insurrection

Low tax rate

High total output

Weak dictator

Many soldiers

High probability of insurrection

High tax rate

Low total output

Economic Theories of Dictatorship and Combat Compared

Difference: Combat has a 0,1 outcome; The dictator chooses a tax rate

Similarities:

Total equivalence of combat technology in anarchy and dictator game.

Strong dictator	=	anarchy equilibrium of slavery (save tax rate).
Weak dictator	=	anarchy equilibrium of the Paradox of Power.
Dictator game	=	2-player anarchy game with unequal endowments.

Critique: There is only one dictator, not a ruling *class*.

Open questions:

How does the dictator defend himself against a palace revolution?

How do dictatorships arise from anarchy?

Gang Equilibrium

The gang leader tries to maximize future expected consumption utility.

The leader

- defines a sharing rule among members (the more he keeps, the more utility he enjoys, but the higher the likelihood of an internal overthrow),
- decides on the size of the gang (the larger, the stronger, but also the greater the likelihood of an internal overthrow),
- and decides on the size of the territory controlled (the larger the territory, the more income from subjugation, but the greater the likelihood of a peasant revolution).

The gang leader's choice is determined by

- the combat skills of himself and individual gang members, as well as the gang as a whole,
- the productivity and combat skills of peasants,

In equilibrium, there is a finite number of gang members, which subjugates a finite number of peasants into slavery. This is a WARLORD Economy.

Predatory Hierarchies

What happens if neighboring gangs collide in warfare?

Subjugation of rival gangs into slavery is suboptimal, because the territory is increased beyond optimal size.

Integration of the losing gang into the winning gang is suboptimal because of an increased probability of a palace revolution.

One solution: *Peregrinacam*

Predatory Hierarchies

We offer **SUBORDINATION** as an organizational solution to increase the span of control of predatory teams.

Subordinated gangs have to be

- weaker than the central gang
- better off than the peasants they control
- and must pay dues to the central gang

The equilibrium to prevent subordinated gangs from toppling the central gang is similar to the equilibrium within a gang to minimize the chances of a palace revolution. Important is the probability that the aristocracy (the subordinated gangs) overthrow the King (central gang).

DIVIDE ET IMPERA

The Emergence of Nations

Are there limits of empire?

Like gangs, predatory hierarchies have an optimal scale.

Examples:

The fall of the Roman Empire, the disintegration of the territory controlled by Charlemagne, and the reduced power of the King of England after the Magna Charta make the case empirically.

Geography and the Emergence of Nations

A geography may randomly feature areas that

- can either provide no advantage for either offensive or defensive technology (e.g. open plains; *weak defense*), or that
- can provide significant advantages to defensive technologies (e.g. mountain ranges, rivers, coast lines; *strong defense*).

Predatory teams control territory offering no advantage to defensive technology, while the borders are defined by lines offering great defensive advantages.

Within borders, dictatorships emerge as predatory hierarchies, and enforce an equilibrium of **SLAVERY** with their peasantry.

THIS IS OUR DEFINITION OF A NATION!

Across borders, anarchy prevails. Since border regions favor defensive technology, neighboring states can achieve an equilibrium of **CO-OPERATION** (Peaceful coexistence).

Efficient Rent-Extraction

How does a rational dictator maximize his income?

The literature simply talks about a tax *rate*.

Taxation problems:

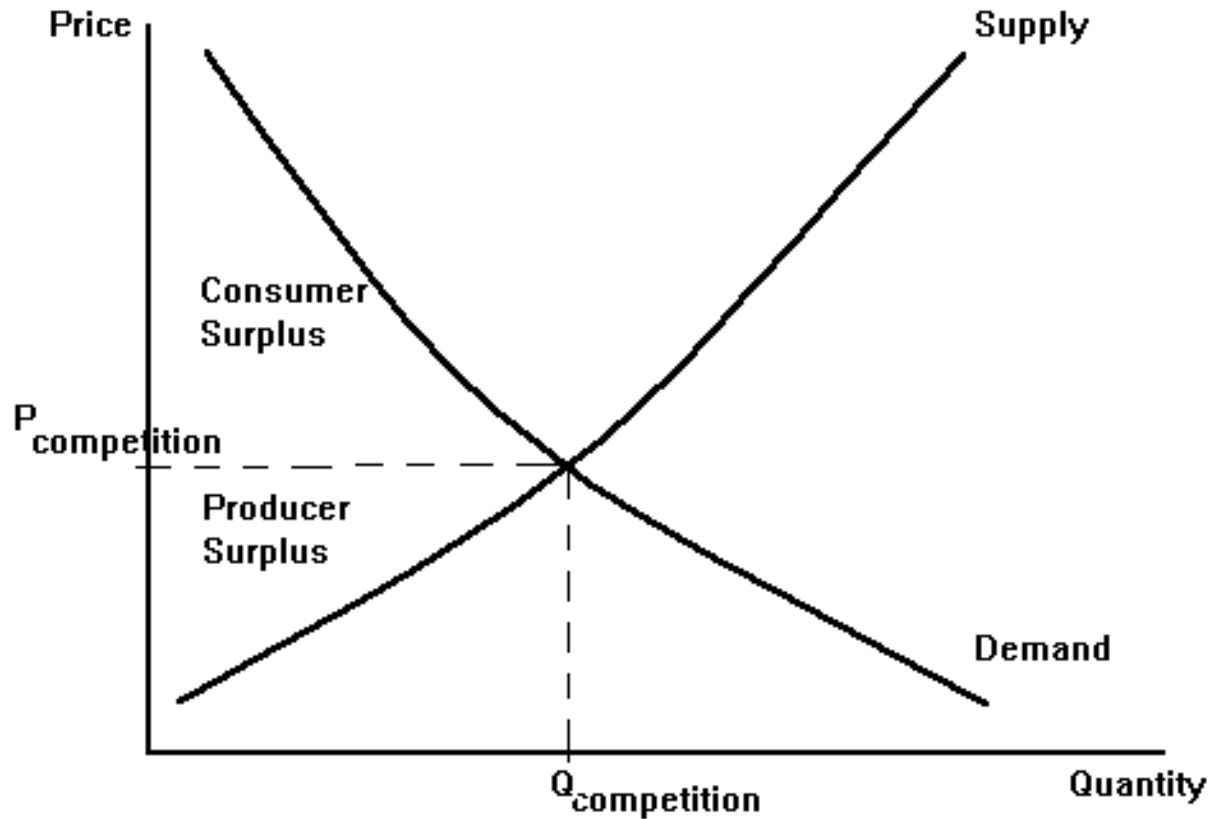
- Fixed collection costs per head.
- How to tax consumer surplus?

Solution: Taxation via monopolies

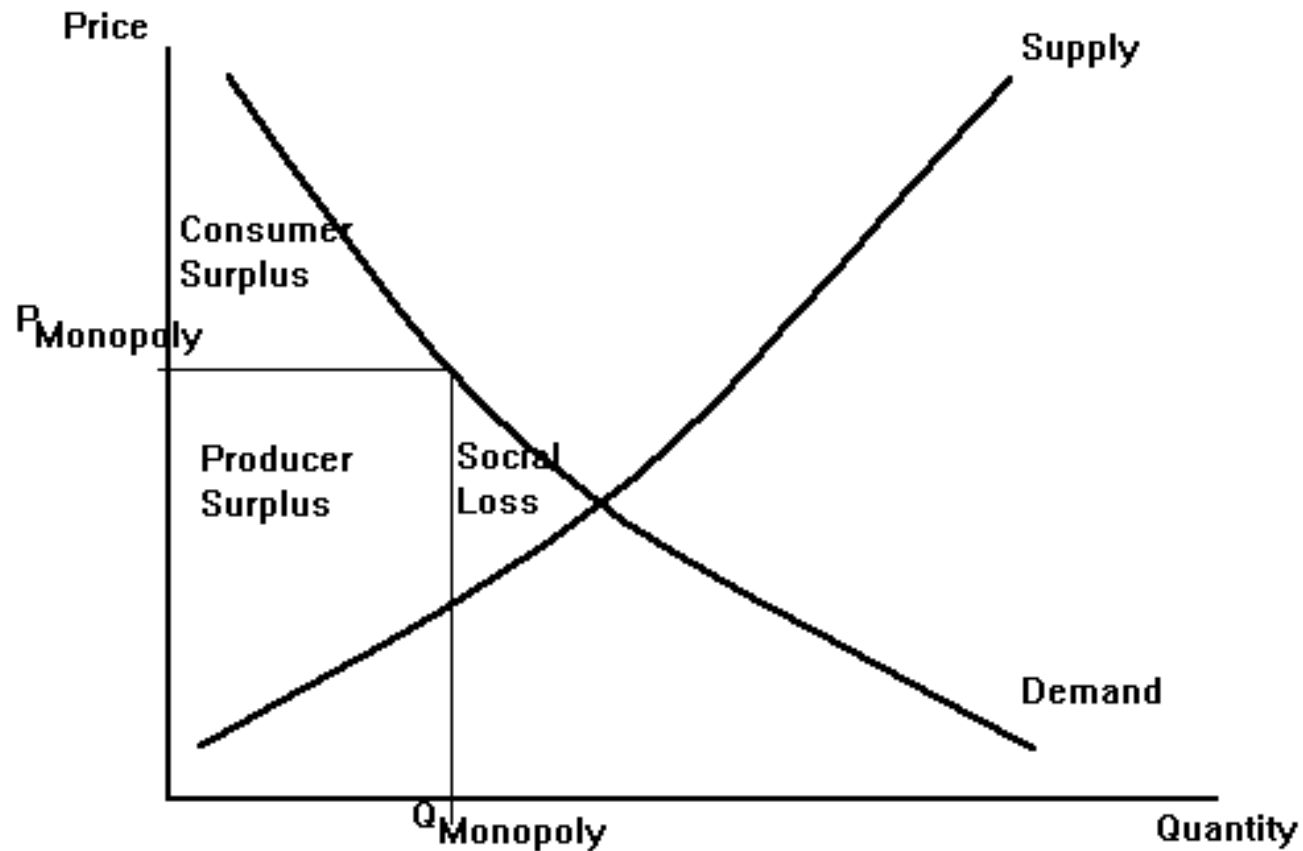
- Large industry is monopolized directly: **Crony Capitalism**
- Small industry is forced (by Law) through a licensing bureaucracy: **Corruption**

Both monopolies and corrupt bureaucracies are equivalent to the predatory hierarchies that stabilize a dictator's span of control. They are both an efficient means of rent extraction as well as a device to solidify the dictatorship.

Competitive Equilibrium



Monopolistic Equilibrium



Crony Capitalism Then and Now

The agricultural society

Agricultural production is land-intensive.

Land is thus economically as well as militarily important

The monopolization of agricultural production is aided by the monopolization of land.

Kings, Aristocracies, “Lehenswesen”

Alternatively Marcos in the Philippines: Marketing Boards for Sugar and Copra

Crafts

Trade Guilds monopolize access to jobs

This finances German “Fürsten” as well as Chinese Mandarins

Industry

Overtook European Aristocracy

Indonesia: Suharto’s friends and family on altogether 1200 corporate boards

Corruption Pyramids

How does the dictator gain from corruption?

Low-level bureaucrats are given licensing monopolies to extract rents from the public. These are the 'collection agents' (Equivalent to the Finanzamt in a democracy).

How does the money get from the bureaucrat to the dictator?

- The bureaucrat receives a below subsistence salary (his income does not feed his family).
- He thus depends on corruption income from his licensing monopoly.
- If he doesn't pass most of the corruption proceeds upstream, the signature authority regarding the licensing monopoly is diluted.
- Similar mechanisms are at work at higher places in the hierarchy.

Institutionalized Corruption

The contribution to the corruption literature here is

- Corruption is not necessarily a decentralized and coincidental phenomenon
- Corruption can be systemic and deliberate
- Corruption pyramids are the rent-seeking tools of predatory political regimes
- They both stabilize and maximize the income of the dictatorial elite

But: corruption pyramids serve to prevent an internal overthrow:

FIGHTING CORRUPTION CAN THREATEN POLITICAL STABILITY!

Is corruption the right term for this rent-seeking activity?

As Ronald Wraith and Edgar Simpkins say of English history: *"For two hundred and fifty years before 1688, Englishmen had been killing each other to obtain power ... The settlements of 1660 and 1688 inaugurated the Age of Reason, and substituted a system of patronage, bribery and corruption for the previous method of bloodletting."*

Corruption, Rent-Seeking and Politics

We learn that corruption was - in its origin - a political innovation arising from pure anarchy.

CORRUPTION IS RENT-SEEKING!

We can now establish a link from political system to rent-seeking structures:

POLITICAL REGIME

Anarchy

Warlordism

Dictatorship

Benevolent Monarchy

'Weak' Democracy

Modern Democracy

RENT-SEEKING PATTERN

'Each against all'

Competitive corruption

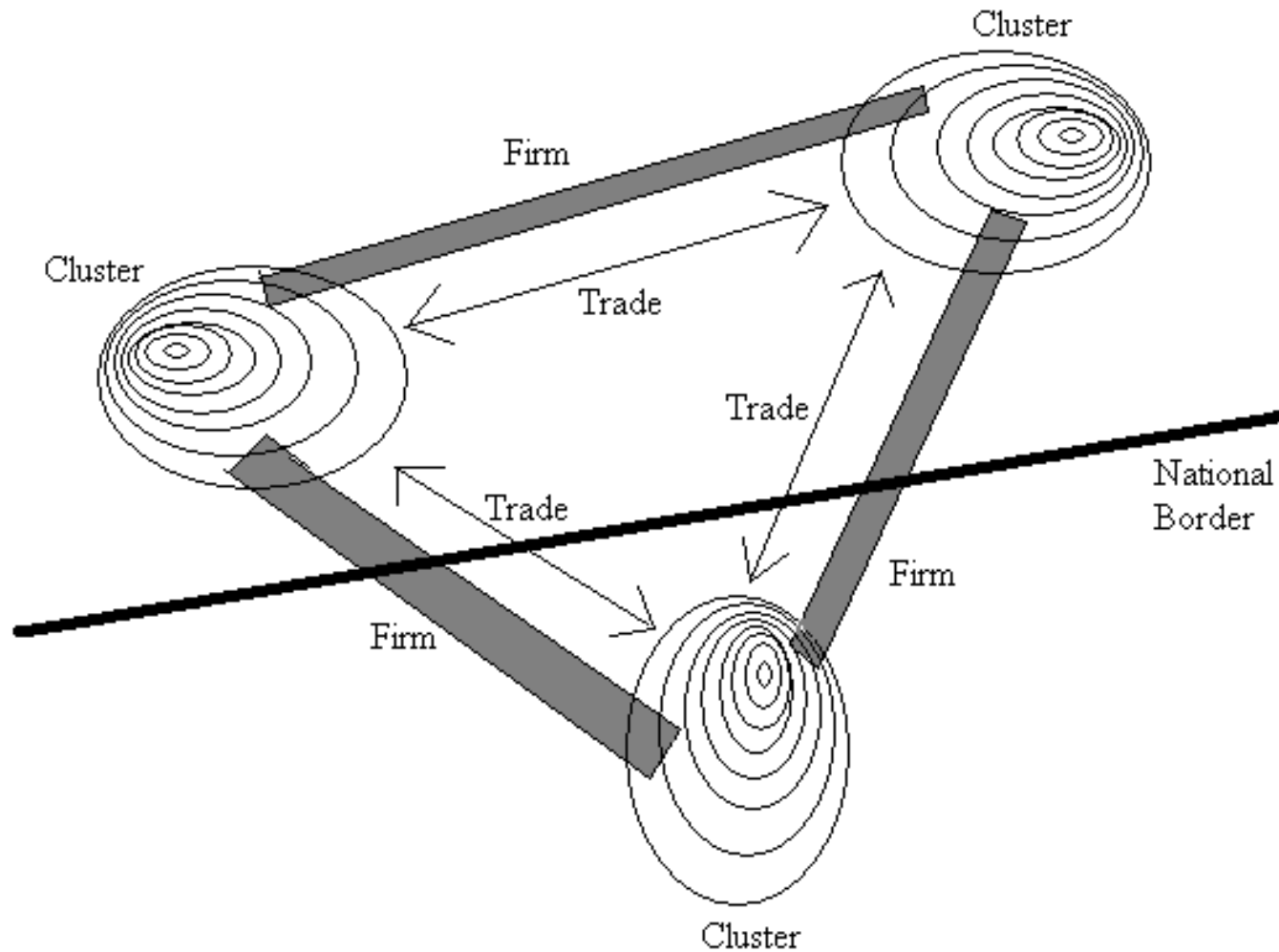
Monopolistic Corruption

'True' Corruption

Political Corruption

Interest Group Rent-seeking

Putting it all together: Politics and International Economic Theories



Mature Democracy

Characteristic:

Democratic elections; political constituencies

Redistribution towards small but significant interest groups

Corollary: labor has better representation than consumption

Governments:

Welfare / growth orientation, interest group constraints

Supremacy of Ricardian trade ideal; special interest aftermath

WTO negotiations, EU development

Labor is favored over consumption

Exports are good, imports are bad

Inward FDI is good, outward FDI is bad

Subsidies to attract inward FDI, prevent outward FDI

Neo-mercantilism! Equilibrium?

Clusters: *Giesskannenprinzip!*

MNE: Strong Lobbying efforts; PR awareness

Recent examples: Western Europe, North America, Japan
Vorlesung Western European Business

Weak Democracy

Characteristic:

On the surface, identical to mature democracy

Legislative choices in part determined by political corruption

Governments:

Officially behave like mature democracies

Inofficially support those who can pay bribes: only “capital”?

Irony: Logical inconsistencies of mature democracy give rise to corruption

Political corruption may “restore” equilibrium:

Less - or more exceptions to - import restrictions

Illicit subsidy flow-backs from inward FDI (Leuna?)

More prioritization of regional clusters

MNE: Lobbying plus illicit campaign financing

Increased risks: Japanese Yakuza?

Recent examples: Western Europe, North America, Japan, South Korea