

# A Primer on Important Legal Aspects of the International Business Environment

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## Abstract

“Despite the power of globalization, various systems still prevail in the world. Certainly, there are points of overlap and convergence. Yet, for all intents and purpose, significant differences persist between the principle forms of legal systems.”<sup>1</sup>

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**JEL Classifications Codes:** F23, K30, K33

## 1. Introduction

**Globalization** reflects the business orientation or viewpoint based on a core belief that the world is becoming more homogeneous and that distinctions between national markets are not only becoming less relevant, but for some products or services, will actually disappear. However, is there such a thing as a globalized legal environment?

*Kenichi Ohmae*, the Japanese management expert, coined the phrase “borderless world.”<sup>2</sup> Much of our understanding about globalization comes from the writings and research of Professor Ohmae, Japan’s management *guru*.

## The Five Stages of Globalization

According to Professor Ohmae, there are five interrelated stages in the globalization process:<sup>3</sup>

1. Exporting, using the distribution system or agents of a business found in the *host* country;
2. Exporting, setting up a distribution system in the host country;
3. Manufacturing and distributing products in the host country—but maintaining a company’s ties with its “home” country, perhaps by acting as a subsidiary corporation or entity of the *parent* company;

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<sup>1</sup> See <http://www.droitcivil.uottawa.ca/world-legal-systems/eng-monde.html> (last visited May 18, 2007).

<sup>2</sup> Kinichi Ohmae, *The Borderless World* (1990).

<sup>3</sup> Professor Ohmae’s “stage theory” is discussed in John Baguley, Chris Cornforth & Geoff Mallory, “How do Northern Non-Governmental Organizations (NGOs) Internationalise?: A Stage Theory Approach,” at [www.crida-fr.org/03\\_actualites/streams/stream%202/2-ISTR-EMES\\_paper\\_Conforth.rtf](http://www.crida-fr.org/03_actualites/streams/stream%202/2-ISTR-EMES_paper_Conforth.rtf) (last visited May 21, 2007).

4. **Insiderization**, becoming like any other manufacturing concern located in the host country—acquiring the **identity of a national company or entity**; and finally,
5. **A fully globalized company**—operating in many host countries simultaneously; where it may be difficult to ascertain the country to which a fully globalized company is associated or which is its origin.

### Business Strategies

In an attempt to become a globalized company or to operate in a fully globalized world, companies must plan. What are some business strategies and business organization forms that have been traditionally employed by companies seeking to penetrate into the international business arena?

- An **international company** is a business that engages directly or indirectly in *any form* of international business activity such as exporting, importing, or production. Most American companies (and perhaps foreign national companies, as well) would be classified as international companies today under this broad definition!
- A **multinational company** (MNC)<sup>4</sup> is a business that has *direct investments* (in the form of marketing/sales or more usually, *manufacturing subsidiaries*) abroad in one or several nations, called *host countries*.
- A **joint venture** is a separate company or entity that is created and *jointly owned by two or more independent entities* (joint venture partners) in order to achieve a common business objective.<sup>5</sup> Joint ventures are popular because they reduce risk, involve opportunities to penetrate markets that would not be possible without significant local ownership or access (often, in *emerging markets*, the joint venture partner will be the government, thus reducing political risk), and help gain access to another company's distribution or marketing network.

For example, the Chinese market was originally penetrated through joint venture activities, with the Chinese government itself as the joint venture partner. *International franchising* is often considered as a sub-set of joint venture activities and is a direct form of business penetration into the economy of a host country,<sup>6</sup> however, based on the *quality control* obligation of the franchiser.

- A **strategic alliance**<sup>7</sup> occurs where two or more entities cooperate but do not form a separate company to mutually achieve the strategic goals of each. The building of the European Air Bus was accomplished through a multinational governmental alliance.<sup>8</sup>

<sup>4</sup> See [http://cnmoney.com/magazines/fortune/global500/2006/full\\_list/](http://cnmoney.com/magazines/fortune/global500/2006/full_list/) (containing a complete list of the 500 leading global companies or MNCs by revenue in 2006). The "top ten" includes:

|                      |                    |
|----------------------|--------------------|
| 1. Exxon Mobil       | 6. Chevron         |
| 2. Wal-Mart Stores   | 7. DaimlerChrysler |
| 3. Royal Dutch Shell | 8. Toyota Motor    |
| 4. BP                | 9. Ford Motor      |
| 5. General Motors    | 10. ConocoPhillips |

<sup>5</sup> The Cornell Law School, Legal Information Institute (LII), offers the following definition-discussion:

A joint venture is a legal organization that takes the form of a short term partnership in which the persons jointly undertake a transaction for mutual profit. Generally each person contributes assets and share risks. Like a partnership, joint ventures can involve any type of business transaction and the "persons" involved can be individuals, groups of individuals, companies, or corporations.

Joint ventures are also widely used by companies to gain entrance into foreign markets. Foreign companies form joint ventures with domestic companies already present in markets the foreign companies would like to enter. The foreign companies generally bring new technologies and business practices into the joint venture, while the domestic companies already have the relationships and requisite governmental documents within the country along with being entrenched in the domestic industry.

Retrieved from [http://www.law.cornell.edu/wex/index.php/Joint\\_venture](http://www.law.cornell.edu/wex/index.php/Joint_venture) (last visited May 21, 2007).

<sup>6</sup> See, e.g., Hector R. Lozada & Richard J. Hunter, Jr., "Master Franchising/International Franchising—A Primer on Marketing and Legal Aspects," *Jones Law Review*, Vol. 22, No. 1 & 2, pp. 45-71 (December 2000); Richard J. Hunter, Jr., Hector R. Lozada & Gary H. Kritz, "Master Franchising as an Entry Strategy: Marketing and Legal Implications," *The Coastal Business Journal*, Vol. 4, No. 1, pp. 16-28 (2005).

<sup>7</sup> See, e.g., David C. Mowery, Joanne E. Oxley & Brian S. Silverman, "Strategic Alliances and Interfirm Knowledge Transfer," *Strategic Management Journal*, Vol. 17 [Special Issue: Knowledge and the Firm], pp. 77-91 (Winter, 1996).

<sup>8</sup> See <http://www.airbus.com/about/history.asp> (last visited May 21, 2007).

Airbus was established in 1970 as a European consortium of French, German and later, Spanish and U.K. companies, as it became clear that only by co-operating would European aircraft manufacturers be able to compete effectively with the U.S. giants. By overcoming national

## 2. Forces Spurring Globalization

In the past decade, there have been several major forces that have spurred the move toward globalization. These include:

1. *Lowering of trade and investment barriers*, originally through a trading regime called the GATT<sup>9</sup> (accomplished through various negotiations, termed *Trade Rounds*<sup>10</sup>), development of Intellectual Property Rights (IPRs),<sup>11</sup> and the creation of the World Trade Organization (WTO)<sup>12</sup>;
2. The *development of information technology*, especially in E-Commerce, finance, banking, and medical technology;
3. Innovation and improvements in *transportation and communications*; and
4. *Economic transformation through privatization* efforts throughout the world—either through *economic privatization* (caused by the collapse of the former command-and control system)<sup>13</sup> or *political privatization* (caused by a change in the governing economic philosophy in a nation—i.e., “Thatcherism” in Great Britain or the recent debate in the United States concerning thus far unsuccessful efforts to privatize a portion of the Social Security system).

All of these forces actors include significant legal implications that must be considered and addressed. Effective managers operating in an international business environment must understand the legal environment within which they will operate. This imperative leads us to a discussion of the major legal systems that exist throughout the world. In attempting to gain an understanding of the world’s leading legal systems, it is also important to understand who is the “decision maker” within a nation’s legal system. In general terms, legal systems will vary greatly from country to country in terms of treatment of several important legal variables which may include “tradition, precedent, usage, custom, or religious precept.”<sup>14</sup>

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divides, sharing development costs, collaborating in the interests of a greater market share, and even agreeing a common set of measurements and a common language, Airbus changed the face of the business, and brought airlines, passengers and crews the benefits of real competition.

*Id.*

<sup>9</sup> The General Agreement on Tariffs and Trade (GATT) was originally created by the Bretton Woods Conference as part of a comprehensive plan conceived of by the United States and Great Britain for economic recovery after World War II. The GATT was organized in order to reduce barriers to international trade through the systematic reduction of tariff barriers, quantitative restrictions and subsidies on trade through a series of intergovernmental agreements. The GATT was an *agreement, not an organization*. The founder of the GATT envisioned that it would one day become a full international organization like the World Bank or IMF called the International Trade Organization. However, the agreement was never ratified, and the GATT remained in its original form. The functions of the GATT have been replaced by the World Trade Organization which was established through the final round of negotiations in the early 1990s.

<sup>10</sup> Round are a cycle of multilateral trade negotiations under the authority of the GATT, culminating in simultaneous trade agreements among participating countries to reduce tariff and non-tariff barriers to trade. Eight "Rounds" have been completed thus far: Geneva, 1947-48; Ancey, France, 1949; Torquay, England, 1950-51; Geneva, 1956; Geneva, 1960-62 (the Dillon Round); Geneva, 1963-67 (the Kennedy Round); Geneva, 1973-79 (the Tokyo Round); and Geneva, 1986-1993 (the "Uruguay Round"). The present round of negotiations is termed the “Doha Round.”

<sup>11</sup> See Richard J. Hunter, Jr., “A Primer on Key International Intellectual Property (IPR) Issues,” *European Journal of Economics, Finance and Administrative Sciences*, Issue 5, pp. 103-111 (2006).

<sup>12</sup> See <http://www.wto.org> (last visited May 24, 2007).

<sup>13</sup> For a case study of economic privatization in Poland, see Richard J. Hunter, Jr. & Leo V. Ryan, C.S.V., “Privatization and Transformation in Poland,” *The Polish Review*, Vol. 49, No. 3, pp. 919-943 (2004). Central planning literally collapsed in the region of Central and Eastern Europe at the beginning of the decade of the 1990’s because of a combination of four interrelated factors:

- Failure of the system to create economic value;
- Failure of the system to provide adequate incentives;
- Failure of the system to “measure up” to comparative economies; and
- Failure of the system to satisfy basic consumption needs (creating the “dollarization” of the economy through the existence of large “black markets.”).

Reform of the central planning system has involved the following actions on the part of both society and individuals:

- Attaining political stability and pluralism, accomplished through holding free and multiparty elections;
- Implementing a program of real economic reform with the evolution to a full market economy, involving an emphasis on the development of a substantial private sector and a reduction of the state sector through a multi-track program of privatization; and
- Creating and nurturing basic institutions of capitalism, including banking systems, credit institutions, customs and clearing houses, currency exchanges, a stock market, and creation of investment funds and investment vehicles.

<sup>14</sup> John D. Daniels, Lee H. Radebaugh & Daniel Sullivan, *International Business*, p. 102 (11<sup>th</sup> Ed., 2007).

### 3. Systems of Law

In general terms, a nation's legal system provides the context, the means, and methods within which it regulates business practices, defines the parameters within which companies and individuals conduct business transactions, specify both the rights and obligations of parties who are involved in business transactions, and addresses the methods of legal redress to those who believe they are entitled to some type of recourse in the legal system.

The following legal considerations are often listed as paramount in deriving, formulating, and executing an international company's strategic plans:<sup>15</sup>

#### Strategic-Legal Concerns

- Product Safety and Product Liability: Many international companies are required to customize or modify products to comply with local standards and specifications. Product liability law is well developed in the United States, the European Union, and in many wealthy nations throughout the world. In contrast, product liability laws are nominally existent, non-existent, or arbitrary throughout much of the less-developed world. While product liability law provides for an award of punitive damages<sup>16</sup> as a measure of damages in product defect cases,<sup>17</sup> this practice is far less common in most countries throughout the world.
- Marketplace Behavior: National legal systems determine the legality of such practices as *pricing, distribution, advertising, and promotion* of products and services. Antitrust or anti-monopoly law is an important aspect of international business law.
- Product Origins: National legal systems determine the flow of products across its national borders in order to assess any charges (import fees or duties) that may be due for the right to bring products into a local market. In many cases, nations are especially concerned with the issue of *local content*—the proportion of a product that is made in the local market versus made outside of the local market.
- Legal Jurisdiction: Each country has developed a comprehensive regime for determining which law should apply in any given situation and where litigation should take place (venue) in case of a dispute between multinational parties. Companies involved in international business transactions must be careful to include a *choice of law clause* and a *choice of forum clause* that specifies which law will govern a dispute. Internationally, many nations subscribe to the CISG, or the United Nations Convention on Contracts for the International Sale of Goods,<sup>18</sup> in order to resolve contract disputes arising under international contracts.

<sup>15</sup> Adapted and developed from *id.* at p. 108.

<sup>16</sup> Punitive or exemplary damages are damages awarded to a plaintiff *over and above* provable damages where a wrong done to the plaintiff was aggravated by circumstances of violence, oppression, malice (libel/slander); fraud ("scienter"); "wanton or wicked conduct" on the part of the defendant; to punish a defendant for "evil behavior"; or to make an example of him.

In many products liability cases based on a theory of strict liability cases, the issue of awarding punitive damages usually occurs **after the case-in-chief** (*sometimes called Step 2*), where the plaintiff can offer proof regarding the nature of the defendant's conduct. It should also be recognized that while the normal quantum of proof in civil cases in the United States is that of the preponderance of evidence ("is it more or less likely that the event took place..."), courts will require "clear and convincing proof" to prove that type of conduct required to award punitive damages.

<sup>17</sup> The predicate of a suit in products liability is a *defective product*. This defect can be shown from three common sources:

- A manufacturing or production defect, which occurs from a random and atypical breakdown in the manufacturing process.
- A design defect that is a characteristic of a whole product line (the classic *Pinto* case from the United States is a prime example of a design case).
- A marketing defect – involving defective warnings about risks or dangers or inadequate instructions about how to properly (or safely) use a product (most cases involve food, drugs, or more recently, children's toys or car seats).

<sup>18</sup> For U.S. citation purposes, the UN-certified English text is published in 52 Federal Register 6262, 6264-6280 (March 2, 1987); United States Code Annotated, Title 15, Appendix (Supp. 1987). The **United Nations Convention on Contracts for the International Sale of Goods (CISG)** is a treaty offering a uniform international sales law that, as of 2006, had been ratified by 72 countries that account for three-quarters of all world trade. (It should be noted that as a common law country, the UK is not among the countries that have ratified the CISG, despite being a leading jurisdiction for the choice of law in international commercial contracts.) The CISG was signed in Vienna in 1980. The CISG came into legal force as a multilateral treaty on January 1, 1988, after being ratified by ten countries. Countries that have ratified the CISG are referred to within the treaty as

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"Contracting States." Under international law, unless specifically *excluded* by the express terms of a contract, the CISG is deemed to be incorporated into (and supplant) any otherwise applicable domestic law(s) with respect to a transaction in goods between parties from different Contracting States.

At present, "Contracting States" include:

- [Argentina](#)
- [Australia](#)
- [Austria](#)
- [Belarus](#)
- [Belgium](#)
- [Bosnia-Herzegovina](#)
- [Bulgaria](#)
- [Burundi](#)
- [Canada](#)
- [Chile](#)
- [China \(PRC\)](#)
- [Colombia](#)
- [Croatia](#)
- [Cuba](#)
- [Cyprus](#)
- [Czech Republic](#)
- [Denmark](#)
- [Ecuador](#)
- [Egypt](#)
- [El Salvador](#)
- [Estonia](#)
- [Finland](#)
- [France](#)
- [Gabon](#)
- [Georgia](#)
- [Germany](#)
- [Greece](#)
- [Guinea](#)
- [Honduras](#)
- [Hungary](#)
- [Iceland](#)
- [Iraq](#)
- [Israel](#)
- [Italy](#)
- [Republic of Korea](#)
- [Kyrgyzstan](#)
- [Latvia](#)
- [Lesotho](#)
- [Liberia](#)
- [Lithuania](#)
- [Luxembourg](#)
- [Macedonia](#)
- [Mauritania](#)
- [Mexico](#)
- [Moldova](#)
- [Mongolia](#)
- [Montenegro](#)
- [Netherlands](#)
- [New Zealand](#)
- [Norway](#)
- [Paraguay](#)
- [Peru](#)
- [Poland](#)
- [Romania](#)
- [Russian Federation](#)
- [Saint Vincent & Grenadines](#)
- [Singapore](#)
- [Slovakia](#)
- [Slovenia](#)
- [Spain](#)
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- [Ukraine](#)
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- **Arbitration:** Internationally, arbitration has become a favored mechanism to resolve disputes. Generally, most arbitration is governed by the *New York Protocol*,<sup>19</sup> adopted in 1958, that allows parties to choose their own mediators and resolve disputes on truly “neutral” grounds. Appeal options are severely limited.
- **Protection of Intellectual Property Rights:** The level of protection of international intellectual property rights leads to a conclusion that poorer countries provide weaker legal protection than do richer countries.<sup>20</sup> Likewise, cultural attitudes may also serve to explain differences among countries in the protection and violations of IPRs and in the ability of a nation to attract significant amounts of foreign direct investment or FDI.<sup>21</sup>
- **Property Risks:** Key concerns arise over the protection of private property rights through such actions as *expropriation, nationalization, or confiscation*.<sup>22</sup>

## International Legal Systems

**Common law** is essentially *judge made law*. The common law is found in cases or opinions of judges. The common law is based upon the rule of *stare decisis* or precedent. Judges in common law countries thus rely on *tradition, history, and usage* as expressed or found in prior court rulings in deciding current cases or controversies. The major common law countries of the world are Canada, Great Britain, Ireland, New Zealand, and many of the former British colonies in Africa (for example, Nigeria<sup>23</sup>) and Asia (Singapore and until recently, Hong Kong<sup>24</sup>). Common law is said to provide a great deal of *stability and predictability over time* to the legal system; although *stare decisis*, the basis of the common law system, has also criticized for encouraging the application of outdated precedents or even wrongly-decided cases that perhaps should be discarded. Countries that follow the common law tradition will certainly use statutes, codes, and legislation in deciding cases, but will first look to the rules of a court, custom,<sup>25</sup> judicial reasoning, principles of equity, and prior court decisions in deciding cases.

**Civil law or code law** is a system of law is based on a systematic and extensive codification of laws in a nation. The civil law system thus may have much more rigidity or predictability than the common law system. The civil law tradition may be traced to Roman law (the Code of Justinian)<sup>26</sup> and

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- [Uruguay](#)
  - [Uzbekistan](#)
  - [Yugoslavia](#)
  - [Zambia](#)
  - [USSR\(superseded\)](#)

<sup>19</sup> See *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, Done at New York, on 10 June 1958. “This Convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.”

<sup>20</sup> See Robert L. Ostergard, Jr., “The Measurement of Intellectual Property Rights Protection,” *Journal of International Business Studies*, Vol. 31, p. 349 (Summer 2000).

<sup>21</sup> See, e.g., Richard J. Hunter, Jr., Robert E. Shapiro & Leo V. Ryan, “Legal Considerations in Foreign Direct Investment,” *Oklahoma City University Law Review*, Vol. 28, No. 2 & 3, pp. 851-872 (Summer/Fall 2003/2004). “Perceived obstacles to doing business,” several of which involve significant “legal” aspects include: Corruption; political instability or uncertainty; street crime, theft or social disorder; presence of organized crime or localized mafia; inflation; financing “roadblocks”; exchange rate difficulties; anti-competitive practices; infrastructure deficiencies; unclear system of taxation and unclear tax regulations; and problematic functioning of the judiciary and differences in the legal system.

<sup>22</sup> See Richard J. Hunter, Jr., “Parallels and Lessons of *Kelo*: Property Risks in International Business,” *Business Law Review*, Vol. 39, pp. 35-55 (Spring 2006).

<sup>23</sup> In recent years, there has been a marked extension of Shari’a law in northern Nigeria. See <http://www.africaaction.org> (last visited May 25, 2007). See also Paul Oranika, *Nigeria- One Nation, Two Systems: How Ethnic Rivalry and Religious Fundamentalism Threatens Africa’s Most Populous Nation* (1984).

<sup>24</sup> For a discussion of the unique issue of “One Nation- Two Systems” with regards to Hong Kong, see Tony Fry, “The ‘Futurings’ of Hong Kong,” *Design Issues*, Vol. 19, No. 3, pp. 71-82 (Summer 2003), posted online March 13, 2006, at <http://www.mitpressjournals.org/doi/abs> (last visited May 21, 2007).

<sup>25</sup> Some commentators list as a separate category the *customary law system* that is based on experiences or traditions within a society. At present, only Andorra, Guernsey Islands (U.K.), and Jersey Island (U.K.) apply only customary law in deciding cases.

<sup>26</sup> *Corpus Iurus Civilis* or the Justinian Code was the result of the Roman Emperor Justinian’s desire that all existing Roman law be collected into a simple and clear system of laws, or “code.” Tribonian, a legal minister under Justinian, lead a group of Roman scholars in a 14-month effort to codify the then-existing Roman law. The result was the creation of the first Justinian Code, completed in the year 529. This code was later expanded to include Justinian’s own laws, as well as two additional books on areas of the law. In 534, the Justinian Code, made up of the *Code*, the *Digest*, and

later, to the Napoleonic Code,<sup>27</sup> which was also transported to parts of America through the French. Civil law is based upon a comprehensive *statute or code enacted by the legislature*. (A code is a *compilation* of various individual statutes in any given subject area; for example, in the United States, the *Uniform Commercial Code* or the *Uniform Bankruptcy Code*.) Statutes or codes are enacted by a *legislative body* and may apply to a variety of topical areas such as commercial law, penal (criminal) law, civil procedures, and criminal procedures. Generally, all obligations, rights and duties of citizens or others operating in a civil law nation will flow from the relevant code provision. There are about 70 civil law countries, including France, Germany, most of Eastern and Western Europe, Japan, Cuba, Puerto Rico, Quebec, as well as most non-“English-speaking” nations of Africa, Asia, and Latin America. The United States is a “mixed” common law/statutory law nation, where many of our statutes reflect their common law traditions or roots. The civil law system, at its essence, trusts its elected political officials, rather than its judges, with the responsibility to specify and provide the basis for decision-making in its legal system.

As with American statutory law, *legislative history* is an important part of “filling in gaps” in statutory law. Legislative history comprises the full record of the debates, discussions, hearings, submitted statements, and other materials “made part of the record,” etc. that accompany the passing of an individual statute.

It must be recognized that while judges do not literally “create law,” as in the common law system, judges still play a vital, perhaps critical role, in civil law nations. For example, as most civil law nations do *not* provide for jury trials in many civil cases, the role of the judge is to both *find the facts* (the traditional role of the jury) and *apply the law* (the traditional job of the judge)!

**Theocratic law** relies on religious and spiritual principles to define the legal environment within which both business and individuals will operate. Nations that follow theocratic law may confirm ultimate *legal authority* on religious leaders who will use religious law, precepts, or ideals to govern civil society. An important example of theocratic law today is **Islamic Law**.

Islamic law, followed by many nations in the Middle East and many nations in Central Asia, and Africa, as well as Indonesia, is based on a religious or *theocratic* view of the law. It traces its authority on the dictates of God (Allah), scripture, the *Sunnah*, or the prophetic utterances and practices of the prophet Muhammad, and interpretations of prominent scholars. Islamic law is both *religious and philosophically* based. Islamic law is equated with *Shari’a*<sup>28</sup> or God’s law and is based extensively on the *Koran (Quran)*. Islamic law not only dictates personal conduct but also determines conduct in a commercial setting. For example, in Islamic banking or other commercial undertakings, *Shari’a boards* may assess the religious acceptability of transactions, activities, contracts, or plans.

There are two great principles applicable to the business environment:

- It is an individual’s absolute duty to *honor all agreements* entered into; and
- Parties must observe “*good faith*” in all commercial dealings.

In the context of the business-legal environment, there are a few interesting concepts that need some explanation in order to understand Islamic law:

- **Halal**: a practice that is *permitted* under Islamic Law.
- **Haram**: a practice that is *forbidden* under Islamic law.
- **Riba** (literally, interest): a principle of Islamic law that prohibits unearned or unjustified profits in the form of *interest* in a commercial transaction. Specifically, the Koran warns that money should not be “created from money.” Islamic law, however, does permit a bank

the *Institutes*, was completed. Adapted from Justinian Code, "The Institutes: Book I, Section I," *Medieval Legal History Sourcebook*, Last modified: March 4, 2001, at <http://www.fordham.edu/halsall/basis/535institutes.html> (last visited May 22, 2007); Linda Karen Miller, "Justinian as a Law Reformer," *The Byzantine Empire in the Age of Justinian: A Unit of Study for Grades 7-10*, National Center for History in the Schools, University of California, Los Angeles, pp. 35-45 (1997); and, perhaps most importantly, Edward Gibbon: *The Decline and Fall of the Roman Empire*, Vol. IV. Chapter XLIV: "Idea Of The Roman Jurisprudence," at <http://www.fordham.edu/halsall/ancient/gibbon-chap44.html> (last visited May 23, 2007).

<sup>27</sup> French civil code enacted by Napoleon in 1804. It clarified and made uniform the private law of France and followed Roman law in being divided into three books: the law of persons, things, and modes of acquiring ownership of things. In Louisiana, the only civil-law state in the U.S., the civil code of 1825 (revised in 1870 and still in force) is closely connected to the Napoleonic Code.

<sup>28</sup> See, e.g., Michael Mumisa, *Islamic Law: Theory & Interpretation* (2002).

to engage in “project financing” or other forms of “project participation” that do not result strictly in the earning of interest as would be the practice in Western banking.

- **Gharar**: prohibits any gain that is not clearly outlined or defined at the time of the making of the contract.

How then are normal commercial transactions carried out in Islamic nations? How does the legal system conduct itself in a manner that would be considered “normal” in the western world?<sup>29</sup> The Islamic financial-legal system employs the basic concept of *participation* in creating an enterprise, utilizing funds at-risk on a profit-and-loss-sharing basis. The purpose of the participation model is to reduce, as far as possible, speculative risks through the implementation of a “careful investment policy, diversification of risk, and prudent management by Islamic financial institutions.”<sup>30</sup>

- **Ijara**: Islamic project financiers *purchase* the assets of a business and then *lease* them back to the project sponsor at a predetermined markup and on a deferred payment basis during the term of the lease. At the end of the lease, title to the assets passes to the project sponsor.
- **Murabaha**: This is a typical “short-term” commercial finance agreement. A bank buys equipment, fuel or raw materials and sells them to the project manager at a predetermined markup and on a deferred payment basis.
- **Modaraba**: a *partnership type arrangement* where one party (the bank) contributes the financing and the other party provides assets such as property, equipment, or entrepreneurship (experience). Profit sharing is predetermined according to the agreement and losses are borne by the financier (bank).
- **Musharaka**: a typical *joint-venture agreement* where both parties contribute capital and share in the profits and losses in proportion to their investment (similar to a partnership).

It must be recognized that there are many differences between and among Islamic nations, especially nations that are termed as *fundamentalist* (those nations that believe that early Islamic scholars had interpreted the divine law sufficiently and that “independent reasoning” [ijtihad], sometimes meaning modern interpretation, is not necessary or is even forbidden!). In addition to the proscriptions on earning interest, many Islamic nations place *restrictions on the nature of specific investments*. For example, firms may be precluded from investing in alcohol or tobacco products or many forms of “adult” entertainment. Other Islamic nations may restrict the public role that women can play in public life or in many institutions of society, including education and business. These restrictions may also place an Islamic nation, a business entity, or an American subsidy in direct conflict with one or more of the statutes enacted in the United States regarding employment discrimination because American courts have ruled that many of our employment laws apply outside the territory of the United States when an American company operates on foreign soil.

**Socialist law** is *ideologically based*.<sup>31</sup> Socialist law was practiced in the former “fraternal socialist-communist” nations of Central and Eastern Europe, socialist nations in Africa or Asia, and Cuba. Socialist law may trace its origins to the writing, theories, and philosophy of the German philosopher, Karl Marx (1818-1883). Unlike the common law and civil law traditions, in Marx’s view, law has a distinct role and responsibility in society: The purpose of law is to **underscore and support the socialist base and nature of society**. Socialist law is still practiced in many nations that have a strong tradition of state-ownership of the factors of production (land, labor, capital, enterprise or management<sup>32</sup>)—for example, China, North Korea, and Vietnam—as well as many Western European

<sup>29</sup> For a discussion of core principles of Islamic Banking, see Institute of Islamic Banking and Insurance (London), “Islamic Banking—What is Islamic Banking?” at <http://www.islamic-banking.com/ibanking/whatib.php> (last visited May 20, 2007). “Although the western media frequently suggest that Islamic banking in its present form is a recent phenomenon, in fact, the basic practices and principles date back to the early part of the seventh century.” *Id.* (quoting *Islamic Finance: A Euromoney Publication* (1997)).

<sup>30</sup> *Id.*

<sup>31</sup> See, e.g., Christine Sypnowich, “The Concept of Socialist Law,” *The Philosophical Quarterly*, Vol. 41, No. 162, pp. 117-118 (Jan., 1991).

<sup>32</sup> The term factors of production relates to the key factors that go into making goods such as:

- **Land** refers to physical land and other natural resources, e.g., the land that a building is constructed on, oil that is extracted from under the sea, under the land, forests, and fish reserves. Providers of land receive *rent*.
- **Labor** refers to physical and mental effort. Providers of labor receive *wages*.

nations that exhibit state ownership of certain industries or sectors of the economy even though their general orientation is strongly towards “*the market*”—although the emergence of capitalism makes the application of socialist law quite problematic.

There are three *core principles* of socialist law applicable to the international business environment:

1. There is *no real need for an extensive body of commercial law or recourse to courts* because disputes can be resolved through politics or through bureaucratic decision-making (for example, by the *nomenklatura*<sup>33</sup> or the *bureaucratic class that existed in Central and Eastern Europe and still predominates in China*);
2. There is *no (or very little) private property*—all or most all property is owned by the state;
3. *Individual rights may not be of such great concern as are collective or societal rights.*

In this context, law is not seen as a limitation on the rights or powers of government, as it is in the United States (recall the Bill of Rights under the United States Constitution restricting or limiting the power of the Federal government). *Law is simply to function to strengthen the socialist orientation of society.*

#### 4. Conclusions

A thorough understanding of the role and function of law in the international business environment is a critical “skills piece” of the international manager. Only by understanding the range of issues and the elements and characteristics of the legal system, and by developing a clear knowledge of who will be the key decision-maker in the legal environment, can the international manager avoid the pitfalls and traps that might befall the unsophisticated and unknowledgeable in a globalized economy.

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- **Capital** exists at two levels. First, there is financial capital, used to purchase physical capital that goes into making other things. Physical capital consists of machinery, equipment, tools, etc. Providers of capital receive *interest*.
  - **Enterprise** or management is the skill of combining the other factors of production. Entrepreneurs are the risk takers that set up and run business enterprises. Entrepreneurs receive *profit*.

<sup>33</sup> The generic term for the bureaucracy in centrally planned economy is the *nomenklatura*. For an interesting, “inside” description of the *nomenklatura* system, Milovan Djilas, *The New Class* (1957). Djilas is accredited with coining the term “New Class” as a description of the *nomenklatura*. The term “*apparatchik*” usually referred to party members. By the time of the collapse of the Soviet system, first in Poland in the period 1988-1989, and later, throughout the region, the *nomenklatura* system had developed into a highly centralized administrative structure—not only for national economic and political organs but also for intermediary organizations, whereby smaller enterprises operated only as a part of a huge centrally organized bureaucracy. (The other key players in the tripartite structure typically were the State and the Communist Party.) By the late 1980’s, the system had virtually elapsed into a “lunatic collage of incompetence, privilege, pandering and outright corruption,” based on a “principle of underqualification and a ‘perverted practice’ of negative selection.” See Lawrence Weschler, *Solidarity: Poland in the Season of its Passion*, p. 46 (1982). The role of the *nomenklatura* is still hotly debated, especially in Polish society. A pattern was common throughout most of the region of Central and Eastern Europe. Perhaps, not surprisingly, the *nomenklatura* almost immediately became active in private businesses and banks—especially as the prospects for advancing their bureaucratic careers in the new system appeared more limited. [The particular type of privatization carried out by the *nomenklatura* in the early period has sometimes derisively been referred to as “spontaneous privatization.” For a discussion of the phenomenon of “spontaneous privatization,” see Richard J. Hunter & Leo V. Ryan, *From Autarchy to Market*, pp. 112-113 (1998). Directors and managers exercised their new authority to split up state companies or to spin off or divest units into limited liability companies or other new joint ventures. Skilled workers were often transferred to the new enterprises. Members of the *nomenklatura* have also certainly benefited politically and economically from popular discontent that is practically unavoidable during economic reforms started under very difficult economic conditions and circumstances. Members of the *nomenklatura* have been major “winners” in the transformation process. The issue of winners vs. losers in post-communist Poland is discussed at length in Richard J. Hunter, Jr., Leo V. Ryan & Andrew Hrechak, “Out of Communism to What? The Polish Economy and Solidarity in Perspective,” *The Polish Review*, Vol. 38, pp. 328-329, 334-335 (1994).

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