Governments as Owners: Nationalization of International Business and Social Responsibility

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Governments as owners:

Nationalization of International Business and social responsibility

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Purpose – This paper presents a discussion and an analysis of the literature on nationalization of international business. National governments have justified the expropriation and nationalization of the operations of foreign multinational in their jurisdiction based on the social responsibilities as welfare providers, and safeguarding the short and long term interest of their citizens.

Design/methodology/approach – There are multiple studies that show the processes and impacts of nationalizations and privatizations (also called denationalizations) worldwide. This paper analyses specific cases to the light of existing international business literature and proposes prepositions for future studies.

Findings – This paper presents an analysis where theories of internationalization, could be used to analyse specific advantages of States and domestic investors when assuming ownership of operations of international business in their national territory.

Originality/value – The context, processes and consequences of nationalization of foreign firms historically, economic, and politically have generally a correlation either with political changes, and macroeconomic scenarios related to scarcity and uncertainty in the international market of extractive industries; or with nationalistic political views in national governments.

ABSTRACT

This paper presents a discussion and an analysis of the literature on nationalization of international business. The context, processes and consequences of nationalization of foreign firms historically, economic, and politically have generally a correlation either with political changes, and macroeconomic scenarios related to scarcity and uncertainty in the international market of extractive industries; or with nationalistic political views in national governments. National governments have justified the expropriation and nationalization of the operations of foreign multinational in their jurisdiction based on the social responsibilities as welfare providers, and safeguarding the short and long term interest of their citizens.
This paper presents an analysis where theories of internationalization, could be used to analyze specific advantages of States and domestic investors when assuming ownership of operations of international business in their national territory.

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KEYWORDS

Nationalization, Expropriation, FDI, Internationalization, Latin America, CSR, Corporate Social Responsibility.

INTRODUCTION

The end of the 20th century and the beginning of the 21st century have seen a great wave of nationalizations that followed heavy foreign investment in the 1990s, and it has been led by Latin America (Jacobs & Paulson, 2008), portrayed by the expropriation of YPF by the Argentinean government in April-May, 2012. Indeed, many Latin American governments have shifted away from neo-liberal discourses and practices toward policies that greatly support nationalization and protectionism. In particular, the so-called infrastructure industries have been nationalized at a growing speed (Hemphill, 2008). These moves are a return to mid-20th century policies, when, because of Import Substitution Industrialization, public companies in Latin America were conceived as having a vital role in the economic development of the region (Werner, 1996).
Nationalization waves are not new. Several industries were nationalized after the Second World War in Latin America, Asia and Africa, that is, former European colonies (Reed, 2002). This was done in order to rid countries from vestiges of colonialism, like long-term concessions to foreign companies (Jacobs & Paulson, 2008). Moreover, the fact that in the 1980s and 1990s Latin American countries, regardless of their political orientation, adopted neo-liberal reforms including “dramatic privatizations and trade liberalization” (Brooks, 2004: 408) after the nationalization wave of the 1970s is evidence that, as argued by Kevin T. Jacobs and Matthew G. Paulson (2008), nationalization processes are part of a privatization-nationalization cycle which is present throughout the world.
Correspondingly, the 1970s internationally also experienced a sequence of expropriations and nationalizations associated with the peak oil, and the predictions of present and future international scarcity of the resource. However, the amount of cases of expropriations and nationalizations declined in the years after. In 1976, it was published in JIBS a paper by Hawkins, Mintz & Provissiero (1976) in which there were analyzed 170 cases of takeovers of American firms by foreign governments after the Second War World. It was reported in this paper that most of these takeovers occurred in Latin America, the vast majority of them were in extractive industries, and almost fifty percent of the cases were associated with crises in leftist governments, and nationalistic trends. Schrijver (1997) claims that these series of nationalizations obeys to the desire of developing nations to safeguard fair exploitation provisions regarding natural resources, in a context of domestically and internationally highly demanded raw materials.

After presenting this introduction, this paper will analyze the literature on nationalization of foreign firms. Furthermore, it will discuss corporate social responsibility approaches, while exploring if theoretical frameworks of firm internationalization could be used to explained nationalizations.

NATIONALIZATION AND PRIVATIZATION

There are multiple studies that show the processes and impacts of nationalizations and privatizations (also called denationalizations) worldwide. There are studies of nationalizations in regions, like Latin America (see Murillo, 2002, and Murillo & Martínez-Gallardo, 2007) and the Middle East (see Jacobs & Paulson, 2008). Other studies focus on the experiences with nationalization and privatization in specific countries, like Peru (see Champion, 2001), Argentina (see Werner & Montes-Rojas, 2008) and France (Cohen, 2010). Even other studies focus on the specific industry that was nationalized or privatized: the case of bank nationalization in Pakistan (see Shar, Shah & Jamali, 2010, and Akram et al., 2011), in Mexico (see Maxfield, 1992) and in India (Ketkar & Ketkar, 1992); the case of pension funds in Argentina (see Kay, 2009); the case of coal in the United Kingdom (see Haynes, 1953, and Ackers & Payne, 2002); the case of bauxite in Guyana (see Grant, 1973) and copper in Chile (see Petras, 1973) and in Zambia (see Stoever, 1985); the nationalization of the oil sector in Venezuela (see Bye, 1979; Cho, 2011), in Nigeria (See Genova, 2010), in Iran (see Ghasimi, 2011; Qaimmaqami, 1995), in Spain (Shubert, 1980) and the diffusion effect of oil nationalization across several countries or regions (Kobrin, 1985); nationalization of gas in Bolivia (see Haarstad, 2009); and even education in Taiwan (see Mok, 2002).

As can be seen, not only governments of the developing world have taken upon nationalizing industries: even some of the world's most advanced economies, like France and Great Britain, have done it. Nor is it an exclusive phenomenon of the political left: France, dubbed "the nationalization nation" by Paul Cohen (2010), underwent a wave of nationalizations shortly after the Second World War led by right-wing president Charles De Gaulle. The state took control of companies in the energy, transportation (including Air France) and finance sectors, while reorganizing extractive industries. In Great Britain, on the contrary, the nationalization of the coal industry began with a broad coalition of the 'Old Left' (Ackers & Payne, 2002) and little or nothing changed with the return of the Conservatives in 1951 (Haynes, 1953).

Hence, there are arguments on both sides of the political spectrum to support nationalization (and even within socialism there are different conceptions of nationalization: is it about redistribution or production? See Petras, 1975). As explained by A. Beacham (1950), for the socialists nationalization is a matter of principle and they approach the issue with notions of social welfare, whereas for the liberals it's a matter of expediency and they approach the issue with notions of economic efficiency. The latter have three main arguments to nationalize an enterprise: first, whenever fixed capital costs means losses, subsidies are required to continue, which bring state control. Thus, state ownership is easier. Second, given that monopolies (as in energy and basic services) require state control, public ownership could be easier as well. Finally, nationalization is preferable whenever private companies are unable to "take sufficiently long views" (Beacham, 1950: 552) or when there is a divergence between public (social) and private interests.

Three more recent theories, according to Jean-Jacques Rosa and Edouard Pérard (2010), explain nationalizations and privatizations. The first is a political theory, which considers ideology as the driver of either process. However, the authors argue, it's weak because it assumes that decisions are taken irrationally and changes of ideas go unexplained. The second theory is that of efficiency, which leans particularly to privatization because state-owned enterprises (SOEs) are considered inefficient. Finally, the third theory explains privatization by constraints in state budget, that is, privatization serves a state's financial needs at a given time.

Regarding the political theory, Ellen M. Pint (1990) argues that nationalization and privatization processes have very definite political goals because governments use these processes to redistribute benefits and costs among several stakeholders and interest groups. Although they may be inefficient economically, such processes can be efficient politically because it reinforces a party's rule over the country by benefiting its constituencies. In the end, whether nationalization or privatization is successful or not, the author explains, it depends on the viewpoint because economic inefficiency could be part of successful policies aimed at reinforcing government power or staying in power

Regarding the efficiency explanation, Ernesto Crivelli and Klaas Staal (2010) analyze two efficiency arguments: first, state-owned enterprises have lower allocative efficiency because they have a higher risk of overinvestment than private ones because the latter seek only profit maximization, whereas the first seek social welfare, thus investing in risky opportunities that private actors may not take. Second, regarding productive efficiency, governmental support in favor of private firms reduces their efficiency because it cancels either the incentives to employees or their risk of losing their job. Thus, nationalizating an enterprise can decrease productive efficiency (because of the reduction of employee incentives) and allocative efficiency (because of the risk of overinvestment).

Reasons for privatizing a state-owned enterprise (SOE) are somewhat similar to those argued for nationalization. According to Pierangelo Toninelli (2008), these reasons can be classified in three types: first, there are political and ideological reasons supporting privatization, but they are the opposite of those supporting nationalization. Second, a state may consider privatizing an SOE because of public finance problems, that is, the state may be in need of more liquidity or even a given amount of money to finance something else. Finally, there are also economic reasons for privatization, which basically refer to SOE inefficiency or politicization. In addition, the author reminds that, in the 1990s, privatization processes were thought of as an economic miracles to make former SOEs efficient and harness social welfare, but a mere change of ownership is not enough for that.

So, does nationalization work? William W. Haynes (1953) considers the British nationalization of the coal industry either a mild success or a slight failure because of the few changes, but it would have been worse in private hands for two reasons: one, the attitude of the miners might have been more aggressive, and two, a private owner might not have been willing to invest as much as was needed to reorganize the industry. On the other side of the Channel, France's nationalization was useful for saving companies that were on their way to bankruptcy (like the steel industry), for stimulating both economic growth and the creation of new industries and ensuring the sustainability of sectors such as transportation and energy production (Cohen, 2010).

On the contrary, Werner Baer (1996) explains that, in Latin America, state enterprises started to crumble between the 1970s and the 1980s because they were used as macroeconomic policy instruments, their monopoly positions were abused and their operation was hindered because of political actions. Moreover, the author also argues that income distribution worsened during the period of maximum state intervention in the economy through nationalization and public firms. Thus, the region moved toward a structural reform and privatized many state-owned enterprises, but privatization concentrated wealth in fewer hands than before, thus furthering income distribution imbalances.

Neo-liberal reforms were also aimed at attracting foreign direct investment (FDI). However, the renewed wave of nationalization in Latin America as becomes a danger to FDI inflows. According to Glen Biglaiser and Karl DeRouen, Jr. (2006), it is neither the political regime type nor general economic reforms but the risk of expropriation that is a critical aspect in assessing a country's attractiveness for investors. Moreover, multinational corporations (MNC) will reinvest their profits in the host country if the expropriation risks are minimal and economic prospects still attractive. In other words, the risk of nationalization can be linked to uncertainty of return of investment, which means profit unpredictability and leads to decreasing interest in investing in a risky country.

However, if a company was already operating in a country with expropriation risks, then they could count on their home governments to help them if and when a nationalization occurred. Indeed, the backlashes of both the Mexican and Iranian oil nationalizations prove how powerful companies were: these countries were effectively isolated from the international market. Nevertheless, Theodore H. Moran (1973) explains that, because companies can't count on their home governments to intervene as they used to, they can adopt three strategies to protect themselves from nationalization: first, they must subject as little capital as possible to the risk (that is, halt new investments from the parent companies into the risky country). Second, they must gain as many international supporters as possible because they could react to the nationalization in tandem with the companies' parents. Finally, they must raise the cost of nationalization to the host government to try and dissuade nationalization.

Indeed, such protection is logical for businesses, as their objectives and interests may be at odds with state's or society's. Thus, the question on primacy of interests arises: which come first, corporate or social interests? This question reemerged recently: "Since the beginning of 2008, the privatization movement has dramatically slowed down and the trend has even reversed with the beginning of the financial crisis in September 2008" (Rosa & Pérard, 2010: 110). An enormous amount of calls for bank nationalization in the U.S. has been heard since the abovementioned date, even from recognized figures such as Joseph E. Stiglitz (Rasmus, 2009). Fred Moseley (2009) argues that, if the big banks of the U.S. are too big to fail, then they should be permanently nationalized because government bailout is, in the end, a bailout paid by the taxpayers because of the extreme risks taken by those banks.

Opponents of nationalization (even within the White House) argue that it would be a step backwards, that banks only need liquidity to continue operating soundly and that bank management is too complex and too demanding for the government's capacity. However, the fact that bailouts aren't working means that liquidity is not the issue. Moreover, "[h]ow could government possibly do any worse than the so-called "private experts" now running the banks into the ground?" (Rasmus, 2009: 5).

Thus, the debate is open: to what extent is the government responsible for welfare and the pursuit of social objectives, and to what extent are companies? The next section will address the second part of the question by reviewing corporate social responsibility amidst the current nationalization.

CORPORATE SOCIAL RESPONSIBILITY, WHEN GOVERNMENTS ARE OWNERS

Tobias Grössling and Chris Vocht (2007: 372) explain that "[t]he history of CSR shows that the popularity of the concept is steadily increasing and that more and more companies adopt it as a tool for building or maintaining their legitimacy in society". Nevertheless, despite good intentions, corporate actions continue to be amateurish regarding their social responsibility strategies (Jamali & Mirshak, 2007) because CSR is created through an ongoing series of actions and, in particular, through corporate choosing in three levels: principles of the strategy, processes to be undertaken and results to be expected in line with the principles (Cramer, Jonker & van der Heijden, 2004).

According to Elisabet Garriga and Domènec Melé (2004), studies on CSR can be classified in four groups of theoretical approaches: first, the instrumental theories, which posit that a company's goal is only wealth creation; second, the political theories, which focus on corporations' power, regarding both societies and political arenas; third, the integrative theories, which consider corporations as focused on satisfying social demands; and fourth, ethical or value theories, which focus on companies' responsibility to the societies they operate in. Likewise, Paul C. Godfrey and Nile W. Hatch (2007) argue that there are two major disciplines that frame the academic discussion about CSR: economics and moral philosophy. Theories of CSR are located somewhere along the continuum between the two extremes, either considering them as opposite or as complementary.

Regarding corporate activity itself, Bryan W. Husted and David B. Allen (2006) conclude that MNCs have two broad choices regarding the pursuit of a CSR strategy because, as any other strategy to be implemented, deploying a company's resources follows the assessment of needs and projections of outcomes. Thus, a company can either manage issues bearing in mind a case-by-case analysis, that is, assessing each local and global issues and implementing a tailored strategy for each; or implement a one-size-fits-all CSR strategy globally and, by doing so, accepting the risks of misfits. Additionally, a company's own concept of its social role and responsibilities affects its reputation and enable it to better deal with social demands (Grössling & Vocht, 2007).

However, Vanessa M. Striker, Jijun Gao and Pratima Bansal (2006) explain that social responsibilities of MNCs are part of the debate regarding welfare creation as argued by neoliberal trade philosophy. Neoliberals posit that free trade generates economic gains that, in turn, facilitate the creation and improvement of social welfare, whereas the opponents of this view argue that the abovementioned philosophy actually goes against social justice and is a threat to the environment. Indeed,

> [w]here the CSR agenda is particularly problematic, however, relates not only to limits regarding the scale, scope and quality of CSR interventions and institutions, but the fact that it is part and parcel of a broader 'reform' agenda that promotes both market liberalisation and self-regulation, often at the cost of labour rights, decent wages, employment security, corporate social welfare, universal social provisioning, and both state and trade union regulatory capacity (Utting, 2007: 709).

Thus, "firms can be simultaneously socially responsible and socially irresponsible" (Striker, Gao & Bansal, 2006: 850). Nevertheless, in her studies, Marjo Elisa Siltaoja (2006: 108) has found that "a good business policy with an ethical reference has more influence on reputation than separate, external responsibilities within CSR. It is, of course, worth noting that CSR and corporate reputation are constructions that vary in time as well as in place" because, indeed, the construction of a company's reputation is a process dependent on the perception of key stakeholders. Moreover, and because of the above, a company can have several reputations.

But where do we draw the line drawn between CSR and state responsibilities? Dima Jamali and Ramez Mirshak (2007) argue that improving the welfare of the population in developing countries is unlikely to happen without the participation of the private sector through responsible business activities. In addition, Michael Blowfield (2005) explains that the conception of CSR has, of lately, changed from the simple amelioration of the negative consequences of FDI (particularly focused in environmental protection) to a way to further FDI. Thus, CSR has become linked not only with sustainability but also with international development.

On the other hand, Peter Newell and Jedrzej George Frynas (2007) argue that the fact that some local communities resort to special strategies to hold companies accountable to their actions and promises is evidence that both corporate responsiveness and state support is lacking or even nonexistent in several contexts. Thus, people have to take matters into their own hands to prevent corporate irresponsibility. In addition,

> [n]owhere in the developing world is there any clear example of [resource extraction industries (REIs)] providing an effective spur to development (…) Typically [REIs] have operated in ways - often morally questionable ways - that were clearly designed to frustrate the development plans of developing countries (Reed, 2002: 209)

It thus seems that the question of development and welfare – whether the state or the company is responsible – is quite complex. This paper will contribute to the growing literature on the subject by analyzing the most recent nationalization wave in light of CSR in order to assess the public and private sectors' role in the creation of welfare. By evaluating the social and economic changes caused by the recent nationalization processes in Latin America, it will be possible to conclude whether or not SOEs do actually create more welfare than the CSR strategies of the private sector companies.

NATIONALIZATIONS AND INTERNATIONALIZATION SPECIFIC ADVANTAGES OF STATES AND DOMESTIC INVESTORS

Classical theory of trade (Smith (1776), Ricardo (1816)) explains that foreign direct investment and international trade are the result of the combination of specialization and trade related to the difference in the cost of production of goods between two countries. For this theory, benefits of FDI and international trade to a particular country are determined if international trade has absolute cost advantages over other.

On another hand, Stephen Hymer (1960) assumes that a firm will establish foreign operations only if they have strong, specific and monopolistic advantages created and developed at home to overcome the liability of foreigners. Along the same lines, Kindleberger (1969) state that in order to be competitive, foreign operations of a firm, must be capable to obtain higher returns than a local firm. This implies an analysis of FDI at the firm level. For this, a firm must have a differentiated product, higher marketing skills, availability of exclusive technology, and to ensure concessions by governments.
Dunning (1980)'s eclectic approach (OLI paradigm) proposes that firms internationalization modes are interlinked based on ownership, locational and internalization advantages. This could be potentially used as a framework for analyzing government decisions to nationalize the operations of foreign companies in their national jurisdiction as it will be explained below:
If a government has specific OLI and monopolistic advantages for taking over the operations of a multinational company which might allow it bypassing external markets, establishing a market position, gaining special access to inputs and markets, and still remind attractive to foreign and national investors due its operation efficiency and competitiveness, it could be potentially prospective a nationalization.

FINAL COMMENTS AND RECOMMENDATIONS FOR FURTHER STUDIES

In the cases presented in the previous section, the following prepositions could be proposed to be tested in future studies. It could be observed a perception by governments that foreign firms have their advantage mostly related to the concessions given by them. This might be in conjunction with the perceived capacity of a State of managing by itself or by national investors' current operations of foreign companies in their jurisdiction. This might be associated with observations of having locally absorbed technology, managerial skills and product innovation capacity from multinational companies, to be able of successfully managing local operations and domestic and international markets with sustainable level of competitiveness, and overcoming product life cycle limitations. Furthermore, there might be perceived opportunities and evidences of increasing benefits for local companies and citizens at the short and long term. In the specific case of companies in extractive industries, this also might be associated with the assumed responsibility of governments of safeguarding the availability to raw material and energy sources for their countries.

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