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Political risks and nationalism

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INTRODUCTION

What impact did political risk and nationalism have on global business? Have wars and other conflicts caused by national interests and identities retarded or even reversed the trend towards globalization? When faced with political and geopolitical threats such as war, occupation, expropriation, economic blockade and sanctions, requisition, persecution, or boycott, how did multinational enterprises (MNEs) and other international economic actors manage (or fail) to overcome the situation they found themselves in? Also, how did the response of economic entities like MNEs transform global business, or change political risks and the sovereign state system? Furthermore, what insight does the examination of such phenomena present to business history and international business research?

In this chapter, risks arising from political phenomena including nationalism, are regarded as a part of various ‘non-market risks’. Non-market risks include political as well as natural disasters and other risks (Casson and Lopes 2013, 377–379). One cannot always draw a clear line between political and other non-market risks, on the one hand, and market and economic risks on the other. In many cases, political risks influence MNEs and international economic activities indirectly, rather than directly, for example through changes in economic conditions (such as price, volume of transactions, and transaction conditions) in the market. Nonetheless, there are good reasons to regard political risk as a subject in its own right.

First, political and geopolitical phenomena may directly inhibit or promote business activities without waiting for market mediation, and therefore specific analysis is required. Second, political risk not only affects the profitability and competitiveness of the firm, but may also become an existential threat to the corporate assets, life, and property of managers, employees, and shareholders. Third, the dominant theoretical frameworks in business history and international business base themselves on economic logic, and the problem of political risk tends to be treated as an accidental, exogenous variable and as such has not been considered sufficiently (Bremmer and Keat 2009, 1–9).

Although risks will not hurt companies unless they materialize, once an awareness of such risks is developed, it triggers a response by economic entities. Risk is also an economic opportunity. If one entity can avoid risks more skilfully than others, it puts this entity in a relatively advantageous position in market competition. In this chapter, therefore, we focus on actual
Nationalism is a polysemous concept, but this chapter uses it in its broadest sense (Pickel 2005). In addition to perceptions and acts based on patriotism, nationalism also more widely encompasses action, including war, taken by a state to advance its own interests. It is not enough to discuss the relationship between ‘business and state’ and ‘business and government’ by focusing on a single state. Rather, the main focus of analysis should be on the fact that the international state-system comprises sovereign states which compete with each and whose relationships at times fluctuate between amicable and hostile. MNEs act within the realm of this international state-system and have to adapt to the various national legal conditions. Based on this perspective, this chapter considers the risks caused by conflict, especially between sovereign states, and between sovereign states and MNEs, while keeping in mind general political risk.

The first global economy

In the era of the first global economy preceding the First World War, political risk and nationalism were far from being the major obstacles facing modern businesses in crossing borders. During the century from the end of the Napoleonic War in 1815 to the First World War in 1914, there was no major or long-lasting conflict in Europe. Meanwhile, on a global scale, the colonial wars, regional conflicts, and political disturbances that occurred did not involve expropriation of foreign assets (Lipson 1985, 19), and in several cases such conflicts provided business opportunities for merchants based outside the region concerned. Military power was concentrated in a limited number of the world powers, and this was enough to protect foreign assets, at the time still largely confined to the vicinity of seaport cities.

Colonization and the wars it produced were part of the process of globalizing property rights and the modern state-system that protected them. Colonization extended the legal systems and governance structures of the home countries to various parts of the world, reducing the risks involved in foreign direct investment (FDI). For example, this process happened in Asia through the system of foreign concession and the acquisition of extraterritorial rights (Jones 1996, 27; Lipson 1985, 14). Global business was a promoter as well as a product of colonialism, imperialism, and ‘gunboat diplomacy’.

For much of the nineteenth century, the UK-centred free trade system, the gold standard, and liberal economic thought made stable business possible. State intervention in economic society was miniscule, and the global economy was not organized around the logic of the national economy as its principal unit (Banken and Wubs 2017, 17–20). The major constraints for global business were the physical and cultural distances, not rivalry among the major powers and their policies. Few restrictions were imposed by the state on the movement of people, goods, and capital. Foreign firms were generally treated in the same way as local firms (Jones 2005, 201–202, 209–210). Though protective tariffs were introduced in the US in the 1860s and in many European nations after the 1880s, their rates were still not prohibitive. Even with the emergence of nationalistic discourse in Europe and the Americas regulation of foreign-owned enterprises was still limited, with some exceptions such as restrictions in the US banking business in the latter half of the nineteenth century (Wilkins 1989, 455; Jones 1996, 38–40).

Such openness was also effective in less developed regions. Merchants from diverse home countries, including small European nations and Canada, could enter the colonies of major powers freely. Swiss merchants in India provide a good example: their property rights were upheld and protected by the colonial government and German and American consulates (Dejung and Zangger 2010, 188). Before the First World War, ideas of race or civilization dominated the
perceptions of people; cosmopolitanism based on imperialism, rather than nationalism, prevailed. In the Ottoman Empire, the policies from the end of the nineteenth century to the early twentieth century welcomed foreign capital, and as such political risk was small (Geyikdagi and Geyikdagi 2011, 395–397). In Japan in the latter half of the nineteenth century, the activities of foreign traders were confined within certain ‘foreign settlements’, but after resolving the unequal treaties at the end of the nineteenth century, this restriction was removed and foreign investment was introduced (Yuzawa and Udagawa 1990, 1–50; Jones 2005, 207).

How did the aforementioned situation influence international business? First, the nationality of the company was not explicit and made little difference in policy terms, despite all the nationalist discourse (Jones 2006, 153–157). With the freedom of movement of capital as a precondition, multinational networks of entrepreneurs, owners, investors, and intermediaries were established. Second, ‘born-global’ firms – that is, firms founded with cross-border operations from their inception – were created in the nineteenth century (Jones and Khanna 2006, 459). The freestanding company was a representative example. Even if the actual business activities of such firms were performed in remote areas such as in colonies, the corporate headquarters were located in Europe, especially in London, with its abundant resources of capital and superior institutional and legal infrastructures (Wilkins, 1988). Third, a series of ‘multi-regional’ firms emerged along with cross-border regions, partially due to newly introduced tariffs and the differences in national legal systems. As there was an incentive to invest on the other side of the border, it prompted many multinational enterprises to be formed in the border areas of Germany and Switzerland, and also on the US–Canada border for example (Jones 2005, 22).

However, it is noteworthy that even in this age of relative stability and integration, political risks and apprehension towards nationalism also facilitated the emergence of unique corporate and investment forms. One such example is the case of holding companies, based in politically neutral states, emerging in the 1880s. In the infrastructure and utilities business, such as in railways and gas, and especially in electrification, a small number of engineering companies from a specific country (for example, Siemens, AEG, ABB in the case of the electrical sector) founded financing companies to establish firms in several parts of the world, and solicited investment funds from different countries all over the world. However, when investing in businesses in different regions through holding companies, investors considered public opinion and were wary of potential local opposition should domestic infrastructures and utilities be brought under the control of international bankers or the capital of a hostile country. In light of this, arrangements were made to locate headquarters in medium-sized or small countries such as Switzerland, Belgium, the Netherlands, and Canada, which had flexible corporate legislation (Hausman et al. 2008, 52–72).

The First World War and the 1920s

The First World War was a major turning point for global business. On the one hand, it ended the long-lasting era of relative peace, and signalled the start of an era of political instability and ideological conflict, revolution, dictatorship, and rampant (economic) nationalism. On the other hand, its impact on international business was ambiguous. While international business was hit hard by the war, it also showed amazing resilience. Many business historians who have written on this issue concur with Adam Tooze, the war historian, who has placed emphasis on the US-led postwar reconstruction of the global order (Tooze 2014). They claim that the First World War changed the course of globalization but did not reverse it (Smith et al. 2017, 26, 69, 142, 185, 211). Jones claims that the impediment for international business was not that large in the 1920s: fully fledged de-globalization is identified as taking place only from the 1930s (Jones 2005, 20, 28).
The disconnection and blows to the international order caused by the First World War are clear. The movement of people, goods, and finance, and the exchange of information across borders had become more difficult (Smith et al. 2017). Such problems also occurred between the belligerent and neutral states, destroying the business of the above-mentioned ‘born international’ enterprises. Difficulties hindering international business included military and economic blockades, the confiscation and freezing of enemy assets, the implementation of blacklisting and sanctions, currency control, rationing, the shift to military production and other economic controls, and boycotts against enemy or foreign companies. These outcomes favoured companies from neutral states, but dealt a blow to international business in general (Rossfeld and Straumann 2008; Fitzgerald 2015, 162–178).

During the First World War, nationality became a decisive factor for the first time. Companies dealing with enemy assets were sanctioned. Germany, the UK, and later also the US launched for the first time ever a systematic survey on company ownership. There were more than 50,000 Germans in the UK, but after the war broke out, they were effectively excluded from economic life and many were interned, a trend which escalated during the course of the war (Panayi 1990). Internment was also undertaken in colonies (Lubinski et al. 2018). In order to confirm their neutrality, some multinational corporations domiciled in neutral countries, such as Switzerland, made the executives from belligerent countries resign and replaced them with neutral country personnel. Manufacturing enterprises established in Switzerland by German capital, such as AIAG, became a Swiss company in this way (Ruch et al. 2001, 125).

Foreign-affiliated companies in various countries continued with business even during the war by officially breaking ties with their parent company, leading to a fragmentation of multinational companies. Companies under the control of the enemy were condemned, but the business was maintained by trustees (custodian), and in the case of companies domiciled in the victorious nations, many were revived after the war. Even businesses domiciled in neutral nations but located in belligerent countries were continued – by increasing their independence and localizing their management (Kurosawa and Wubs 2019). The geographical composition of business and product strategy also shifted in line with the war situation. Neutral countries served as supply bases to the belligerent countries. Until then, Nestlé, for example, which had had its major production bases in Switzerland and the UK, made huge investments in the Americas and Australia during the war to convert them into supply bases for Europe (Fenner 2008). Not only the war itself, but also its sudden end dealt a blow to some companies that exploited or catered to wartime demand (Rossfeld and Straumann 2008, 78–87, 194–199, 330–337; Klemann 2007, 298–302).

The geopolitical consequences of the First World War were immense. Four empires collapsed, and, in Russia, the foreign capital-owned assets, including those in oil and electric businesses, were lost during the Bolshevik revolution and its aftermath. Many small sovereign states sprang up in Central Europe, where companies faced fragmented markets and nationalism after the break-up of the Austrian–Hungarian Empire. However, in some other regions, new international relations emerged that to some extent made up for the effects of division; Hungary’s political split from Austria and subsequent strengthening link with the London market provides one such example (Forbes 2017).

On a global scale, the implications and consequences of what contemporaries called the ‘Great War’ were more ambiguous. For the war in Europe, human and material resources were mobilized globally, and global linkages intensified. The US emerged as the bearer of a Global Order, even if this was still a role it played only partially. The US retreated from the world stage politically with the failure of Congress to ratify membership of the League of Nations; but US companies began to expand internationally, particularly in Europe (de Goey 2009, 547).
US banks expanded their business in the issuing of foreign securities and set up new branches in Asia and Latin America (Stratton 2017). In Japan, import substitution and the formation of new industries during the First World War created the foundation for outward FDI to Korea and Taiwan in the following era. In South America, exports to Europe were also maintained, and companies with European roots became more localized in Latin America and integrated Latin American markets internationally (Dehne 2017).

Victory and defeat and the subsequent reparations and rearmament prohibition directly changed the competitive landscapes of countries and companies. German firms also faced the risk of reparation claims in addition to their losses of property conducted by the Allies. Confiscated properties, including patent and trademark rights, became the basis for the British chemical industry, including the establishment of ICI (Reader 1970). Firms from neutral states, such as Sweden, Switzerland, and the Netherlands, had improved their position after successfully continuing their business in and with both camps during the war, and by hosting German firms fleeing confiscation and postwar rearmament prohibition. Sweden’s SKF (Golson and Lennard 2017) and Swiss companies in the chemical, electrical machinery, and metal sectors (Rossfeld and Straumann 2008) and Dutch incandescent lamp manufacturer, Philips (Sluyterman and Wubs 2009, 119–125) are good examples of this.

The First World War changed the strategy and organization of MNEs. Germany lost its overseas assets which were only partially recovered during the interwar period. It was only 50 years later, in the 1960s, that Germany’s overseas assets finally returned to their pre-First World War level (Schröter 1993, 34). The low German level of FDI in mining and petroleum production was an outcome of Germany’s defeat in the First World War (Jones 1996, 78). In the former German territory of Upper Silesia, special political measures had to be adopted to try to sustain German economic interests (Reckendrees 2013). The Netherlands in particular was a favourite destination for German banks and industrial companies during the 1920s (Sluyterman and Wubs 2009, 119–125). This was a response to the risk of confiscation (from reparation claims in the 1920s, and in expectation of another world war after the 1930s). IG Farben’s investment in the US was Germany’s largest FDI in that country, but its holding company was located not in Germany, but in Basle (König 2001, 31–38). German companies frequently secured their international business by joining international cartels, thereby avoiding the exclusive ownership of FDI, with its attendant risks of requisition (Schröter 1988; Jones 1996, 43).

Both during and after the World War, decentralization and localization were musts in dealing with market divisions and the complicated political situation. In the case of MNEs with multinational ownership and management prior to the war, head offices themselves tended to be pluralistic organizations. The relationship between the home country organization and affiliate of the host country also became looser and decentralized. The branches were transformed into local subsidiaries by incorporating local holding-companies (Wubs 2008, 23; Lipold 2003, 216). American companies expanded in Europe after the War. In 1919, GE established International General Electric as a subsidiary for its overseas operations (Wilkins 1974, 138–151). Though this was a unitary organization, it invested in subsidiaries in each country according to their specific, national circumstances.

During the 1920s the use of holding companies became quite common. This was due to the rapid increase of the tax burden since the First World War that made double taxation of the parent company and foreign subsidiaries of multinationals an acute issue (Mollan and Tennent 2015; Izawa 2019). In the 1920s, complex corporate organizational architectures appeared. Multiple holding companies utilizing nominal ‘shell companies’ were established and tied up with complex ownership, borrower–lender relationships and differentiated voting rights. The aims were to obscure the owner’s nationality, ownership, and controlling relations, to avert
political risks and to avoid double taxation. For this purpose, Roche and Nestlé established a special, double corporate structure (Kurosawa and Wubs 2019), and IGC, a British gas utility firm that operated in multiple countries, did this through owning subsidiaries on the continent and providing loans to them (Izawa 2019). While Belgium had lost its position as a safe, neutral country after the German invasion, new tax havens such as Liechtenstein and Panama emerged in the 1920s. They offered flexible corporate legislation and tax laws favourable to holding companies (Kurosawa 2015, 238–239). But also the Netherlands, which remained neutral during the war and non-aligned after it, functioned as a tax haven, particularly for Dutch and German multinational companies. The Netherlands, which did not sign the Treaty of Versailles, kept taxes very low (corporate tax did not exist), had a law against double taxation, and was a relative small jurisdiction with political stability, and, moreover, had banking secrecy (Sluyterman and Wubs 2009, 116; Euwe 2010, 227). Behind the emergence of tax havens, such as Liechtenstein, Switzerland, Panama, and the Netherlands stood the activities of multinational companies, international bankers, lawyers, accounting firms, and the governments of the home countries of MNEs. It can be said that the international business elite developed the informal infrastructure or informal, international public goods by lobbying for changes in the legal and tax systems in several countries.

De-globalization, dictatorship, and the Second World War

The era spanning from the 1930s to 1940s was one in which international business was exposed to the most serious political and geopolitical risks so far (with the exception of the Russian Revolution). The Great Depression was followed by an era of protectionism, economic blocs, and autarchic economic policies, which fragmented the global economy in extremis. The threat of persecution by brutal political regimes seriously challenged international business and created several dilemmas related to ethics and legitimacy. The Second World War and foreign occupations brought about a threat to multinationals of a different magnitude compared to the First World War.

Changes in the political environment that triggered de-globalization in the 1930s were Janus-faced. On the one hand, tariffs were drastically raised, trade blocs formed, import substitution policies adopted, and currency controls and bilateral clearing system emerged; on the other hand, major Western countries still had a receptive attitude towards inward FDI (Jones 2005, 203–204). No serious cases of sequestration were observed until the war broke out (Lipson 1985, 65–84; Wubs 2008, 57), with the tragic exception of ‘Aryanization’ of Jewish companies in Nazi Germany (Bajohr 2002; Forbes 2007; Kohler 2016). To cope with these changes, MNEs shifted from trade to FDI and pursued decentralization, localization, and neutralization of their corporate organizations. Strict currency controls made it difficult for MNEs to remit their profits to their home country, forcing them to reinvest locally (Kobrak 2003; Wilkins 2004a, 28; Wubs 2007; Wubs 2008, 47–49). The number of foreign owned manufacturing subsidiaries grew fourfold from 1914 to 1938 (Teichova 1986, 364). The global business of the pre-war era, comprising a cosmopolitan, multinational network, had been reorganized into an agglomeration of decentralized MNEs, which were loosely integrated, highly self-sufficient domestic businesses, based on the premise of division by borders.

Economic nationalism and state intervention had become a global phenomenon in the interwar period. In Latin America, government intervention and restrictions on foreign capital were strengthened, mainly for utilities and infrastructural projects, affecting ITT and other companies (Bucheli and Salvaj 2013). In Mexico, businesses in the agricultural sector based on foreign investment were nationalized (Lipson 1985, 77). In Japan, MNEs faced heavy competition with
emerging local firms and their anti-foreign capital campaigns. Nestle’s local subsidiary in Japan overcame this problem by replacing its manager and owner with a nominally Japanese one (Donzé and Kurosawa 2013). Oil, and the refining of oil products such as petroleum, which had become strategic goods, were a particular target for nationalization across the world. In Iran, Anglo Persian Oil Company’s concession was temporarily suspended in 1932 (Andersen 2008, 642). The Bolivian government took over the assets of Jersey Standard in 1937, and in the following year Mexico nationalized the assets of Shell, and Standard Oil Company of California (Jonker and van Zanden 2007, 453–456). This was the first large-scale nationalization since the Russian Revolution. Government intervention also occurred in oil-consuming countries. In countries like Chile aiming at price control, and Japan targeting oil refining from a strategic viewpoint, local companies attempted to enter into the refining and distribution of oil backed by the government (Bucheli 2010; Kikkawa 2019).

The Second World War was not at all a replay of the First World War. With the surprisingly swift defeat of France, a much wider area was occupied than had been the case during the First World War, and a great part of the European continent came under the New Order of Nazi Germany. The occupied area included the important headquarters of several MNEs, such as those in the Netherlands, Belgium, France, and Czechoslovakia, which threatened not only overseas assets, but also entire companies and the life and property of their managers and shareholders. Except for what had happened in Belgium, such experiences were unprecedented: they were of an entirely different dimension from the risk of economic nationalism experienced during the 1920s and 1930s. The continental blockade mounted by the Allies and the counter-blockade set up by the Axis, divided the world market in two: a continental area under the control of the Axis and the rest of the world controlled by the Allies. This situation, together with the acute ethical challenges caused first by the persecution of the Jews, Gypsies, and political opponents followed by policies of racial genocide, made the decisions of economic actors in and outside the occupied territories extremely difficult and morally burdened (Lund 2006).

For MNEs headquartered in, respectively, allied, neutral, and occupied countries, most of the business was largely maintained given the lack of an alternative strategy. The German or continental subsidiaries of British or American MNEs continued their business by severing ties with their headquarters after the war broke out or upon the entry of the US into the War (for example, Dehomag, IBM’s German subsidiary; Opel under GM). Anglo-Dutch multinationals Unilever and Royal Dutch Shell officially discontinued the relationship between the two headquarters – narrowly avoiding confiscation and direct control by the occupation authorities on the Dutch side – and managed to continue their businesses (Howarth and Jonker 2007, 86–97; Wubs 2008, 179–180). In the case of companies in neutral countries such as SKF (Sweden) and Georg Fisher AG (Switzerland), the property rights of the subsidiaries under German control were respected and it was relatively easy to maintain relations with them (Wipf 2001; Independent Commission of Experts Switzerland – Second World War 2002, 293–310). On the other hand, in the occupied countries, the situation was quite diverse (Lund 2006; Klemann and Kudryashow 2012). In Norway, a large-scale confiscation took place, and both the burden of the German occupation and German investments for strategic purposes were massive. In the case of firms from Denmark, it was possible to catch business opportunities in the Grosswirtschaftsraum, including in Norway (Lund 2006, 115–128; Andersen 2009). The ownerships of the local firms in occupied Eastern Europe were transferred to German, state-owned holding companies (Overy 2002). The assets of German companies under the control of Allied Powers had been much smaller by comparison as a result of the First World War and ensuing German strategies during the 1920s. The assets of the US subsidiary of IG Farben were frozen (König 2001,143–152).
Many studies have focused on the ethical aspects of corporate behaviour in this era. In works aimed at general readers, MNEs are often severely condemned for their cooperation with the Nazi dictatorship, including in relation to the war and the Holocaust. Most business historians nonetheless maintain a critical distance from moral condemnation. Instead, the constraints, dilemmas, and historical backgrounds of corporate behaviour are analysed as well as the impact of this on strategies and organizational structure, hypothesizing that most actions were based on economic rationality and survival strategies, rather than political ideology (Forbes 2000; Heide 2004; Kobrak and Hansen, 2004). According to these studies, the response of the companies varied greatly, depending on their size, resources, and capabilities, their dependency on business in the two camps and the countries they were operating in, the possibility of shifting their business to a safe area, the strategic importance of their products, the form of entry, the attitude and features of their home country government, and their room for manoeuvre (Boon and Wubs 2016).

Companies such as Nestlé, and Roche were relatively less dependent on the German market, thus they could manage to control risks and to maintain a certain distance from the oppressive government. In contrast, companies that relied heavily on the German market like Maggi were weak in the face of pressure from the regime (Ruch et al. 2001, 172–177). Insurance or financial companies such as Allianz, and producers with sizeable foreign market sales such as Schering, were especially vulnerable to the Nazi government’s exchange controls, and that limited their freedom of action (Feldman 2001; Kobrak 2003). A company like Unilever, one of the largest multinationals in the world at the time, was simply too large, and its products were indispensable for the population and army. This gave the company enormous leverage over the Nazi regime. Companies were positioned in a competitive environment, thus they tended to be more keenly aware of the risk of withdrawal rather than that of cooperation with the regime (Forbes 2004). In Germany, the impact of political risks transformed more than corporate behaviour, it also greatly affected corporate organization (Kobrak 2002).

Although the above-mentioned financial and legal structures of companies using complex architecture were not necessarily all for the purpose of hiding their activities, they had also turned into a crucial means of cloaking (camouflage), especially when currency controls and war risk increased its importance. This was not just limited to German companies (Aalders and Wiebes 1996; Uhlig et al. 2001; Wilkins 2004a, 29; Kobrak and Wüstenhagen 2006; Jones and Lubinski 2012). MNEs from Allied and neutral countries also resorted to it. Not only Sweden and Switzerland, but also Latin America, South Africa, and other locations became bases for such activities, involving American, Dutch, Swiss, Swedish, and Danish ‘nominees’ (Wüstenhagen 2004; Wilkins 2004a). The Allies were aware of asset concealment by the Nazis and by German companies, and conducted an operation ‘Safe haven’ to contain it (Lorenz-Meyer 2007).

The reasons for cloaking were diverse. Dutch companies that had their home country occupied by the Nazis faced the risk of confiscation not only by Germany but also by the Allied authority (Van der Eng, 2017). They divided their parent companies into two, legally independent companies, and further evacuated their corporate overseas assets to safe areas in the Dutch Antilles or South Africa (Blanken 2002, 120–121; Wubs 2008, 63–65). Various organizational and legal structures were invented as seen in the ‘Ring’ structure established by Beiersdorf in Germany for their brand ownership (Jones and Lubinski 2012). While such financial and legal structures tended to be regarded as nominal ones, they sometimes threatened the control over the subsidiary by the parent company and thus the unity of the company, as in the cases of Nestlé and Roche (Lüpold 2003; Kurosawa 2015; Ruch et al. 2001, 86–211). On the other hand, Japanese companies, which experienced no serious damage during the Second World War, took no precaution against defeat or occupation of Japan.
The Second World War changed the competitive landscape significantly. For companies in the Axis nations, the effect of cloaking was limited, and they lost most of their assets (including trademarks and patents) outside the reduced territory. As a result, both German and Japanese companies focused more on exports than FDI for a few decades after the war. The position of firms of the victorious, occupied, and neutral countries varied, but Roche, Philips, and Unilever, for example, shifted their operations to the Western Hemisphere, transforming themselves from European-based MNEs to global ones (Blanken 2002, 312–314; Howarth and Jonker 2007, 103; Wubs 2008, 185; Kurosawa and Wubs 2019).

There was also a great impact on how MNEs organized themselves. Particularly in Europe, a decentralized and multi-domestic organizational structure had emerged during the interwar period. What had been established as an organizational architecture to survive war and occupation became a tool that could be used for political risk management during the Cold War and to avoid high taxation in the postwar period. In Japan, the wartime regime and occupation after the war fundamentally changed the corporate structure, and brought about bank-centred, horizontal business groups that were no longer based on the family ownership of Zaibatsu (Ohata and Kurosawa 2016, 170, 175–178).

Cold War, decolonization, and economic nationalism

The period from 1945 to the 1970s was marked by two elements: a bipolar world of the Cold War and proliferated economic nationalism. Although international business was eliminated from the Communist bloc and the risk that the Cold War could turn into a hot war was not unlikely (regional proxy wars were actually waged), serious threats to the home of Western MNEs did not disappear. The postwar period until the end of the 1970s was the era of mixed economies, state dirigism, and national industrial policies. It is true that the postwar General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) regime under American hegemony guaranteed financial stability and increasing free trade – international trade actually expanded dramatically – but the segmentation of global markets into national economies still stands out in comparison with the pre-First World War era (Jones 2006). Property rights, which were self-evident during the first globalization wave, were rendered vulnerable, and most nationalizations by governments in states that had formerly been colonies took place in this period (Lipson 1985, 85–139).

As a consequence of Sovietization in Central and Eastern Europe, and the Communist revolution in China, the international economic network both in Warsaw Pact countries and East Asia was dismantled. Private firms, including international businesses, were nationalized without compensation in Eastern Europe (Wubs 2008, 166–169). In East Asia, investments from Japan in Korea, Taiwan, and China (railways, electricity, cotton spinning in Shanghai, sugar industry in Taiwan) were taken over and domesticized by local governments. Intra East Asian FDI declined sharply. As a consequence of the Chinese Civil War, businesses, including foreign firms, had escaped to Hong Kong, or had been nationalized when physical transfer of assets was difficult (Jones 1996, 170). North Vietnam also followed this path of nationalization. In the 1960s, FDI from Japan to Asian countries, including Taiwan and South Korea, was resumed, but the full-scale economic reintegration of East Asia took place only after the 1980s. In Japan, the postwar re-establishing of American and European MNEs showed little progress due to restrictive regulations (Jones 2005, 220).

Up to the 1970s, interventionist-style economic policies and ‘national’ industrial policies were maintained in many West European nations and in Japan, despite the incremental (and eventual) abolition of exchange controls and regulations on capital. During the two decades
after the War, for most German and Japanese manufacturers, exporting was much more important than FDI (Jones 1996, 47). MNEs from the UK, the Netherlands, Belgium, and France, however, soon revived their foreign activities and increased investments in Europe and the US (Sluyterman and Wubs 2009, 160–164; Wubs 2012). Most European MNEs maintained a ‘parent–daughter’ type of organization. The subsidiaries abroad often had a high level of autonomy, and control over them was often informal and personal. European companies often chose a multi-domestic model rather than an international or global model, even in the context of an increasing level of European integration; the degree of integration among their national subsidiaries lagged behind what was occurring with American companies (Jones 2005, 177). This, of course, corresponds to the actual division and fragmentation of markets and variations of national economies, but it was partially also a legacy of war and other political risk, or, at the very least, the influence of memory in helping to determine the decisions of business leaders.

Nationalization resulting from policies of economic nationalism in developing countries is symbolized by the nationalization of the Suez canal by Egypt in 1956: in fact, nationalizations increased in the 1960s, and peaked in 1975 (Lipson 1985, 97–123). Unlike the all-encompassing nationalization under Communist regimes, nationalization in developing countries usually focused on specific industries (typically oil, minerals, and utilities). With the exception of Cuba, Egypt, Iraq, and Syria, economic compensation was paid more or less at a reasonable rate. By 1976, virtually all oil-producing countries had nationalized crude oil production (Williams 1975; Jones 1996, 93). In the 1970s, many foreign-affiliated plantations in Asia were subject to nationalization or forced localization. In the mid-1980s, half of the extraction capacity of mining resources in developing countries had become state owned. As a result, direct ownership by multinationals in mineral resources and commodities decreased, thereby reducing the risk of expropriations (Kobrin 1984).

Besides nationalization, other forms of policies brought about political risk. In Chile and Japan, both lacking petroleum resources, the government preferred joint ventures between domestic firms and foreign multinational corporations, and ensured that this was realized (Bucheli 2010; Kikkawa 2019). Many developing countries such as Brazil adopted industrial policies, aiming at import substitution, and urged MNEs to set up factories in the host country (Jones 1996, 259–262). In Africa, a strategy of indigenization rather than nationalization was chosen (Decker 2008). In Indonesia after independence, a policy of so-called Indonesianization of human resources was adopted to achieve a higher level of economic independence (Sluyterman 2018). In some countries, economic nationalism took a form of ethnic policy. Policies in Indonesia and Malaysia constrained international business owned by migrant entrepreneurs and business groups with Chinese ethnicity. In Indonesia, political instability plagued foreign investment in general (White 2012).

MNEs were far from passive actors as regards these various policies and risks, and their proactive countermeasures transformed global business and political risk itself. The most extreme example was the political mobilization of home-country governments. In the coup d’état in Iran (against Mosaddegg in 1953) and in Chile (against Allende in 1973), MNEs resorted to motivate the US government to overthrow the host regime, which it did, and to maintain their favourable business position. Shocking though such blatant behaviour may be, these interventions carried their own risks, and the interests of the home country may not necessarily match the interest of the MNEs; so, in fact, it was not a commonly or preferred strategy of international business. However, in general, the relationship with the home country and its government remained important (Blaszczyk 2008; Bucheli 2008, 2013; Decker 2011).

Conversely, MNEs pursued exit strategies from foreign markets, or did so partially, with withdrawal from the ownership of assets in the host countries. MNEs that had lost their advantage...
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in natural resource extraction often integrated the downstream part of the value chain and achieved vertical integration. Some withdrawals led to bold business transformation or diversification by tapping into unrelated sectors. In the mining industry and primary goods sectors, several MNEs adopted a strategy to avoid the risk of asset ownership. For example, United Fruit Company had a vertical integration strategy in Colombia up until the Second World War. However, it divested from that country, no longer owning plantations, but maintaining its influence in procurement (Bucheli 2008).

Localization by joint ventures and other means were also common. An ‘absorption’ strategy was used to internalize the source of political risk within the firm (Ring et al. 1990; Andersen 2009). In this case, typically, a joint venture with local business groups or the government-owned enterprises was formed, often by inviting government bureaucrats, politicians, and the local economic elite to be added as owners or managers. The investment by Japanese paper producers and steelmakers in Brazil were such examples. Whilst in Africa, they cooperated with the indigenization policy and secured their legitimacy by maintaining a favourable relationship with developing countries’ elites (Decker 2008).

The effects of such actions, however, were sometimes seriously limited. The case of United Fruit Company in Central America shows that these beneficial relationships with the local elites depended on economic stability, and that democratization did not necessarily bring an open liberal policy to MNEs (Bucheli 2008). The examples of ITT in Chile and of Du Pont in Iran show that once the local elite had lost their legitimacy and fundamental social upheaval took place, great consequential blows can be brought about (Bucheli and Salvaj 2013; Blaszczyk 2008). Alternatively, the case of Sears Ruebuck and other firms that succeeded in Mexico where nationalization of oil companies was taking place, shows that political risks could be overcome, if the symbolic meaning of business (in this case, material prosperity, upward mobility, and consumer democracy) corresponded to the values of local society (Moreno 2003). A localization strategy was also important for the Philips, a technology company headquartered in Amsterdam. The survival of its subsidiary in Australia, for example, had to deal with a kind of ‘post-colonial’ context (van der Eng 2018).

After the Second World War, the existential threat to MNEs from their home countries reduced remarkably, and therefore the necessity for cloaking decreased. However, political and geopolitical risks in host countries as well as international taxation risks continued, and so MNEs often maintained complex legal structures for foreign subsidiaries and overseas projects. This coincided with the new emergence of host countries that provided safe infrastructures. ‘Safe havens’ emerged in the ocean of political instability; examples include Hong Kong during China’s Communist revolution and Singapore amid Southeast Asia’s heightened nationalism. Offering also a flexible corporate law and low tax rates, these locations also served as tax havens and centres for tax evasion or avoidance. Also, in the Western Hemisphere, Offshore Financial Centres (OFCs) were created in small jurisdictions in the Caribbean, for example in the Dutch Antilles (Curaçao) and British Cayman Islands (Van Beurden 2018, passim; Zucman 2015, 35). The rise of these tax paradises, however, did not happen in isolation; the geographical shifts of MNE operations during the 1950s and 1960s was closely linked to international developments and to regulatory and financial institutional changes in home countries.

Second global economy

After the 1980s, political and geopolitical risks for international businesses reached the lowest level since the outbreak of the First World War. Both the Cold War and ideological conflicts over the economic systems appeared to have ended. The Soviet state collapsed and collective
property was rapidly ‘privatized’ and taken-over by ‘oligarchs’. The former socialist countries in Eastern Europe entered the capitalist camp, privatized state-owned companies welcomed investments of foreign MNEs (King and Szelenyi 2005, 42). China had adopted an open door policy in 1978, and returned to the global market incrementally. In developed countries, privatization, financial liberalization, and market-oriented reforms created new opportunities (utility, transportation, insurance) for direct investments from abroad. In developing countries, nationalization policies became rare, and measures to attract foreign capital became paramount. As regional economic integration was promoted, trade expanded globally, and FDI increased even more.

Nevertheless, even under such conditions, political risks for international business did not disappear. In this period, potential trade conflicts between developed nations were an ever-present threat. For example, between Japan and the US a conflict began with fibres and extended to steel, automobiles, and semiconductors (Bergsten and Noland 1993). Under US diplomatic pressure, the Japanese manufacturers were forced to accept ‘voluntary export restraints’. In the automobile industry, Japanese companies addressed concerns over American protectionism by means of FDI in the US. Political risk thus promoted multinationalization of Japanese car manufacturers (Anastakis 2017, 62–63). In the textile and steel industries, the protectionist measures taken by developed countries, such as the US and European nations, caused production shifts and outsourcing from the country targeted for such measures to third countries. In other words, political risk and MNEs’ active response to it have given rise to today’s global value chain (Gereffi 1999).

In former communist economies, market institutions and the rule of law were not sufficiently established; this caused significant uncertainty and posed risks for MNEs. China is an extreme example of such risk. During its open-door policy since the 1980s, access to the market was conditional on the transfer of technology. In the case of the car industry, foreign manufacturers could not enter the market without setting up joint ventures with local state-owned enterprises. Even after joining the World Trade Organization (WTO) in 2001, state intervention did not disappear. The Chinese government also used attacks on private enterprises as a means of putting diplomatic pressure on foreign governments. In the territorial dispute between Japan and China in 2012, Japanese companies in China faced state-approved attacks by mobs and boycotts by the public. In 2017, the Chinese government condemned the installation of a missile defence system by South Korea and openly boycotted South Korean MNEs.

As a result of the perpetual search by global enterprises for tax avoidance schemes and the competition among sovereign states to attract investments, the number of tax havens increased. The liberalization of international capital flows and financialization of entire economies also facilitated this phenomena (Ogle 2017, 1454). As in the case of attempted and failed ‘corporate inversion’ by Pfizer/Allagan in 2016 and Ireland’s special position, these phenomena are becoming some of the decisive factors helping to shape the form and activities of MNEs.

It is still hard to assess the impact of the recent rise of right-wing populism in the advanced countries, the Brexit campaign in the UK, and the disruption of the postwar economic order by the President of the US. However, these developments have contributed to the realization by MNEs that political and geopolitical risks, and the threat of uncertainty, were not just problems of the past.

In what way did the international business change the international politics and international order? Needless to say, the political clout of multinational corporations and multinational banks has been one of the main drivers of globalization since the 1980s (Slyterman and Wubs 2010, 822). Banks, law firms, accounting firms, consultants, among others, were practically involved in the design of taxation and corporate laws of the countries that are prominent in the financial offshore industry, including Dubai, the Netherlands, UK, and Ireland (Garcia-Bernardo et al. 2017, 1).
Likewise, these actors were active promoters of market-led economies and are evermore involved in government policy-making. In this sense, MNEs and other international business entities had a proactive and decisive role to play in the management of political risks as well as the creation of institutional and organizational loopholes designed to avoid the regulatory power of sovereign nations.

Conclusions

Political risk and nationalism have had major impacts on the development and retardation of global business. Two World Wars, the protectionism of the 1930s, and subsequent waves of economic nationalism damaged the global economy severely and threw it into reverse, though temporarily and partially, and changed the trajectory of globalization during the twentieth century. Wartime blockades, interwar trade barriers, and policies of sovereign nations protecting or serving national interests dealt a blow to the global integration of the market. The two World Wars also brought about technological innovation, and partly contributed to the rise of regions that had been traditionally on the periphery, and laid the basis for today’s multipolar global economy.

Under these pressures, global business looked to transform itself from being based on a unitary structure to a multi-centred one: today’s multinational corporations were created to operate beyond the constraints imposed by the sovereign states. In addition, the economic entities involved in global business created international public goods on their own, such as special safe havens, rather than remaining passive to the actions of sovereign states. Ironically, however, this seems to be creating a new kind of political risk and widespread anti-globalism.

The effects of political risks, due to their nature, showed significant geographical differences; they varied widely between European and US companies. In Europe, where serious risks such as war and occupation became a reality, the capability to address political risks had a great impact on the rise, fall, and survival of firms. A significant number of European MNEs survived, however, by adopting an organizational structure to control and resist political risk, or by strategically changing the allocation of geographical and business portfolios. Although business history has focused more on these issues recently, the situation after the Second World War and cases outside Europe are still under-researched. In addition, research on the history of corporate law and taxation and the effects on MNEs is only just emerging in the discipline, and interdisciplinary dialogues have not yet taken place. Herein lies an important opportunity for an exciting re-interpretation of international business history.

References


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