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Governing for the Corporations: History and Analysis of U.S. Promotion of Foreign Investment

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I. Introduction

Throughout the 20th Century the US government has repeatedly used its international political influence to benefit US corporate activities abroad. The US government and others assumed initially that this was in the larger interests of the United States because US companies would represent and promote the United States’ policy agenda.

However, US corporate activities abroad over the last century seem to indicate this assumption was flawed. In numerous examples, US corporations have either ignored or thwarted the stated interests of the US government. At first glance, however, the US government still seems to embrace the assumption by continuing to act on behalf its corporations’ foreign investments.

What explains the US government’s continued support of US corporations’ activities abroad? In my opinion, the answer lies in investigating the difference between what the interests of the US government should be and what they actually are. If we assume that the US government’s interests are identical to the interests of the US people, then the question remains a mystery. But if we study the actual incentives that operate upon the US government, I believe that the answer will become clearer.

I will not attempt to undergo that study in this essay; however my hunch goes as follows: the interests of the US government are inseparable from the sum total of the individual interests of the politicians and bureaucrats that compose it. The US government, of course, does not have
a will of its own; it only has the wills of the people who compose it. As a matter of realpolitik, the primary interests of the politicians that compose the government are to win reelection. The reason for the government’s continued support of US corporate investments abroad, therefore, may be that supporting corporate interests is a more effective strategy for winning reelection than supporting the broader interests of the US people. This article will track the history of the often one-sided relationship between the US government and US companies and discuss the possible future of government involvement in international investment.

II. History of the (One-Sided) Relationship Between the US Government and US Companies Investing Abroad

The assumption that companies based within a country will respond to the orders of that country’s government was perhaps stated most forcefully by J.J. Servan-Schrieber during the aftermath of World War II. Schrieber denounced the spreading dominance of US corporate subsidiaries across post-war Europe as a threat to sovereignty and the development of a social market economy that would serve as an alternative to US capitalism. To him, there was no such thing as a multi-national corporation, corporations always responded to the interests of their home states. Companies owned by US corporations, therefore, would ultimately stifle European-owned businesses because US companies would never outsource research and development or management decisions for the benefit of another country. Without the transfer of this knowledge, Europe would always remain a rung behind the US.

Looking in hindsight, Schrieber’s concerns appear to have misstated the connection between US corporate activity and US foreign policy that unfolded in the 20th century. Rather than the US companies responding to the objectives of the US government, we have seen instead the US government continually intervening on companies’ behalf in oil negotiations and other
foreign investment agreements. This section will analyze this pattern and the possible factors that contributed to it.

A. Establishing “American” Control Over Oil

The industry where the US government has perhaps relied most heavily on its corporations to support US interests abroad has been oil production. In 1923, the US government helped secure a stake in what later became the Iraq Petroleum Company (IPC) for the company that is now Exxon Mobil. In return, it promised France that if any company invested within an area demarcated by a red line—an area that included Saudi Arabia—it would bring the other IPC investors along with it. However, in 1947, when Exxon Mobil wanted to buy into Aramco (the Saudi oil company) without its IPC partners, the US government again intervened on Exxon Mobil’s behalf by convincing France not to enforce the redline agreement. In return, the US allowed France to take a disproportionate share of oil from its interest in Iraq. Still, the French harbored resentment over this deal for decades to come, a resentment that affected its attitude toward the US-led invasion of Iraq in 2003.

Then, in 1954, the US oil companies appeared, at first glance, to respond to the US government’s foreign policy interests. After Mossadeq nationalized oil production in Iran and the US and British governments helped overthrow him the next year, Saudi Arabia feared that the sudden surge of Iranian oil on the market would disrupt oil production and depress prices. To appease the Saudis, Herbert Hoover convened a meeting with the eight major oil companies (five of them being American) and convinced them to bring the Iranian oil back on the market in an orderly way and in amounts that would not exceed Saudi oil production. Iran’s newly installed Shah was infuriated at the US government for the preferential treatment shown to Saudi Arabia, considering that Saudi Arabia had far few people to provide for than Iran.
To many in France, Hoover’s meeting demonstrated that US companies would respond to the interests of the US government, leading the French to fear the near stranglehold Anglo Saxons—primarily Americans—had on post-war Europe’s supply of oil. This assumption, however, should be qualified by noting how one-sided the relationship between US companies and the US government was. After the Hoover meeting, the US majors received a 40% share of Iran’s oil (US independents held an additional 5%), a monopoly on Saudi Arabian oil, and a still significant share in Iraqi oil. Their agreement to guarantee Iranian oil production did not exceed Saudi oil production was a small sacrifice to make in return, especially considering that evidence now shows that Iranian oil production could not have exceeded Saudi oil production anyway.

Events in the 1960s and 1970s further undermined the assumption that American companies could be relied on to support the US government’s objectives. During this period the balance of power began to shift in favor of the oil producing states. Growing nationalism, combined with new, US-trained domestic oil experts, increased these states’ confidence that they could handle their oil production themselves. They formed the OPEC cartel to control the price of oil and they increasingly threatened to nationalize oil production within their borders. Furthermore, Libya helped nurture US independents by giving them a share in its oil production and using them as a check on the US majors’ ability to intentionally limit production. Meanwhile the world was experiencing explosive demand for oil far in excess of any nation’s predictions.

By the early 1970s the United States had lost all of its spare domestic capacity and was entirely dependent on foreign oil to meet increases in demand. This aroused suspicions, particularly from Senators Muskie and Church, that the US majors had intentionally underestimated projected demand and delayed developing new deposits to raise prices.
Furthermore, distrust between the US majors and independents led to failures in their ability to negotiate with OPEC with a unified front, which John McCloy had enabled them to do by securing business review letters from the Justice Department that guaranteed their immunity from prosecution under the Sherman Act.

Then, in 1973 Saudi Arabia issued an oil embargo against the United States and the Netherlands for their resupply of an Israeli fleet during the Yom Kippur war. US companies complied with the embargo, yet agreed to mitigate it by allocating the shortage of Arabian oil across all their other customers. The US agreed to stop resupplying, yet the Saudis did not lift the embargo right away, which Henry Kissinger claimed to never understand. However, significant evidence points to the fact that during the whole period of the embargo, Aramco had suffered from technical difficulties that constrained their production anyway. Theses technical shortages, therefore, may have been much more of a motivating factor behind the 1973 oil embargo than the alleged geopolitical issues invoked.

Some evidence indicates that Aramco’s technical difficulties were caused by overproduction of its oil reserves. During the years leading up to the embargo, Aramco—which was wholly owned by US corporations—feared that the Saudi government would soon nationalize it. Consequently, Aramco may have intentionally sped up production to a degree that it knew would permanently damage its future production. Little is known about Aramco’s management during this time, however, because CIA agents were not allowed inside its facilities. Instead, it regularly met with US officials to assure them that oil production was fine. The US had assumed that its companies could be trusted to let them know if the country’s supply might be affected.

1 The UK prime minister protested this action to the head of Royal Dutch Shell, who responded by stating that he should put his complaint in writing. He never did.
B. National Treatment and Beyond

Another primary way the US government has acted on behalf of its companies’ investments abroad has been first through securing guarantees of national treatment for its companies’ foreign subsidiaries and then through invoking international standards against expropriation. After World War II, the US government agreed with the European Coal and Steel Community to grant national treatment to US corporate subsidiaries in Europe, meaning that they would be treated on no worse terms than domestically owned companies. In many ways this gave a tremendous advantage to these corporations over European competitors because they brought with them superior capital, technological, and human resources as well as (as Schrieber noted) a pan-European, border-blind mindset that European companies lacked.

In Latin America, however, the US government went further. There, the obsolescent bargain theory had been playing out to place US companies in very vulnerable positions. US companies would invest enormous sunk costs in mines or utilities after securing agreements with the host governments on very favorable terms. Several decades later, however, the US companies would lose bargaining power because they were unable to move without losing their investment and face threats of expropriation.

The US government responded to these threats in the late 1960s and early 1970s through direct action and through reshaping international law. In Chile, it directly helped ITT Corporation, which owned the country’s telecom infrastructure, to resist and eventually overthrow the leftist-Allende regime when it threatened to nationalize ITT. ITT, for its part, provided the CIA with millions of dollars to bribe the Chilean legislature while Allende was in power to resist nationalization. The US government also supported US corporate activity abroad by establishing the Overseas Private Investment Corporation, which uses US government funds
to insure US companies that invest abroad against political risks, such as nationalization. The US government’s exposure if ITT were nationalized was $96 million.

During this time, President Richard Nixon announced that expropriation without prompt, adequate, and effective compensation was a violation of accepted principles of international law. By invoking international standards, President Nixon exceeded the previous national treatment standard. Now, the US government would insist that its investors receive even more favorable treatment than domestic companies.

Over the next few decades, the United States began codifying this international standard in bilateral investment treaties and in Chapter 11 of NAFTA. These agreements give investors a direct right of action against sovereigns in the event of expropriation or other violations of the agreement, rather than requiring them to go through the US government to seek recourse on their behalf. As an alternative to domestic courts, investors’ claims can be brought in international forums, such as the International Center for the Settlement of Investment Disputes, which has an explicit aim of creating an environment favorable to foreign investment. These forums often offer foreign investors more expansive legal rights and remedies than domestic companies receive in domestic courts.

Policy makers’ objectives in supporting private investment in developing countries were not corrupt. Many US policy makers, including Senators Javitz and Humphrey, viewed private investment as a far-superior instrument for international development than aid. US private companies, therefore, were relied on to be the engine for promoting the US’s interests in helping poorer countries develop.

However, it is questionable whether US companies have fulfilled this role adequately. Because of the many protections they received by making investments in developing countries,
US companies could venture into markets with low labor and environmental standards with greatly reduced risks. Rather than merely seeking the US government’s help in defense of wrongs suffered abroad, US companies began relying on their government to help transform developing countries into export platforms where the companies could charge very low wages, offer few labor protections, and pollute the environment.

Despite benefiting from the government’s promotion of international standards with regard to investor protections, US companies have not responded reciprocally by supporting the US government’s efforts to promote international standards with regard to other protections. For example, in the Trade Promotion Authority, the US government has expressed support for enforcing core worker rights as an international standard (as opposed to requiring countries to merely enforce their domestic labor laws, which are sometimes weaker). US corporate investors, however, often suppress or ignore these rights. In China, in fact, US companies lobbied the Chinese government to not acknowledge these rights when workers protested. US companies have also contributed to horrible working and living conditions in and around the maquiladora factories on the US-Mexico border.

III. Future of International Investment

Unfortunately, it appears likely that home-government intervention and geopolitical power relations will likely drive foreign investment, especially in the oil production industry, even more in the decades to come. I think this is unfortunate, because the US government’s intervention on behalf of its companies has led to several undesirable outcomes. First, US companies are in a position to dominate industries in developing countries because domestically owned companies are unable to compete. Even under national treatment, US companies can exert their superior financial, technical, and human resources to squash fledgling industries in
nations. Under international investment standards, US companies not only have superior resources, but they have superior legal rights and remedies than domestic companies.

Second, because the US government does not counterbalance these international investment standards by enforcing international labor and environmental standards, US companies can use their superior resource and legal footing to worsen living conditions in developing countries. While poverty naturally lowers the price of labor and, perhaps, the degree of environmental protection a country can afford, the US government’s intervention allows companies to depress labor value and environmental conditions even further. This happens because the international investment standards promoted by the US government suppress domestic competition for labor. With more domestic competition for labor, workers’ wages would rise, which would cause power to be distributed more evenly and enable the people to demand better protection of their environment.

Third, the US government’s intervention undermines host nations’ sovereignty and strips their incentive to reform. Because investors enjoy the protection of international standards enforced in international (as opposed to domestic), investor-friendly tribunals, host nations’ governments have limited ability to legislate or enact policies adverse to foreign investors. They also have reduced motivation to improve their domestic judicial system, bureaucracy, or other institutions because they are not necessary to attract investment. If foreign investors invested at their own risk, host-nation governments would have to clean out corruption and inefficiency and ensure stability in order to generate investor confidence.

Furthermore, recent studies seem to indicate that bilateral investment treaties do not seem to greatly improve foreign investment anyway. Consequently, removing government-created investor protections like this would not likely have a deleterious effect on international
development; on the contrary, it would likely improve international development for the reasons stated above.

Foreign government involvement in foreign direct investment, however, is likely to only grow in the decades to come. It will probably grow because US politicians’ argument that the government’s intervention is crucial to maintain US companies’ competitiveness abroad is likely to only grow more convincing. China, Russia, India, Brazil, and other new emerging economies will increase their level of foreign investment in developing countries in years to come. US politicians will argue that US companies will face enormous challenges bringing profits back to the US economy if the US government doesn’t do its utmost to support them.

The international-competitiveness rationale is only worsened by the fact that many of the new emerging economies themselves have a strong history of state support for private industry. The Chinese government, for example, will probably intervene internationally on behalf of its oil companies in the 21st century to fuel its rapid growth even more strongly than the US government did in the 20th century. The US and other governments will probably respond by also intervening more heavily for their oil companies to be competitive. Furthermore, the earth may soon reach peak oil, if it hasn’t already, which could make governments even more ravenous to gobble up the remaining oil resources. The result will be an oil market that is even more affected by geopolitical factors, and less by market forces, than ever before.

One positive factor may work on behalf of developing nations, however. The rise of China and India means that these nations have other markets to sell to than the United States. This competition will reduce the United States government’s ability to secure as one-sided of a bargain for its private companies. If developing countries don’t like the bargain the United States offers, they can turn to other new consuming countries.
IV. Conclusion

Ultimately, the future of US government involvement in foreign investment comes down to the ability of the US people, and the people of developing nations, to make their voice effective at shaping policy. This essay started by noting that the interests of the US government are inseparable from the interests of the political figures that compose it. It also suggested that these political figures have more on an incentive to support corporate foreign investors than the general US population because supporting corporate investors has become a more effective strategy for winning elections. The US people can change this dynamic with their voices and votes, however, and demand that the US government more closely reflect their interests, which include not only domestic job supply, but also living and working conditions abroad.