

Relations between transnational corporations and Governments of host countries: a look to the future

Charles R. Kennedy, Jr.*

Market-oriented policies and privatizations are sweeping the developing world, but those developments should be judged in historical perspective. In particular, the causes for the earlier era of confrontation between TNCs and the Governments of host countries should be clearly understood and used to judge the desirability of recent events and policy options. The contrasting cases of Mexico and Argentina under Presidents Salinas and Menem, respectively, are studied in this respect. This article concludes that political reactions against external dependency explain the wave of expropriations during the 1970s, and that policies in the 1990s that allow foreign firms to regain control over politically sensitive and strategic sectors of developing countries run the risk of debt fatigue, causing a return to more radical foreign-direct-investment policies in the future.

An overview

One could divide the relations between TNCs and Governments of host countries since 1945 into three eras: TNC domination, confrontation between Governments of host countries, and negotiation between TNCs and Governments of host countries. The first era lasted into the early 1960s, while the second era was at its height during the 1970s. By the 1980s, the third era had begun.

The history of expropriation activity by developing countries tracks those eras quite well. By the mid-1960s, the number of expropriation acts began to rise, but that activity was most pro-

*Director, Flow Institute for International Studies, Wake Forest University, Winston-Salem, North Carolina.

nounced in the 1970-1979 period (see table 1). In the 1980-1985 period, however, the number of expropriation acts dropped dramatically [Kobrin, 1980, pp. 71-72].¹

A number of important questions can be asked and explored. First, what explains the upsurge and decline in expropriation activity over the 1970-1985 period? Second, is the era of confrontation a one-time aberration in relations between TNCs and the Governments of host countries or could the incidence of expropriation significantly increase in the future? Third, what role will the international debt crisis and its management have on future relations between TNCs and Governments of host countries? In particular, how should the issue of privatization be approached? Should foreign bank creditors, their respective Governments and international organizations aggressively push developing countries into privatizing politically sensitive and strategic industries, such as oil, communications and banking? Is it desirable for TNCs to return to a commanding or prominent position within key economic sectors of developing countries?

These are important questions to explore. As a first step, insights into the root causes of expropriation will be offered. The present article will show that the vast majority of expropriations were undertaken by only a few political regimes. In fact, 28 Governments accounted for over 62 per cent of all expropriation acts in the 1960-1985 period (374 of 598 acts). Explaining why those 28 regimes (out of the over 300 political regimes that existed in the 79 developing countries that were studied) expropriated foreign direct investment (FDI) on such a massive scale will substantially increase the understanding of why the era of confrontation occurred.

Explaining the era of confrontation is critical for understanding trends in the 1980s. A recent study by Michael Minor (1990) specu-

¹ Stephen J. Kobrin's database was constructed on the basis of expropriation acts, defined as the "forced divestment of any number of firms in a single industry (3-digit SIC code) in a single country in a given year". Such a definition was used because in many instances firms are not comparable units across countries. For example, the huge International Petroleum Company in Peru or Anaconda Copper in Chile cannot be equated with 233 tea estates in Sri Lanka.

Table 1. Expropriation acts by year

Year	Number of acts	Number of countries expropriating
1960	7	6
1961	8	5
1962	8	5
1963	11	7
1964	22	10
1965	14	11
1966	5	3
1967	25	8
1968	13	8
1969	24	14
1970	48	18
1971	51	20
1972	56	30
1973	30	20
1974	68	29
1975	83	28
1976	41	14
1977	18	14
1978	15	7
1979	28	13
1980	12	7
1981	5	3
1982	1	1
1983	3	3
1984	1	1
1985	1	1
	<hr/> 598	

Source: Data for 1960-1978 are from Stephen J. Kobrin, "Foreign enterprise and forced divestment in the LDCs", *International Organization*, 34 (1980), pp. 65-88 and "Expropriation as an attempt to control foreign firms in the LDCs: trends from 1969-1979", *International Studies Quarterly*, 28 (1984), pp. 329-348; data for 1979-1985 were compiled by this author. One should also note that some adjustments were made in Kobrin's data for the 1960-1978 period, as explained in footnotes for table 2.

lated that the dramatic decline in expropriation activity can be explained by two factors: a drop in commodity prices increased the need for capital in developing countries; and, as the capabilities of Governments of host countries increased, they became more confident and sophisticated in their abilities to gain greater economic

benefits from TNCs without resorting to expropriation [Minor, 1990, pp. 28-30]. Those explanations will be analysed in the light of the root causes of the earlier era of confrontation. The author will conclude that those explanations are not entirely convincing and a resurgence of expropriation could be expected to occur, since an increased need for external capital could trigger a radical response within developing countries if TNCs, both industrial and financial, are perceived as being responsible for the capital shortage and any resulting economic hardship.

Resolving the relationship between external capital needs and the propensity to expropriate has important policy implications for the management of the international debt crisis. Since heavily indebted developing countries have large external capital needs in order to repay old loans and have been subject to economic liberalization policies as part of debt-rescheduling packages and IMF stabilization programmes, FDI has recently become more attractive to those societies. There may be a point at which FDI is no longer viewed positively, however, particularly if the external dependency represented by the debt burden and internationally imposed economic reforms is exacerbated by the renewed control of key economic sectors by TNCs. A radical political reaction that results in an increase in expropriation is a real possibility, especially in Latin America, where fears of "Yankee imperialism" are ever present. From that perspective, the policy implication is clear: the international debt crisis should be managed in ways that minimize "debt fatigue", as described by Rudiger Dornbusch and others [Dornbusch, 1985, pp. 352-353], and with sensitivity to the root cause of earlier confrontations between TNCs and Governments of host countries. In particular, privatizations should proceed cautiously in strategic sectors of developing countries' economies; furthermore, developed countries, foreign bank creditors and international organizations should avoid pressuring developing countries to do otherwise.

Methodology

Past attempts to explain the propensity to expropriate have generally followed one of two approaches: either in-depth case studies of a select number of expropriations [Mikesell, 1971;

Bostock and Harvey, 1972; Einhorn, 1974; Ingram, 1974; Moran, 1974; Kline, 1987], or cross-national statistical analyses [Knudsen, 1974; Jodice, 1980; Fagre and Wells, 1982; Burton and Inoue, 1987; Minor, 1990]. Although case studies have greatly added to our knowledge of expropriation, particularly as regards the role of bargaining power in relations between TNCs and Governments of host countries, their ability to identify the structural causes of expropriation across countries and regions is limited by the very nature of their narrow focus. Although quantitative studies have generated statistically significant correlations between certain variables and the propensity to expropriate, their findings are suspect because hard data have been either unavailable, unreliable or difficult to operationalize. The methodology employed by the author tries to draw on the relative strengths of those two approaches, while avoiding their drawbacks. Statistical analysis is used to guide in-depth case studies, but rather creative and questionable ways to operationalize variables due to data constraints are avoided. Numerous cases can then be systematically analysed by group-wise comparisons, which facilitate generalizations across countries and regions. That approach gives the analysis the in-depth richness of cases, while at the same time allowing some structural causes of expropriation across countries to be identified.²

Explaining the era of confrontation

As noted above, the extensive expropriations of the late 1960s and 1970s were primarily the result of actions taken by a select group of Governments. Not only did those political regimes account for nearly two thirds of all acts of expropriation in the 1960-1985 period, but their actions greatly encouraged or pressured other more selective expropriators to seize FDI as well. This "demonstration effect" on expropriation has been studied in connection with the oil industry [Kobrin, 1985]. Thus the number of expropriation acts that can be attributed to those 28 regimes is much larger than their own acts of expropriation would suggest.

Those 28 Governments were identified as mass expropriators

² For more detail on how statistical analysis was used to guide these case studies and on the group-wise comparisons, see Kennedy (1991a).

because they nationalized FDI in all major sectors of the economy. Those sectors included banking, natural resources (agriculture, petroleum and mining), services (insurance, utilities, transportation, communications and trade) and manufacturing. Those regimes are listed in table 2 in terms of expropriation acts, number of firms seized and the years in which the expropriations took place.

Extensive case research was conducted in an effort to explain why those regimes expropriated FDI across all key sectors of the economy. Although in a short article one cannot provide methodological details, events leading up to those massive expropriations were analysed, and certain common denominators were identified. In particular, the following variables were found to be strongly associated with mass expropriation: colonialism; political instability; leadership characteristics and ideology; the ruling elite's political power, particularly with respect to military support; and the role of FDI in the economy.

The conceptual framework of mass expropriation based on the analysis is illustrated in figure I. All the important variables noted above are incorporated in the framework and are inter-related in a way that shows two major paths to mass expropriation. The most common path had the following characteristics: the political regime came to power violently and in countries where strong external dependency relationships existed. Those dependency relationships usually had colonial roots, but when the country did not have a recent colonial past, either FDI dominated politically sensitive and strategic sectors, like petroleum, or the country was closely tied to the West through military relationships. Those dependency relationships fostered considerable resentment within the country and, at some point, particularly if the existing regime was highly corrupt or inept, a military coup or revolution propelled a new, more radical regime to power. When the new regime had a supportive military, faced no major geopolitical threats and was headed by a dedicated nationalist, a policy of mass expropriation ensued. That pattern was evident for 16 mass expropriators. Three other regimes should be added to this list even though they rose to power at independence. Though protracted and violent anti-colonial struggles in Angola, Indonesia and Mozambique had the

Table 2. Mass-expropriating political regimes and expropriation acts

Country of firms	Heads of Government	Years	Acts	Number of firms
Algeria	Boumedienne	1965-1978	33	107
Angola	Neto	1975-1978	15	128
Benin	Kerekou	1974	4	10
Burma a/	Ne Win	1962-1983	10	24
Chile	Allende	1970-1973	30	46
Congo Democratic	Ngouabi	1970-1977	10	31
Yemen	Robaje	1969-1978	5	30
Egypt	Nasser	1956-1967	7	70
Ethiopia	Mengistu	1975-1978	26	105
Guinea	Touré	1959-1979	7	9
India	I. Gandhi	1967-1975	6	48
Indonesia	Sukarno	1957-1965	15	24
Iran (Islamic Republic of)	Khomeini	1979-1980	17	58
Iraq	al-Bakr/Hussain	1968-1977	7	8
Jamaica	Manley	1972-1977	7	12
Libyan Arab Jamahiriya	Qadaffi	1969-1974	11	33
Madagascar	Ratsiraka	1975-1978	12	50
Morocco	Hassan	1965-1975	13	30
Mozambique	Machel	1975-1980	18	43
Nigeria	Gowon	1967-1974	7	35
Peru	Velasco	1968-1975	28	47
Somalia	Barre	1970	5	10
Sri Lanka	Bandaranaike	1971-1976	6	254
Sudan	Nimeiri	1970-1978	13	25
Trinidad and Tobago	Williams	1969-1981	9	10
Uganda	Obote	1970	5	9
United Republic of Tanzania	Nyerere	1963-1978	28	127
Zambia	Kaunda	1964-1980	20	21
			374	1404

Source: Data for 1960-1978 were drawn from Kobrin, but these data were reclassified by the political regime that did the expropriating, since Kobrin had only classified each act only by the country and year of the seizure. Data for 1979-1985 were compiled by this author.

a/ The name of Burma was changed to Myanmar in June 1989.

characteristics of social revolutions, the regimes were similar to those which overthrew post-colonial Governments by force.

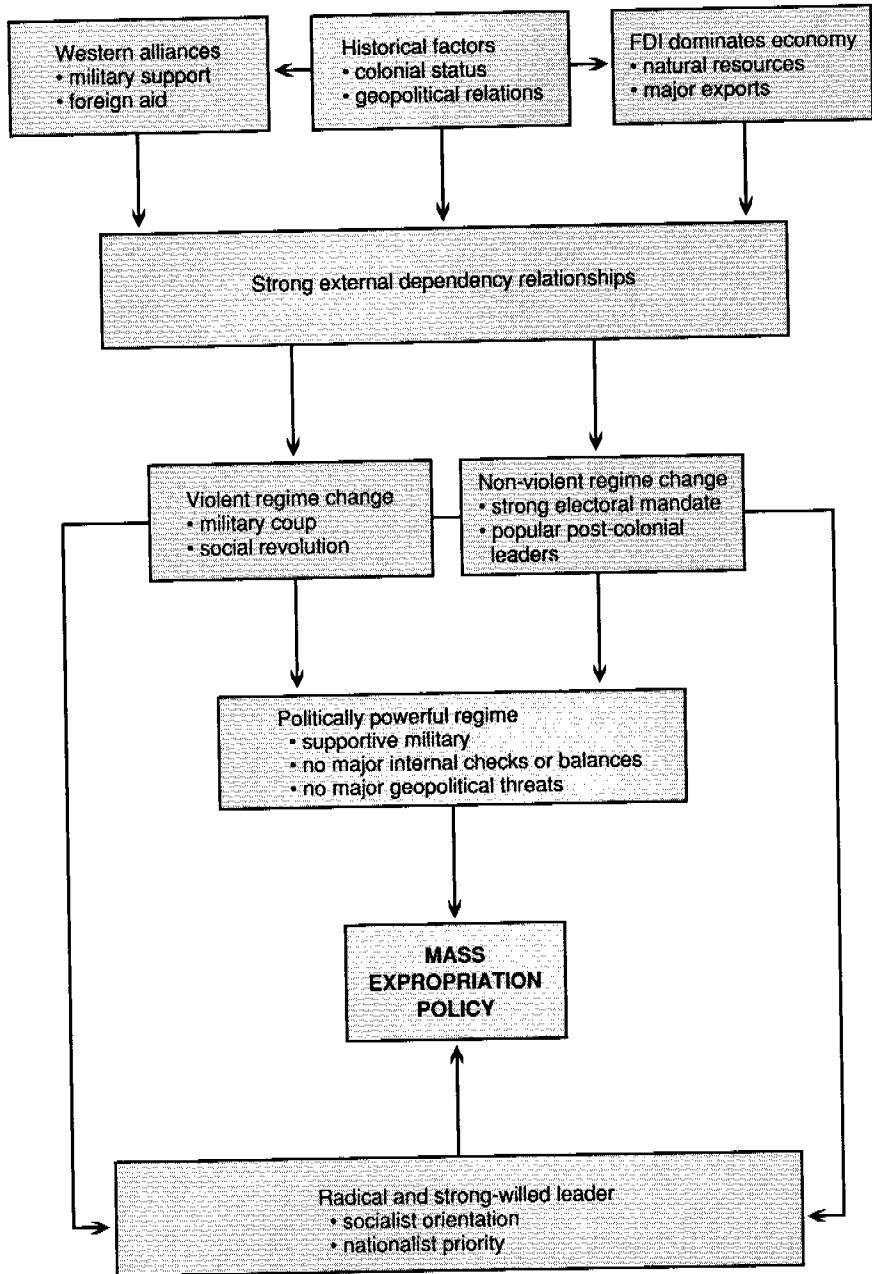
Kobrin, who also explored the reasons for mass expropriation, saw a strong relationship between the extensive seizure of FDI and a colonial past as well.³ As Kobrin [1984, pp. 339-340] observed:

"Six of the 10 cases of mass expropriation closely followed independence, with Angola and Mozambique the best examples. . . . The end of the colonial era and the rise of Third World assertiveness and independence during the late 1960s and early 1970s influenced the preference for expropriation as opposed to regulatory control of behavior . . . there was a tendency on the part of many countries to use foreign investment as a symbol of Western industrialization and Western colonialism; expropriation may have represented a rejection of the general context as well as of the specific enterprise."

In other words, mass expropriators were reacting against the general context of being externally dependent upon foreigners, with colonialism being the most visible and hated vestige of those dependency relationships. Certainly, in most cases, an intense anti-colonial reaction was the driving force behind mass expropriation. At the same time, in nearly all former colonies, FDI dominated key economic sectors, like banking and natural resources, and that aggravated the anti-colonial reaction. Interestingly, in the one case of mass expropriation that occurred after a coup in a country without a recent colonial past (Peru), important natural resources were owned and controlled by foreign companies; removing that ownership was the key issue that propelled the regime to power. In two

³ Stephen J. Kobrin's research on mass expropriation, however, had a number of weaknesses that this paper attempts to address. First, Kobrin's definition of a mass expropriator can be challenged in a number of respects. Most fundamentally, the distinction between a mass and a selective expropriator was based on an arbitrary standard, namely, the number of expropriation acts in a country during the 1960-1979 period. The threshold for a mass expropriator was set at 15 acts over a 20-year period, thereby placing some countries with 13 acts in the selective category. Relatedly, countries do not expropriate foreign investments; instead political regimes execute public policies. Thus the unit of analysis should be focused on the nature of and circumstances under which these kinds of Governments come to power. For those reasons, study of mass versus selective expropriation in this article focuses on sectors and regimes and cannot be based on the number of firms expropriated in a country over a long time period.

Figure I. Conceptual framework of mass expropriation



other cases of mass expropriation (Ethiopia and the Islamic Republic of Iran), major revolutions took place against traditional monarchs closely allied to the West. In both instances, reactions against Western support tied to the Emperor and the Shah were important. Thus, for this path to mass expropriation, one or more of three conditions were present: (i) firms domiciled in the former colony held the largest percentage of total or industrial FDI; ⁴ (ii) foreigners owned politically sensitive and strategic natural-resource industries that generated large volumes of foreign exchange for the Government; ⁵ or (iii) revolutionary leaders were severing a range of geopolitical, military and economic relationships that had developed between deposed monarchs and a "decadent" West, particularly the United States. ⁶

One should stress that there was also a strong relationship between political instability and those reactions against external dependency. The Velasco coup in Peru was the most symbolic example: when the alleged secret protocol between the Belaunde Government and the International Petroleum Company was announced, the military immediately seized power [Einhorn, 1974; Ingram, 1974; Philip, 1976]. The coups that put Barre, Nasser, Nimeiri, Ne Win, Qadaffi and Ratsiraka in power were also motivated in terms of the need to end "foreign dependence" or "neo-colonial manipulations" [Laitin, 1976; Kent, 1979; Wai, 1979; Steinberg, 1981; Waterbury, 1983; Bearman, 1986]. ⁷

Of course, a rejection of dependency was also a motivating factor behind the violent anti-colonial struggles led by Machel, Neto and Sukarno [Brian, 1978; Isaacman, 1983; Wolfers and Bergerol, 1983].

⁴ This condition was found when the following 15 regimes began to expropriate FDI on a massive scale: Bakr/ Hussain, Barre, Boumedienne, Gowon, Kerekou, Machel, Nasser, Neto, Ne Win, Nimeiri, Obote, Qadaffi, Ratsiraka, Robaje and Sukarno.

⁵ This situation was present when these 10 mass expropriators came to power: Bakr/ Hussain, Barre, Boumedienne, Gowon, Neto, Ne Win, Ngouabi, Qadaffi, Sukarno and Velasco.

⁶ This was the case for four mass expropriators: Khomeini, Mengistu, Nasser and Qadaffi.

⁷ See these references for more information on these coups as reactions against foreign dependency.

In other respects, coups or revolutions are related to mass expropriation because they can result in a consolidation of political power. If the preceding ruling elite is preoccupied with political survival, a policy of fundamental economic reform is rarely attempted. That is particularly true when it takes the form of mass expropriation, which usually has negative economic consequences, at least in the short term. In addition, political instability and mass expropriation are related because of the lack of credibility or legitimacy that previous contracts have in the eyes of leaders who have gained power by force against discredited regimes. The rule of law and the sanctity of contracts are often viewed in a totally different light by revolutionary or military coup leaders. Since they see the former Government as having little or no legitimacy, all contracts signed or honoured by former leaders are equally illegitimate. The forced seizure of foreign investment property readily follows such a perspective.

The other path to mass expropriation was similar to the above group in some ways, but differed in others. For both paths, strong external dependency relationships were present, and they usually developed as a consequence of colonial rule. In addition, the leader of the mass expropriating regime was a dedicated nationalist who headed Governments that had military support and no major checks on their power from other factions or parties. This pre-eminent political position, however, was not gained by force, but was instead captured through an electoral process or as the consequence of a popular anti-colonial movement. Seven regimes followed this path to mass expropriation .⁸

By comparing mass and selective expropriators who came to power through legal and non-violent means in countries without a recent colonial past, an important explanatory variable, the role of FDI, is highlighted. In particular, this question can be asked: How was Allende of Chile different from Goulart of Brazil, Peron of Argentina or Paz of Bolivia? All four were attracted to socialist goals of state ownership of the major means of production. In addition, the role and relationship of the military to those four leaders

⁸ These regimes were those of Allende, Bandaranaike, Gandhi, Kaunda, Manley, Nyerere and Touré.

were not all that different, in that the military elite was at least deferential to the civilian Government when they first took power, although all four were eventually overthrown by military coups. The critical distinction between Allende and the other three was instead rooted in the role of FDI in those countries. In Chile, foreign companies owned and dominated a very strategic, politically sensitive and economically vital industry (copper). In Argentina, Bolivia and Brazil, on the other hand, either those kinds of investments had already been nationalized or vital natural-resource sectors had never been dominated by foreigners [Ferrer, 1967; Malloy, 1971; Moran, 1974; Eckstein, 1976; Mamalakis, 1976; Randall, 1978; Stallings, 1978; Evans, 1979; Evans and Garaffi, 1982; Baer, 1983; Lewis, 1990]. Again, mass expropriations are political acts against real or perceived dependency on foreigners. That is why colonialism is such a key factor in explaining mass expropriation. In countries without a recent colonial past, however, the ownership of politically sensitive industries in the natural-resource sector appears to be a particularly important variable explaining mass expropriation.

The only possible anomalies to either of those paths are represented by Hassan of Morocco and Williams of Trinidad and Tobago. In both cases, the regimes reacted to intense pressure being generated by political radicals, and they subsequently followed cooptive politics. By expropriating FDI, Hassan and Williams attempted to enhance their popularity. Expropriation also increased the power of the State. Some Moroccan analysts, however, have argued that expropriation never really took place, since former owners maintained effective control over their operations. Some of the same observations have been made about expropriation policies in Trinidad and Tobago [Waterbury, 1973; Damis, 1975; MacDonald, 1986]. Thus, if one defined expropriation as the transfer of both ownership and control of FDI to local nationals, then Hassan and Williams might well be excluded from the list of mass expropriators.

In summation, although there are two distinct paths to mass expropriation, depending on the way political power has been seized or gained, there are more similarities than differences between the two groups. Strong external dependency relationships exist, and

political power has been consolidated around a leader who is dedicated to severing that dependency. Those paths were discovered and confirmed through extensive case studies that compared not only mass expropriators with each other, but also mass expropriators with selective expropriators.

Explaining the era of negotiation

Given the preceding analysis, a major reason why the number of expropriations declined in the 1980s is due to changes in external dependency relationships. In large part, developing countries became less dependent on external actors because their internal capabilities and resources increased. Thus one factor that Minor identified as a cause of the decline in expropriation has merit, but the explanation should be clearly understood in the context of why extensive expropriations occurred in the previous period [Minor, 1990]. In an earlier study, Kobrin hypothesized four reasons for the decline in expropriation, which were evident by the late 1970s [Kobrin, 1984]. First, the most politically sensitive and strategic industries, like mining and petroleum, had been almost completely nationalized by 1976. Second, as time passed, the country's colonial history became less of an issue, and attitudes towards FDI became more pragmatic as a result. Third, the administrative, technical and managerial capabilities of developing countries increased dramatically, making regulatory control of TNCs a viable option. Fourth, greater external capital needs that followed the oil shocks and the rising debt burden placed constraints on developing countries that made expropriation less attractive. Minor, of course, echoed two of those factors in his recent study, and three of Kobrin's hypotheses are entirely consistent with the argument in this article that political reactions against external dependency explain mass expropriation.

The rise in developing-country capabilities has already been discussed, but an additional point should be made to support the proposition that this factor should be viewed in terms of its impact on external dependency, not in terms of rational policy choices based on notions of relative bargaining power, which is the Kobrin perspective [Kobrin, 1984, pp. 340-343]. Since Kobrin saw that factor as the most important cause for the decline in expropriation,

one would not expect mass expropriation to occur in a country with a high degree of administrative, technical and managerial capabilities, especially after 1979.

The Islamic Republic of Iran, however, represents an example of mass expropriation in 1979-1980, and this was a country that had demonstrated a level of regulatory control over TNCs that was perhaps unmatched in the developing world. Kobrin might argue that the revolution removed or forced to flee the country much of the technical, administrative and managerial expertise, giving the country's new leaders few regulatory options, but such an argument would miss a critical point. Namely, the primary objective of Iran's revolutionaries, particularly the religious leadership, was the eradication or removal of the Shah and his allies, which included most TNCs and the Government of the United States. Mass expropriation was viewed as a desirable end for ideological reasons. It was not a policy based on a rational calculation of economic costs and benefits. In essence, the Iranian revolution was a political reaction against external dependency and excessive Western influence in the country, just like earlier mass expropriations.

Two of Kobrin's other causes for the decline in expropriation are also consistent with the thesis that the propensity to expropriate should be judged in terms of political reactions against external dependency. Clearly, since TNCs no longer own and control key natural resources in developing countries, one of the most symbolic vestiges of colonialism or neo-colonialism has been removed. Given past expropriations and the increased capability of developing countries to operate their own mines, oil fields and refineries, real and perceived dependency on foreigners declined. Those earlier acts of expropriation, however, served to vent the many frustrations and resentments that had accumulated since colonial or "gunboat" diplomacy days. Lastly, the passage of time is also a factor in lessening the current political impact of the earlier era of colonialism. With lapse of sufficient time, most citizens of today would not have personally experienced colonial dependency and so its impact on future expropriation policy will decline.

In terms of the fourth factor hypothesized by Kobrin, however, the claim that a higher debt burden has reduced the likelihood of

expropriation is questionable. At best, this is a short-term explanation for a decline in expropriation, since it is tantamount to saying that the chances for expropriation have gone down because the World Bank, IMF, developed nations and TNCs have more leverage and control over the foreign investment policies of developing countries. In short, Kobrin's argument rests on the proposition that expropriation is less likely because capital-poor countries are now more externally dependent. That proposition runs counter to the historical record of why mass expropriation took place and, by doing so, it ignores the possibility of radical regime change that is stimulated by the desire to reduce external dependency as an end in itself. By examining the international debt crisis and various views of how it should be managed, this possibility will be highlighted.

Debt fatigue, privatization and policy implications

During the 1982-1988 period, three different views of the international debt crisis and how it should be managed emerged. One was represented by the Baker plan, which had three major features: major structural reforms and the liberalization of developing countries' economies; a strong role for the World Bank and IMF in promoting the liberalization and reform process; and substantially more lending by commercial banks. The Baker initiative, which was announced at the annual meeting of the World Bank and IMF in October 1985, clearly had the support of those two organizations.

A second and contending perspective on how the international debt crisis should be managed was developed in direct opposition to the Baker plan. That position criticized Baker for not recognizing the need to reduce developing-country debt. The debt-service burden of developing countries was viewed as already too high therefore, a policy that encouraged more lending was inappropriate. Reducing the debt burden of developing countries would be accomplished by debt write-downs and forgiveness.

Major proponents of that position were represented by Senator

⁹ For a detailed review of those contending perspectives on the international debt crisis, see Kennedy [1987, pp. 108-131].

Bill Bradley and economist Rudiger Dornbusch. The focus of their concern was on the political consequences of excessive debt within developing countries. Dornbusch talked about "debt-service fatigue", which could undermine the political stability of debtor countries [Dornbusch, 1985, pp. 352-353]. Senator Bradley was even more blunt: "If we fail to establish a partnership for growth with the present set of democratic leaders in Latin America, I can imagine repercussions that will put another set of people in power who share neither our commitment to the present international financial system or to the market system".¹⁰ From that viewpoint, since the return to radical economic policies was a distinct possibility in debtor countries, particularly those of Latin America, the excessive debt burden should be reduced at an international trade-debt summit under the aegis of GATT.

The third perspective also predicted a return to confrontational and radical politics in debtor countries, but, unlike Bradley and Dornbusch, saw such a development as welcome. The most prominent proponent of that view was Fidel Castro, who observed that "The political, economic and social situation of Latin America is such that it can't hold up under any more restrictions and sacrifices . . . If a solution isn't found for the economic crisis and above all for the crisis of the debt-South America is going to explode". Although that dire prediction was not fulfilled, a number of analysts and public officials of various political persuasions, from Castro to Bradley and Dornbusch, certainly agree that a return to the era of confrontation is a real possibility.

International bankers and investors alike feared that Peru under Alan Garcia had come close to the explosion point in the 1985-1987 period. With Garcia's decision to expropriate Belco Petroleum and to limit debt-service payments to 10 per cent of export earnings, many TNCs and bankers with branches in Peru wondered if further, more massive expropriations were likely. When Garcia, in fact, nationalized the domestic banking industry in 1987, foreign banks initially thought those actions could affect

¹⁰ Senator Bill Bradley, quoted in *The Washington Post*, 6 July 1986, p. K5.

" Fidel Castro, quoted in *The Wall Street Journal*, 12 June 1985, p. 30.

their operations as well. If they had, Garcia would have been well on the road to becoming a mass expropriator.¹²

The viewpoint presented in this article, however, would have predicted that Peru had a low probability of becoming a mass expropriator. First of all, Peru does not have a recent colonial past, and Garcia was elected in a competitive party election. In that context it is worth remembering that only one non-colonial, popularly elected regime was ever a mass expropriator—Allende of Chile. In a number of respects, the situation confronting the Garcia Government was different from that of the Allende Government.

Four major differences between the Allende and Garcia regimes can be cited: (i) unlike Chile, key extractive industries were not owned by foreign firms in Peru; (ii) unlike Allende, Garcia was not elected with a popular mandate to expropriate; (iii) the Peruvian military was more likely to overthrow Garcia if his politics became too radical, whereas the Chilean military was historically apolitical and inclined to allow the electoral mandate to be carried out; and (iv) while the international context encouraged expropriation in the early 1970s, the demonstration effect was discouraging expropriations in the mid-1980s, since privatization policies had become widespread. Nevertheless, even though conditions were not conducive to a policy of mass or extensive expropriation in Peru under Garcia, this case demonstrates that the concerns of Bradley and Dornbusch are well placed. Those involved in international policy and the management of the debt crisis should take seriously the possibility of severe debt-service fatigue and the radicalization of developing countries' policies.¹³

In that connection, the recent wave of privatizations can be properly judged. The cases of Argentina and Mexico are particularly important, given recent developments and their contrasting approaches to privatization. Interestingly, Argentina, under Presi-

¹² For a complete review and analysis of expropriation policy in Peru under President Garcia, see the case "Occidental and Belco Petroleum in Peru", written by Kennedy (1991b, pp. 44-59).

¹³ As the Brady plan, which emphasized debt relief and forgiveness, was being formulated, concerns about debt fatigue and political instability were certainly mounting. See Cohen (1988) and Robinson (1989).

dent Menem's leadership, is following a course of action that may result in many strategic industries being returned to TNC ownership and control, whereas Salinas of Mexico appears unwilling to allow that to happen. In Argentina, for example, Menem has started a process that represents the first oil privatization in Latin America and has already consummated the privatization of the country's telephone company, Entel, with significant control by two foreign-led consortiums [Ryser and Kessler, 1989; Peagam, 1990; Scott, 1990; Kamm, 1991]. In Mexico, on the other hand, the recent privatization of the national telephone company, Telmex, was implemented in a way that forbade foreign majority ownership and control, and in the oil sector, President Salinas has emphatically declared that this industry will remain totally within the ownership and control of the State-owned company, Pemex [Shoreham, 1990; Laurie, 1990; Solis, 1991]. The implication of research in this article is that Menem is running a very risky course indeed.

In fact, it is recognized outside and within Menem's Government that Argentina's privatization policies carry significant political risks [Peagam, 1990; Luxner, 1990]. As *Euromoney* observed:¹⁴

"Antonio Erman Gonzalez is a long-standing Menem aide . . . Gonzalez appreciates the political ramifications of the new *economy of sacrifice*. 'We are making every effort to make people understand that privatizing public operations does not mean giving away national assets, but rather taking the burden away from maintaining those inefficient operations' . . . Privatization also preoccupies Carlos A. Carballo, Undersecretary of Economics . . . He too is concerned that the public may misinterpret privatization."

Those concerns are especially acute as the Menem Government moves to privatize YPF, the State-owned oil company. With McKinsey as their consultants, the head of YPF, Jose Estenssoro, a Bolivian-born former manager at the Houston-based Hughes Tool Company, has the goal of floating YPF shares on a foreign stock exchange, which would take control of the company out of

⁴ "New Argentina regime using privatization and free market measures to revive economy", *Euromoney: Special Supplement* (September 1990), p. 8.

the Government's hands. As *The Wall Street Journal* recently reported [Kamm, 1991, pp. A1, A4],

"'We're not pulling any punches', Mr. Estenssoro says. 'We're here to transform YPF and make it a private sector company, if possible.' That is a big 'if, of course. But, if he overcomes political, labour and cultural opposition and succeeds, the free-market revolution sweeping Latin America would get a major boost. 'In Latin America, oil is similar to the sacred cows in India and here oil isn't sacred anymore', says Ricardo Zinn, who heads the Transformation Commission set up by Mr. Estenssoro to oversee the process. 'This could be a lesson for others in Latin America. It would prove that you can reorganize a state company in an orderly fashion in the most sensitive sector in the economy.' "

Perhaps the effort of the Menem Government will prove successful, but the risks of an adverse political reaction are too great to warrant the widespread adoption of such policies in other Latin American countries. There are a number of reasons why a significant upsurge in expropriation will not return in the 1990s and beyond, which increases the chances of Menem's efforts paying off. These are: (i) the international demonstration effect today discourages expropriation, since market-oriented systems and privatizations are being adopted in the most socialist of countries; (ii) unlike the expectations of theorists who justified expropriation on the ground of adverse effects of dependence, the history of mass expropriation shows that the economic consequences of such a policy are generally negative, and those would be further exacerbated by the lack of foreign aid from socialist countries, which helped cushion that negative impact in the past; (iii) if the move towards a market-oriented system and privatization creates significant real growth and prosperity for most citizens, then the loss of national control over key sectors may be politically accepted; (iv) the enhanced capabilities of developing countries' Governments have reduced their sense of dependency on external actors and have increased their policy options in managing TNCs, as Kobrin observed; and (v) the current political impact of colonial or neo-colonial experiences on FDI policy has receded. Nevertheless, the risks of a radical reaction against debt-service fatigue and any return of TNC control over certain strategic sectors should not be ignored. Simul-

taneous with the trend towards the adoption of market-oriented policies in many developing countries, there has been growing support for leftist political parties as well. In that regard, one should note the closeness of the recent presidential elections in Mexico and Brazil, where politicians espousing radical solutions to the debt crisis received an historically high number of votes [Kamm, 1989; Tharp, 1990; Cohen, 1988]. Menem himself, moreover, was elected on a fairly radical platform, and his subsequent policies have been dramatically different from his campaign position [Cohen, 1988; Twill, 1989; Peagam, 1990]. Thus there is evidence for likely polarization of politics in many key developing countries on how the debt crisis should be managed. A dramatic swing to the political left may be likely under certain circumstances. Interestingly, many United States banks decided not to buy equity positions during the recent privatizations in Mexico because they "are bothered by Mexican attitudes toward foreign investment and worry about possible policy changes under future governments".¹⁵ The return of TNC control over politically sensitive industries would undoubtedly increase the odds that such a swing and policy change would eventually occur.

Such a possibility is particularly relevant in guiding decisions being taken by the Government of the United States and foreign banks with significant exposure in Mexico. External pressure on the Salinas Government is mounting to privatize Pemex and to allow significantly more FDI in key sectors of the Mexican economy, like oil and banking.¹ Such pressure will probably intensify as negotiations on the United States-Mexico Free Trade Agreement proceed, but to push Mexico too hard on this issue would be a mistake. The forces of political nationalism in Mexico are too strong, and the history of expropriation suggests that the political risks far outweigh any economic benefits that would be gained.

In Argentina's case, the political risks that are being taken are perhaps understandable given the grave economic crisis faced by the country when Menem took office in July 1989. Menem's privatization approach is also the result of internal political decisions and has not been externally imposed. In fact, public opinion polls

¹⁵ "Mexico: suddenly this summer", *The Banker* (April 1991), p. 27.

¹ "Investing in Mexico", *Euromoney* (December 1990), pp. 6-22.

show that most Argentines support Menem's policies, at least for now, whereas most Mexicans would clearly oppose similar privatizations in their country. The same opposition to the privatization of key industrial sectors, especially if such action entails more TNC ownership and control, is evidenced by a recent public opinion poll in Brazil [Tharp, 1990]. As Governments, foreign banks and international organizations manage international debt and trade issues in the future, the root causes of the earlier era of confrontation should be clearly understood and remembered. ~

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