23 Things They Don’t Tell You about Capitalism

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Thing 8

Capital has a nationality

What they tell you

The real hero of globalization has been the transnational corporation. Transnational corporations, as their name implies, are corporations that have gone beyond their original national boundaries. They may be still headquartered in the country where they were founded, but much of their production and research facilities are outside their home country, employing people, including many top decision-makers, from across the world. In this age of such nation-less capital, nationalistic policies towards foreign capital are at best ineffective and at worst counterproductive. If a country’s government discriminates against them, transnational corporations will not invest in that country. The intention may be to help the national economy by promoting national firms, but such policies actually harm it by preventing the most efficient firms from establishing themselves in the country.

What they don’t tell you

Despite the increasing ‘transnationalization’ of capital, most transnational companies in fact remain national companies with international operations, rather than genuinely nation-less companies. They conduct the bulk of their core activities, such as high-end research and strategizing, at home. Most of their top decision-makers are home-country nationals. When they have
to shut down factories or cut jobs, they usually do it last at home for various political and, more importantly, economic reasons. This means that the home country appropriates the bulk of the benefits from a transnational corporation. Of course, their nationality is not the only thing that determines how corporations behave, but we ignore the nationality of capital at our peril.

Carlos Ghosn lives globalization

Carlos Ghosn was born in 1954 to Lebanese parents in the Brazilian city of Porto Velho. At the age of six, he moved with his mother to Beirut, Lebanon. After finishing secondary school there, he went to France and earned engineering degrees from two of the country’s most prestigious educational institutions, École Polytechnique and École des Mines de Paris. During his eighteen years at the French tyre-maker Michelin, which he had joined in 1978, Ghosn acquired a reputation for effective management by turning the company’s unprofitable South American operation around and by successfully managing the merger of its US subsidiary with Uniroyal Goodrich, which doubled the size of the company’s US operation.

In 1996, Ghosn joined the state-owned French car-maker Renault and played a key role in reviving the company, affirming his reputation for ruthless cost-cutting and earning the sobriquet ‘le cost killer’, although his actual approach was more consensual than that name suggests. When Renault acquired Nissan, the loss-making Japanese car-maker, in 1999, Ghosn was sent to Japan to put Nissan back into shape. Initially, he faced stiff resistance to his un-Japanese way of management, such as sacking workers, but he turned the company completely around in a few years. After that, he has been so totally accepted by the Japanese that he has been made into a manga (comic book)
character, the Japanese equivalent of beatification by the Catholic Church. In 2005, he stunned the world once again by going back to Renault as CEO and president, while staying on as a co-chairman of Nissan – a feat compared by some to a football coach managing two teams at the same time.

Carlos Ghosn’s life story sums up the drama that is globalization. People migrate in search of a better life, sometimes literally to the other side of the world, as Ghosn’s family did. Some of the migrants, like Ghosn’s mother, go back home. This is a big contrast to the days when, for example, Italian immigrants to the US refused to teach their children Italian, as they were so determined not to go back to Italy and wanted their children totally assimilated. Many youngsters from poorer countries with ambition and brains now go to a richer country to study, as Ghosn did. These days, many managers work for a company based in a foreign country, which often means living and working in yet another foreign country (or two) because your company is transnational. Ghosn, a Lebanese Brazilian return-migrant, worked in Brazil, the US and Japan for two French companies.

In this globalized world, the argument goes, nationality of capital is meaningless. Corporations may have started and still be headquartered in a particular country, but they have broken out of their national borders. They now locate their activities wherever the return is the greatest. For example, Nestlé, the Swiss food giant, may be headquartered in the Swiss city of Vevey, but less than 5 per cent of its output is produced in Switzerland. Even if we consider Nestlé’s ‘home’ to be Europe, rather than Switzerland, its home base accounts for only around 30 per cent of its earnings. It is not just the relatively low-grade activities such as production that transnational corporations are conducting outside their home countries. These days, even top-end activities such as R&D are often located outside the home country — increasingly in developing countries, such as China and India. Even their top managers

are drawn, like Ghosn, from an international pool of talent, rather than from exclusively national pools.

The upshot is that a company has no national loyalty any more. A business will do what it has to do in order to increase its profit, even if it means hurting its home country by shutting plants down, slashing jobs, or even bringing in foreign workers. Given this, many people argue, it is unwise to put restrictions on foreign ownership of companies, as many governments used to. As long as the company generates wealth and jobs within its borders, the country should not care whether the company is owned by its citizens or foreigners. When all major companies are ready to move anywhere in search of profit opportunities, making investment by foreign companies difficult means that your country is not going to benefit from those foreign companies that have identified good investment prospects in your country. It all makes sense, doesn’t it?

*Chrysler — American, German, American (again) and (becoming) Italian*

In 1998, Daimler-Benz, the German automobile company, and Chrysler, the US car-maker, were merged. It was really a takeover of Chrysler by Daimler-Benz. But when the merger was announced, it was depicted as a marriage of two equals. The new company, Daimler-Chrysler, even had equal numbers of Germans and Americans on the management board. That was, however, only for the first few years. Soon, the Germans vastly outnumbered the Americans on the board — usually ten to twelve to just one or two Americans, depending on the year.

Unfortunately, the takeover was not a great success, and in 2007 Daimler-Benz sold Chrysler off to Cerberus, an American private equity fund. Cerberus, being an American company,
made up Chrysler's board of directors mostly with Americans
(with some representation from Daimler, which still held a 19.9
per cent stake).

In the event, Cerberus failed to turn the company around and
Chrysler went bankrupt in 2009. It was restructured with US
federal government financial aid and a major equity investment
by Fiat, the Italian car-maker. When Fiat became the leading
shareholder, it made Sergio Marchionne, the CEO of Fiat, also
the new CEO of Chrysler and appointed another Fiat manager
to Chrysler's nine-member board of directors. Given that Fiat
has only a 20 per cent stake at the moment but has the option to
increase it to 35 per cent and eventually to 51 per cent, it is highly
likely that the proportion of Italians on the board will increase
over time, with the increase in Fiat's ownership share.

So Chrysler, once one of the quintessential American companies,
has in the last decade come to be run by Germans, Americans
(again) and (increasingly) Italians. There is no such thing as 'nation-
less' capital. When taken over by a foreign company, even mighty
(former-)American firms end up being run by foreigners (but then
that is what takeover means, when you think about it). In most
companies, however transnational their operations may seem, the
top decision-makers still remain the citizens of the home country
—that is, the country where ownership resides—despite the fact
that long-distance management (when the acquiring company
does not dispatch top managers to the acquired firm) can reduce
management efficiency, while dispatching top managers to a
foreign country is expensive, especially when the physical and
the cultural distances between the two countries are great. Carlos
Ghosn is very much an exception that proves the rule.

It is not just in terms of the appointment of top decision-makers
that corporations have a 'home bias'. Home bias is also very strong
in research and development, which are at the core of a company's
competitive strengths in most advanced industries. Most of a
corporation's R&D activities stay at home. Insofar as they are
relocated abroad, it is usually to other developed countries, and
at that with a heavy 'regional' bias (the regions here meaning
North America, Europe and Japan, which is a region unto itself
in this respect). Recently an increasing number of R&D centres
have been set up in developing countries, such as China and India,
but the R&D they conduct tends to be at the lowest levels of
sophistication.

Even in terms of production, arguably the easiest thing that a
company does and therefore the most likely candidate for relocation
abroad, most transnational corporations are still firmly based
in their home countries. There are odd examples of firms, for
instance Nestlé, which produce most of their outputs abroad, but
they are very much the exception. Among US-based transnational
corporations, less than one-third of the output of manufacturing
firms is produced overseas. In the case of Japanese companies, the
ratio is well below 10 per cent. In Europe, the ratio has risen fast
recently, but most overseas production by European firms is
within the European Union, so it should be understood more as
a process of creating national firms for a new nation called Europe
than as a process of European firms going truly transnational.

In short, few corporations are truly transnational. The vast
majority of them still produce the bulk of their outputs in their
home countries. Especially in terms of high-grade activities such
as strategic decision-making and higher-end R&D, they remain
firmly centred at their home countries. The talk of a borderless
world is highly exaggerated.

Why is there a home-country bias?

Why is there a home-country bias in this globalized world? The
free-market view is that nationality of capital does not—and
should not—matter, because companies have to maximize profit in order to survive and therefore that patriotism is a luxury they can ill afford. Interestingly, many Marxists would agree. They also believe that capital willingly destroys national borders for greater profits and for the expanded reproduction of itself. The language is radically different, but the message is the same—money is money, so why should a company do less profitable things simply because they are good for its home country?

However, there are good reasons why companies act with home-country biases. To begin with, like most of us, top business managers feel some personal obligations to the society they come from. They may frame such obligations in many different ways—patriotism, community spirit, noblesse oblige, or wanting to 'return something to the society that has made them what they are today'—and may feel them to different degrees. But the point is that they do feel them. And insofar as most top decision-makers in most companies are home-country nationals, there is bound to be some home-country bias in their decisions. Although free-market economists dismiss any motive other than pure self-seeking, 'moral' motives are real and are much more important than they lead us to believe (see Thing 5).

On top of those personal feelings of managers, a company often has real historical obligations to the country in which it has 'grown up'. Companies, especially (although not exclusively) in the early stages of their development, are often supported with public money, directly and indirectly (see Thing 7). Many of them receive direct subsidies for particular types of activities, such as equipment investment or worker training. They sometimes even get bailed out with public money, as Toyota was in 1949, Volkswagen in 1974 and GM in 2009. Or they may get indirect subsidies in the form of tariff protection or statutory monopoly rights.

Of course, companies often fail to mention, and even actively hide, such history, but there is an unspoken understanding among the relevant parties that companies do have some moral obligations to their home countries because of these historical debts. This is why national companies are much more open to moral suasion by the government and the public than foreign companies are, when they are expected, although cannot be legally obliged, to do something for the country against their (at least short-term) interests. For example, it was reported in October 2009 that South Korea's financial supervisory agency was finding it impossible to persuade foreign-owned banks to lend more to small and medium-sized companies, even though they, like the nationally owned banks, had already signed an MOU (memorandum of understanding) about that with the agency, when the global financial crisis broke out in the autumn of 2008.

Important though the moral and historical reasons are, by far the most important reason for home-country bias is economic—the fact that the core capabilities of a company cannot be easily taken across the border.

Usually, a company becomes transnational and sets up activities in foreign countries because it possesses some technological and/or organizational competences that the firms operating in the host countries do not possess. These competences are usually embodied in people (e.g., managers, engineers, skilled workers), organizations (e.g., internal company rules, organizational routines, 'institutional memory') and networks of related firms (e.g., suppliers, financiers, industrial associations or even old-boy networks that cut across company boundaries), all of which cannot be easily transported to another country.

Most machines may be moved abroad easily, but it is much more costly to move skilled workers or managers. It is even more difficult to transplant organizational routines or business networks on to another country. For example, when Japanese automobile companies started setting up subsidiaries in Southeast Asia in the 1980s, they asked their subcontractors also to set up their own
subsidiaries, as they needed reliable subcontractors. Moreover, these intangible capabilities embodied in people, organizations and networks often need to have the right institutional environment (the legal system, informal rules, business culture) in order to function well. However powerful it may be, a company cannot transport its institutional surroundings to another country.

For all these reasons, the most sophisticated activities that require high levels of human and organizational competences and a conducive institutional environment tend to stay at home. Home biases do not exist simply because of emotional attachments or historical reasons. Their existence has good economic bases.

‘Prince of darkness’ changes his mind

Lord Peter Mandelson, the de facto deputy prime minister of the UK government at the time of writing (early 2000), has a bit of a reputation for his Machiavellian politics. A grandson of the highly respected Labour politician Herbert Morrison, and a TV producer by profession, Mandelson was the chief spin doctor behind the rise of the so-called New Labour under Tony Blair. His famous ability to sense and exploit shifts in political moods and accordingly organize an effective media campaign, combined with his ruthlessness, earned him the nickname ‘prince of darkness’.

After a high-profile but turbulent cabinet career, marred by two resignations due to suspected corruption scandals, Mandelson quit British politics and moved to Brussels to become European Commissioner for Trade in 2004. Building on the image of a pro-business politician, gained during his brief spell as the UK’s Secretary of State for Trade and Industry back in 1998, Mandelson established a firm reputation as one of the world’s leading advocates of free trade and investment.

So it sent out a shockwave, when Mandelson, who had made a surprise comeback to British politics and become Business Secretary in early 2009, said in an interview with the Wall Street Journal in September 2009 that, thanks to Britain’s permissive attitude towards foreign ownership, ‘UK manufacturing could be a loser’, even though he added the proviso that this was ‘over a lengthy period of time, certainly not overnight’.

Was it a typical Mandelson antic, with his instinct telling him that this was the time to play the nationalist card? Or did he finally cotton on to something that he and other British policymakers should have realized a long time ago – that excessive foreign ownership of a national economy can be harmful?

Now, it may be argued, the fact that firms have a homocountry bias does not necessarily mean that countries should put restrictions on foreign investment. True, given the home bias, investment by a foreign company may not be in the most desirable activities, but an investment is an investment and it will still increase output and create jobs. If you put restrictions on what foreign investors can do – for example, by telling them that they cannot invest in certain ‘strategic’ industries, by forbidding them from holding a majority share or demanding that they transfer technologies – foreign investors will simply go somewhere else and you will lose the jobs and the wealth that they would have created. Especially for developing countries, which do not have many national firms that can make similar investments, rejecting foreign investment because it is foreign many people believe is frankly irrational. Even if they get only lower-grade activities such as assembly operation, they are still better off with the investment than without it.

This reasoning is correct in its own terms, but there are more issues that need to be considered before we conclude that there should be no restriction on foreign investment (here, we put aside portfolio investment, which is investment in company shares for financial gains without involvement in direct management, and
focus on foreign direct investment, which is usually defined as acquisition of more than 10 per cent of a company’s shares with an intent to get involved in management).

First of all, we need to remember that a lot of foreign investment is what is known as ‘brownfield investment,’ that is, acquisition of existing firms by a foreign firm, rather than ‘greenfield investment’, which involves a foreign firm setting up new production facilities. Since the 1990s, brownfield investment has accounted for over half of total world foreign direct investment (FDI), even reaching 80 per cent in 2001, at the height of the international mergers and acquisitions (M&A) boom. This means that the majority of FDI involves taking control of existing firms, rather than the creation of new output and jobs. Of course, the new owners may inject better managerial and technological capabilities and revive an ailing company – as seen in the case of Nissan under Carlos Ghosn – but very often such an acquisition is made with a view to utilizing capabilities that already exist in the acquired company rather than creating new ones. And, more importantly, once your national firm is acquired by a foreign firm, the home bias of the acquiring company will in the long run impose a ceiling on how far it progresses in the internal pecking order of the acquiring company.

Even in the case of greenfield investment, home-country bias is a factor to consider. Yes, greenfield investment creates new productive capabilities, so it is by definition better than the alternative, that is, no investment. However, the question that policy-makers need to consider before accepting it is how it is going to affect the future trajectory of their national economy. Different activities have different potentials for technological innovation and productivity growth, and therefore what you do today influences what you will be doing in the future and what you will get out of it. As a popular saying among American industrial policy experts in the 1980s went, we cannot pretend

that it does not matter whether you produce potato chips, wood chips or microchips. And the chance is that a foreign company is more likely to produce potato chips or wood chips than microchips in your country.

Given this, especially for a developing country, whose national firms are still underdeveloped, it may be better to restrict FDI at least in some industries and try to raise national firms so that they become credible alternative investors to foreign companies. This will make the country lose some investment in the short run, but it may enable it to have more higher-end activities within its borders in the long run. Or, even better, the developing country government can allow foreign investment under conditions that will help the country upgrade the capabilities of national firms faster – for example, by requiring joint ventures (which will promote the transfer of managerial techniques), demanding more active technology transfer, or mandating worker training.

Now, saying that foreign capital is likely to be less good for your country than your own national capital is not to say that we should always prefer national capital to foreign capital. This is because its nationality is not the only thing that determines the behaviour of capital. The intention and the capability of the capital in question also matter.

Suppose that you are thinking of selling a struggling nationally owned car company. Ideally, you want the new owner to have the willingness and the ability to upgrade the company in the long run. The prospective buyer is more likely to have the technological capabilities to do so when it is an already established automobile producer, whether national or foreign, rather than when it is finance capital, such as a private equity fund.

In recent years, private equity funds have played an increasingly important role in corporate acquisitions. Even though they have no in-house expertise in particular industries, they may, in theory, acquire a company for the long term and hire industry
experts as managers and ask them to upgrade its capabilities. However, in practice, these funds usually have no intention to upgrade the acquired company for the long term. They acquire firms with a view to selling them on in three to five years after restructuring them into profitability. Such restructuring, given the time horizon, usually involves cutting costs (especially sacking workers and refraining from long-term investments), rather than raising capabilities. Such restructuring is likely to hurt the long-term prospects of the company by weakening its ability to generate productivity growth. In the worst cases, private equity funds may acquire companies with the explicit intention to engage in asset-stripping, selling the valuable assets of a company without regard to its long-term future. What the now-notorious Phoenix Venture Holdings did to the British car-maker Rover, which they had bought from BMW, is a classic example of this (the so-called ‘Phoenix Four’ became particularly notorious for paying themselves huge salaries and their friends exorbitant consultancy fees).

Of course, this is not to say that firms that are already operating in the industry will always have the intention to upgrade the acquired company for the long term either. When GM acquired a series of smaller foreign car companies – such as Sweden’s Saab and Korea’s Daewoo – during the decade before its bankruptcy in 2009, the intention was to live off the technologies accumulated by these companies, rather than to upgrade them (see Thing 18). Moreover, recently the distinction between industrial capital and finance capital has come to be blurred, with industrial companies such as GM and GE making more profits in finance than in industry (see Thing 22), so the fact that the acquiring firm operates in a particular industry is not a guarantee of a long-term commitment to that industry.

So, if a foreign company operating in the same industry is buying up your national company with a serious long-term commitment, selling it to that company may be better than selling it to your own national private equity fund. However, other things being equal, the chance is that your national company is going to act in a way that is more favourable to your national economy.

Thus, despite the globalization rhetoric, the nationality of a firm is still a key to deciding where its high-grade activities, such as R&D and strategizing, are going to be located. Nationality is not the only determinant of firm behaviour, so we need to take into account other factors, such as whether the investor has a track record in the industry concerned and how strong its long-term commitment to the acquired company really is. While a blind rejection of foreign capital is wrong, it would be very naïve to design economic policies on the myth that capital does not have national roots any more. After all, Lord Mandelson’s belatedly found reservations turn out to have a serious basis in reality.