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978-1-107-08276-2 - The Shield of Nationality: When Governments Break Contracts
with Foreign Firms

Rachel L. Wellhausen

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The Shield of Nationality

When Governments Break Contracts with Foreign Firms

There is extraordinary variation in how governments treat multinational corporations in emerging economies; in fact, governments around the world have nationalized or eaten away at the value of foreign-owned property in violation of international treaties. This even occurs in poor countries, where governments are expected to, at a minimum, respect the contracts they make with foreign firms, lest foreign capital flee. In *The Shield of Nationality*, Rachel L. Wellhausen introduces foreign-firm nationality as a key determinant of firms' responses to government breach of contract. Firms of the same nationality are likely to see a compatriot's broken contract as a forewarning of their own problems, leading them to fight or to take flight. In contrast, firms of other nationalities are likely to meet the broken contract with apparent indifference. Evidence includes quantitative analysis and case studies that draw on field research in Ukraine, Moldova, and Romania.

Rachel L. Wellhausen is an assistant professor of government and holds courtesy appointments at the McCombs School of Business and the Center for Russian, Eastern European, and Eurasian Studies at the University of Texas at Austin. She is co-editor of *Production in the Innovation Economy* (2014), an interdisciplinary volume emerging from the multi-year MIT project on the links between innovation and manufacturing in the United States and abroad. Wellhausen has published in the *Journal of Conflict Resolution*, *Business and Politics*, and *Systems and Synthetic Biology*. She has also worked in the political risk industry.

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The Shield of Nationality
*When Governments Break Contracts
with Foreign Firms*

RACHEL L. WELLHAUSEN
University of Texas, Austin



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CAMBRIDGE UNIVERSITY PRESS

32 Avenue of the Americas, New York, NY 10013-2473, USA

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www.cambridge.org

Information on this title: www.cambridge.org/9781107082762

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First published 2015

Printed in the United States of America

A catalog record for this publication is available from the British Library.

Library of Congress Cataloging in Publication Data

Wellhausen, Rachel L.

The shield of nationality : when governments break contracts with foreign firms / Rachel Wellhausen.

pages cm

Includes bibliographical references and index.

ISBN 978-1-107-08276-2 (hardback)

1. Public contracts – Developing countries. 2. Business enterprises, Foreign – Government policy – Developing countries. 3. International business enterprises – Developing countries. 4. Investments, Foreign – Developing countries. 5. Developing countries – Commercial treaties. 6. Developing countries – Commercial policy. I. Title.

HD4420.8.W45 2015

346.02'3–dc23 2014027989

ISBN 978-1-107-08276-2 Hardback

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To my parents

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*Still, though the one I sing,
(One, yet of contradictions made,) I dedicate to Nationality,
I leave in him Revolt, (O latent right of insurrection! O quenchless,
indispensable fire!)*

Walt Whitman, 1871

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Preface

Governments balance domestic priorities with all that is to be gained from economic integration. Finding that governments sometimes have room to tip the scales toward the domestic, despite the demands of international capital, motivates me. My first goal in this book is to establish that one finger on the scale is nationality – a testament to the notion that ours is really an international political economy. But the normative implications of the tipping of the scales are ambiguous. My second goal is that this book spurs readers to reflect on that ambiguity.

Once, a respondent at a multinational subsidiary gifted me a box of his firm's chocolates after our interview. As my luggage was already stuffed, I tried to re-gift the chocolates to my kind taxi driver. He said thanks but no, and showed his toothless smile. I pressed them on him anyway, telling him to give them to his children. Delving too deeply into the sentimental, perhaps, I felt in that moment the tension between what multinationals can contribute, who the hoped-for beneficiaries are, who might benefit in the end, and (with political science on the brain) how governing institutions might mold these outcomes.

I cannot express enough thanks to the many executives, government officials, and others who agreed to give up their time to be interviewed as part of this research. As promised, I hold their identities in the strictest confidence (see Case Studies: Methodology for details). The hours I have spent in offices – and taxis – around the world have been some of the most important of my career. As conflict simmers in a region I hold dear, I hope that the contributions of these people, the people behind economic integration, can have pacifying effects.

To the reader with a legal eye, I acknowledge that my use of the term “breach of contract” conflates a number of different issues, ranging from abrogation of written contracts to violations of treaty commitments, from expropriations that remain international legal disputes to those that have been adjudicated (see Chapter 2). I do this because I understand the presence of breach of contract

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from the investor's point of view rather than from a legalistic one. I do not intend sympathy toward the investor (or the state) with this approach. A companion analysis of what this book's findings mean for the legalities of investor–state dispute settlement is in order.

I am lucky to have many benefactors to thank for research support. This research was assisted by an award from the Eurasia Program of the Social Science Research Council with funds provided by the State Department under the Program for Research and Training on Eastern Europe and the Independent States of the Former Soviet Union (Title VIII). Additional support was provided by the Harvard Center for European Studies, the MIT Center for International Studies, the Kyiv School of Economics, the Danyliw Research Center at the Chair of Ukrainian Studies at the University of Ottawa, the MIT Production in the Innovation Economy Project, and the Niehaus Center for Globalization and Governance at the Woodrow Wilson School at Princeton University. I thank the University of Texas at Austin College of Liberal Arts and the Department of Government, as well as the McCombs School of Business and the Center for Russian, East European, and Eurasian Studies. Portions of Chapter 4 draw from “Investor–State Disputes: When Can Governments Break Contracts?” (2015, *Journal of Conflict Resolution* 59[2]).

My sincerest thanks go to Nathan Jensen, Layna Mosley, Mark Copelovitch, and Andrew Kerner for their close readings of the manuscript and their insightful commentary. I also thank my colleagues at the University of Texas at Austin, including Terrence Chapman, Michael Findley, Patrick MacDonald, and Scott Wolford. For their immense help on parts of the manuscript and research, I thank Anar Ahmadov, Torben Behmer, Andreas Fuchs, Leslie Johns, and Tsveta Petrova. At workshops and conferences along the way, I was grateful to receive feedback from Jim Alt, Phil Arena, Cynthia Buckley, David Carter, Stephen Chadouin, Pey-Yi Chu, Christina Davis, Evgeny Finkel, Jordan Gans-Morse, Benjamin Graham, Farid Guliyev, Jens Hainmueller, Kathryn Hendley, Yasheng Huang, Juliet Johnson, Noel Johnston, Robert Keohane, Richard Locke, Yonatan Lupu, Helen Milner, James Morrison, Erica Owen, William Pomeranz, Ken Shepsle, Beth Simmons, Erin Snider, Edward Steinfeld, Jennifer Tobin, Teppei Yamamoto, and many others, including many anonymous reviewers. Cambridge University Press has been very supportive throughout the publication process, and I thank Robert Dreesen and Elizabeth Janetschek in particular.

I could not have completed this project without the encouragement of my colleagues and friends in graduate school at MIT. Special thanks go to Akshay Mangla, Hanna Breetz, Laura Chirot, Nathan Cisneros, Erica Dobbs, Francisco ‘Paco’ Flores, Phil Haun, Anita Kafka, Joseph Kannegaard, Gabrielle Kruks-Wisner, Joyce Lawrence, Gautam Mukunda, Timea Pal, Hiram Samel, Kathleen Searle, Gustavo Setrini, Joshua Shifrinson, and Paul Staniland. The support of Greg Distelhorst and Jonas Nahm has meant more than I can say.

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Suzanne Berger is one of the most creative, inquisitive, compassionate mentors I have ever had. I cannot thank her enough for teaching me how to wrangle large projects, how to interview executives, how to save myself from getting lost in the weeds. Kenneth Oye refreshed my curiosity about the world. Nothing I write here can convey my thanks to David Andrew Singer for his guidance. I would not be where I am if not for him.

I thank my dear brother, Kurt, and his growing family. I thank my intrepid sister, Emily. And my parents – I thank them for contributing so much to my life. My mom’s generosity is overwhelming. The hours I spend learning from my dad are nowhere near enough. This book is dedicated to them.