International
Politics
and Society

Are multinationals eclipsing nation-states?

Taking back sovereignty from multinationals will require international cooperation – which has been lacking in recent years

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Reuters

When much of the world's business elite gathered in the Swiss mountain resort of Davos last week, the assembled CEOs, hedge fund managers, and other business titans pontificated on many issues, except one: the extent to which they are wielding powers once reserved for governments. At a time when the capacity of governments to deliver for their constituents is shrinking, large corporations' political clout is expanding, sometimes dramatically so, as in the case of Big Tech companies like Facebook and Google.

In the face of today's most urgent challenges – including cybersecurity, climate change, geopolitical turmoil, and migration – nation-states seem incapable of marshalling both the will and the resources to mount an adequate response. Will big business be the solution, or is it part of the problem?

Consider the issue of election security. In response to the growing threat of foreign interference, Google recently unveiled a plan to prevent online meddling with the upcoming European Parliament elections. To compensate for the absence of an EU framework governing the process, the company announced that it was 'creating a pan-European policy' of its own. Likewise,Facebook and Twitter used last November's midterm elections in the United States to test new technologies for detecting and removing fake news and misinformation from their platforms.

In each case, the tech giants were responding to public demands. Within the confines of their increasingly influential platforms, leading social-media companies are now expected to act as all three branches of government. In addition to setting their own guidelines for behaviour online, they also oversee the enforcement of those rules and impose sentences – temporary suspensions, permanent bans, and so forth – on users who are found to be in violation.

These are hardly the only examples of multinational corporations designing and enforcing their own public policies. Microsoft recently pledged USD 500 million to expand the availability of affordable housing in Seattle, which would generally be the job of the US Department of Housing and Urban Development and other public agencies, both state and federal. And at the Paris Peace Forum last November, Microsoft, Google, Facebook, and other tech giants joined 50 governments in signing a new multilateral cybersecurity agreement. Notably absent were the governments of the US, Russia, and China.

The roots of corporate power

While multinationals – particularly US tech companies – have emerged as a global political force in their own right, the loss of authority among nation-states is due to a combination of factors, including faltering GDP growth, record-level public debt, increasingly polarised politics, and legislative paralysis. In 2018, a mere 5 per cent of Americans told Gallup that they had a 'great deal' of confidence in Congress, whereas 46 per cent had 'very little.' That is not surprising, given how many of today's most pressing problems transcend national borders. Multinationals, by their very nature, have thus been able to firm up their influence on policymaking at the global level.

But multinationals also enjoy several other advantages, not least large financial resources. If Apple were a country, its GDP in 2017 (based on revenues of USD 229bn) would have been greater than that of Portugal; likewise, Walmart's income would almost outstrip that of Belgium. And with USD 237bn in cash reserves, Apple theoretically could launch an investment program almost twice the size of the Marshall Plan (in today's dollars).

Multinationals are also well placed to take advantage of the differences between regulatory and tax regimes. According to a recent paper by the economists Gabriel Zucman, Thomas R. Tørsløv, and Ludvig S. Wier, 'close to 40 per cent of multinational profits are shifted to tax havens globally each year.' And multinationals are uniquely positioned to tap into new and constantly changing markets, particularly at the frontier of technological innovation – artificial intelligence, biological engineering, and so forth – where governments are failing to keep up with advances.

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Given these conditions, it comes as no surprise that the large 'moonshot' projects of the early twenty-first century are more likely to come from private corporations than from governments. For example, SpaceX, established by PayPal co-founder and Tesla founder Elon Musk, is leading the effort to colonise Mars. Likewise, Facebook has explored the possibility of providing universal Internet access with solar-powered drones. Alphabet (Google's parent company) has done the same, but with hot-air balloons.

Moreover, unlike in the 1960s, when only the US National Aeronautics and Space Administration could bring together the talent and other resources need to stage the first moon landing, NASA is now considering outsourcing some of its own rocket research and construction to private corporations. More broadly, NASA's schedule for ambitious long-term projects – such as a new moon landing or Mars explorations – is lagging several years behind the private sector.

These developments are of a piece with what Susan Strange of the London School of Economics dubbed the 'retreat of the state,' a phenomenon that holds fundamentally important implications for politics, economics, international governance, and security. The recent backlash against Big Tech calls into question whether today's liberal democracies are even compatible with a political economy in which a select few highly profitable firms are able to introduce their own public policies with little to no scrutiny. How, then, should nation-states and international organisations respond to this challenge?

Private empires

History offers some guidance. For starters, it is worth remembering that today's tech giants operate in a space – namely, the Internet – that was originally created by governments. And as Mariana Mazzucato of University College London points out, most of these companies have benefited extensively from public support at key stages of their development. The same was true 400 years ago, when businesses like the East India Company emerged to exploit the opportunities offered by the discovery of the 'new world.' In time, these companies came to dominate economic relations and the foreign policies of their respective states.

Under their original charters, European governments granted these companies unique privileges in the name of corporate efficiency – an arrangement that translated into unparalleled profits and political power. The most successful 'multinationals' of the age were the British East India Company (EIC) and the Dutch *Vereenigde Oostindische Compagnie* (VOC). These two dominant firms gradually outperformed their French, Portuguese, and Danish counterparts, and eventually expelled them from the Indian subcontinent altogether. Some estimates place the VOC's net worth at its peak at around USD 7.9 trillion in today's dollars – equal to the combined GDPs ofJapan and the United Kingdom, the world's third- and fifth-largest economies, respectively.

In addition to enjoying official trade monopolies on the Indian subcontinent, the EIC and the VOC had the right to sign treaties with regional powers such as the Mughal Empire and the Maratha Confederacy, build forts, issue money, carry out administrative functions in the region, and even recruit armed forces. Owing to their innovative joint-stock governance structure, each became increasingly rich and powerful, and accordingly less accountable to the states that had originally sanctioned their establishment.

Looking ahead, it remains to be seen whether nation-states can reassert their role as the primary providers of governance and security, particularly in new, unregulated domains.

In fact, despite the British and Dutch governments' large initial investments in their national champions, the EIC and VOC eventually ended up answering only to their shareholders. The constant quest for profits led them to conquer new territories, collect tax revenues from the local populations, and expand their military capabilities. By 1803, the EIC had a force of 260,000 soldiers – twice the size of the British Army. In the absence of regulations, these corporations had turned into private empires. When the British and Dutch governments tried to regain control, they realised that the EIC and VOC were buying parliamentary influence to retain their privileges. The parallels to the current era should be obvious.

Costs of doing business

The eventual decline of these trading juggernauts is also illustrative. The EIC and VOC's business model began to flounder when intra-Asian trade slowed, largely as a result of regional wars. In an attempt to consolidate their earlier land grabs, both the EIC and the VOC evolved into more traditional agriculture-based corporations.

But this decision proved to be detrimental in the second half of the eighteenth century, when widespread famines led to significant shortfalls in expected land revenues. The EIC and VOC's mutual competition further weakened their balance sheets. Not surprisingly, their commercial rivalry also had sharp repercussions on their respective countries. Commercial interests dragged Britain and the Netherlands into all-out wars in 1652-1654, 1665-1667, and again in 1672-1674. And, all told, the crises besetting the European India companies caused more than 30 banks across Europe to collapse.

Plagued by internal corruption, the VOC was eventually dissolved in 1799. Its Indonesian possessions were seized by the Dutch government and henceforth administered as a national colony. The EIC, for its part, survived for another half-century. But after 1773, it was a shadow of its former self. In history's first mega-bailout, the British government had to step in to save the company, which gave the state the right to regulate the behemoth back into submission. And after the great Indian Rebellion of 1857, a popular backlash against the EIC's abuses finally gave the British government an excuse to nationalise the company and all of its Indian possessions.

Reclaiming sovereignty

To be sure, despite all the similarities, there are also important differences between the European India companies and today's multinationals. No modern tech giant possesses a private army that could match the US military. And yet, in terms of cyber capabilities, there is far less disparity between states and private actors.

With due caution, such parallels suggest that the lessons of the past can and should inform our approach to managing corporate power today. One lesson is that when private corporations are allowed to chase new large-scale business opportunities on behalf of states, they can all too easily break free from the control of their respective governments. Once that happens, reclaiming state authority can be exceedingly difficult.

A second lesson is that the failure of an outsize corporation's business model can have major repercussions on nation-states and the societies that constitute them. Consider, for example, the Cambridge Analytica scandal, in which Facebook allowed political operatives to harvest the data of more than 70 million users and deploy targeted ads to influence the 2016 US presidential election (a race that was eventually decided at the margin of the popular vote).

Looking ahead, it remains to be seen whether nation-states can reassert their role as the primary providers of governance and security, particularly in new, unregulated domains. There are many possible approaches to the problem, from regulating tech companies' economic activities to treating them like public utilities, thereby limiting their ability to expand.

At the moment, the European Union is attempting to rein in Big Tech by rigorously enforcing its competition policies. In recent years, the EU has imposed or is considering hefty fines on Intel, Google, Qualcomm, and Facebook, and it is considering a new digital tax to curb companies' ability to engage in tax arbitrage by shifting their reported profits from high-tax to low-tax jurisdictions.

By contrast, in the US, President Donald Trump's administration and congressional Republicans have enacted large corporate tax cuts to ensure that most US-based multinationals remain within the country's territorial and legislative reach. Between the EU and the US, it is hard to say which approach will be the most effective.

Most likely, though, divergent national policies will deepen the transatlantic rift without getting to the heart of the problem. At the end of the day, taking back sovereignty from multinationals will require international cooperation, which has been sorely lacking in recent years. As a result, the balance of power will continue to tilt in corporate behemoths' favour for some time to come. And, as we saw at Davos, for these companies' owners and executives, the less said about that, the better.