

Private Municipal Governance and the Company Town

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Abstract

Multinational corporations engaged in the extraction of natural resources in developing countries would do well to consider putting the old industrial form of the company town to new use. Under the company town/private municipal governance model – incidentally well developed in the annals of business history, the firm takes on some or all aspects of providing local governance and public services. It is the suggestion of this paper that the model can be applied to the considerable advantage of both the firm and the host developing country. This paper explores the concept of ‘private municipal governance’ and then attributes the firm’s desires to pursue the company town model to the result of a unique combination of a variety of factors, grouped for simplicity under the headings of self-interest, coercion, and legitimacy. Arguments advanced in the paper are interdisciplinary, drawing on business history and ethics, economics, international relations and political science.

The prospective use of the company town model is applied to a brief case study involving Canada’s Ivanhoe Mines at its operations at Oyu Tolgoi in Mongolia.

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Introduction

The modern era of globalization has brought both new opportunities and challenges to the world's developed and developing nations, although this paper is not the place to rehash this now familiar debate (see e.g. Bhagwati, 2004 & Wolf, 2004). Of course, the opportunities and challenges facing developed and developing countries are both similar and different in degree and kind. This paper takes as its focus the role that the modern multinational corporation may play in the course of development that many of the world's poorer countries are undergoing. The 2005 annual report of the Global Corporate Citizenship Institute of the World Economic Forum notes that one of the most important trends seen in international development efforts "over the past two decades has been a growing awareness of the crucial role that a productive, competitive, well-diversified and responsible private sector plays, not only in underpinning economic growth and wealth creation, but also supporting other key pillars of development" (p. 10). More specifically, this paper will look at what is referred to as 'private municipal governance', in which the company town, a subsidiary of sorts of the multinational corporation working in the developing country, engages in the private provision of some types of public goods and services. Multinational firms operating with large fixed investments in developing countries will often have a strong incentive to commit to playing a significant role in local community development efforts. It is thus argued that a new use of an old industrial form, the company town, can be applied in developing countries to both the advantage of the multinational corporation (MNC) and the host developing country (HDC). The acceptance of the company town model could help the developing country to make better use of its workforce, to upgrade its skills, and to help to build the types of civic institutions that will ultimately assist the developing country on its path

towards development and progress. The potential rise of the company town as a model for development in many of the world's poorest nations signals a new important source of private authority in (global) governance.

This paper will first provide an overview of the form that the multinational firm's company town may take, along with an introductory examination of what is referred to here as 'private municipal governance', in which the firm provides what are essentially public goods to the population in a limited geographic area. Second, the paper will turn to include a quick look at some of the relevant theory that informs the development of the company town/private municipal governance model. The paper next turns to the motivations for the multinational corporation to pursue the company town/private municipal governance project. The reasons why the firm would contemplate the private provision of local governance are briefly canvassed under the familiar triumvirate rationale (self-interest, coercion, and legitimacy) that seeks to explain why an agent decides to act in a certain way. This line of inquiry leads into a case study of Ivanhoe Mines, a Canadian mining corporation now faced with the choice of whether and how to provide local governance at its new site in Mongolia. Finally, this paper concludes by suggesting that the use of the company town/private municipal governance model can bring significant advantages to the multinational firm (and to the host developing country).

The Multinational Corporation, Company Town, and Private Municipal Governance

In business history, the company town was a small isolated settlement centred on a particular form of industrial activity. Though varied in terms of geography and the nature of the industry, a common attribute was the provision of some level of social services by the company itself. Most company towns were involved with the extraction and initial processing of primary industry.

Accordingly, the company towns were situated by necessity where the resources themselves were located; because this was often far from existing settlement, the construction of housing for workers became a requirement. At the centre of the settlement, in a rather prominent fashion, would typically stand the company store, community hall, school, and religious centre (church) around which community civic and social life would revolve (Allen, 1966, p. 79). Community facilities in more recent company towns might also include parks, playgrounds, gymnasiums and libraries.

A common element among the company towns was a distinct streak of paternalism. Although the earliest company towns featured a somewhat haphazard layout, later communities were laid out and planned in a more orderly and deliberate fashion. In many cases, uniform housing was constructed by the company and rented to workers. Families were allocated a separate unit, but unmarried workers (men) often had to stay in common lodgings. Rental fees, typically low, were usually deducted from wages (p. 89).

Company towns frequently housed a few professionals, among them doctors and nurses. If the community did not itself have medical support, medical care would be available from the outside upon summons, or periodic visits would be scheduled. The school, however, lay at the core of the community. Management recognized early that the social life provided by school activities could help to retain employees and to stabilize their performance (p. 56). Similarly, the provision of religious services also helped to attract the stable men who made for dependent workers (p. 70). Even the most paternalistic of employers noted that the provision of social services was actually a means to increase profits; although the company may not have charged an explicit price for the use of these services, the costs might have been recovered through

increases to productivity or compensating reductions in employee wages (Fishback & Lauszus, 1989, p. 125).

The company town need not be under direct corporate control. Instead, the settlement, while largely or wholly paid for by the firm, may be run independently. The degree to which the firm takes an active role in the day-to-day administration of the settlement would seemingly depend on external factors, such as legal constraints, tax implications, community culture and history, and perhaps the general education level of community residents. The form of the firm's involvement in the local community (whether more or less paternalistic) would rely on how these types of external factors combine in each individual setting. In some times and places, bestowing the local community with democratic control over the management of its own municipality would appear to be necessary as a result of the host country's history, while in others a more immature local population would perhaps benefit from the (temporary) direct involvement of the firm in the operation of the local municipality. Over time, one can certainly envision the company town's transformation from a tightly controlled corporate unit to a mixed entity run by some combination of members of the local community and representatives of the firm to a self-governing local population.

As countries and regions developed, company towns became less commonplace. In some cases, town disassembly was motivated by the closure of the local mill or mine. In others, improvements in transportation meant that areas previously considered to be remote became less isolated, and laborers could begin to commute to work. Some communities died with the termination of the business, itself an act motivated by the death of the founder or by economic conditions and commodity prices (Carlson, 2003, pp. 199-204). It should be emphasized, of

course, that the company town has really never gone away, even if it has faded from attention since the mid-20th century. Many company towns have undergone the transformation from ‘company town’ to ‘single industry community’, the essential difference being that governance responsibilities are transferred from the host firm to some form of independent municipality. This transformation seems most likely to occur as the host state attains a certain level of development, implying that the role of the firm in providing local governance is no longer required or desired.

Background Considerations

The first point to consider is the difference between *governance* and *government*. According to Rosenau, “governance is not synonymous with government. Both refer to purposive behaviour, to goal-oriented activities, to systems of rule; but government suggests activities that are backed by formal authority.” Moreover, “governance refers to activities backed by shared goals that may or may not derive from legal and formally prescribed responsibilities and that do not necessarily rely on police powers to overcome defiance and attain compliance.” (1992, 4). As such, governance is a more encompassing phenomenon than government, and even if the private firm’s ability to provide government is disputed, it would seem to be far less contentious to suggest that the firm can provide a limited form of governance.

Reinicke suggests that understanding the distinction between *vertical* and *horizontal* subsidiarity aids in explaining how governance does not necessarily imply government. The goal of either form is to improve the legitimacy, acceptability, efficiency and effectiveness of public policy (1998, pp. 89-90). If the firm attains a robust set of governance powers delegated to it by the host national/regional government, then the private municipal governance provided by the

firm falls under vertical subsidiarity. On the other hand, if the firm is expected to ‘partner’ with the host government in the provision of local governance, then this approach falls under horizontal subsidiarity. Given the diversity of multinational corporations and host developing countries, and the respective resources of each, a variety of new federal governance models may arise, each different to the extent of the responsibilities taken on by the firm and by the state.

The federalism metaphor may be useful in another sense, as well. Late in the 20th century, some international relations scholars increasingly drew attention to the variety of ways in which economic globalization was undermining the nation-state. In this view, authority was shifting away from the state, but not in any one particular direction. Instead, state power was being replaced by that of supra-state, sub-state, and non-state actors. This ‘neo-medieval’ assessment of the future of the nation state hearkens back to Bull. Bull famously raises the possibility that world politics may move beyond the current system of states to a system of neo-medievalism, in which states’ importance as the prime actors in international relations might be diminished, to be replaced by a secular equivalent of the kind of political organization that existed in the Middle Ages (2002 [1977], p. 263). Neo-medievalism’s defining characteristics are overlapping authority and the existence of multiple loyalties. As Kobrin suggests, “[t]he post-modern future may well resemble the medieval past more closely – at least metaphorically – than the more immediate, geographically organized world of national markets and nation-states” (2002, p. 64).

Slaughter modifies the narrative presented by the neo-medievalists in two principal ways. First, she cautions, any power wielded by non-state actors still cannot compare to that retained by the state. The activity of NGOs and multinational corporations is only relevant at the margins of state action. Second, whatever power shift exists is not a zero-sum game: “A gain in power by

nonstate actors does not necessarily translate into a loss of power for the state” (1997, p. 104). Slaughter refers to her alternative to neo-medievalism as ‘transgovernmentalism’. In this view, “[t]he state is not disappearing, it is disaggregating into its separate, functionally distinct parts.” These components of the state, which include courts, regulatory agencies, executives and legislatures, are increasingly networking with their foreign counterparts, thus creating a dense web of transgovernmental relations (p. 184).

Though transgovernmentalism as a theory may provide greater accuracy in describing current trends in global governance than neo-medievalism, it nonetheless (deliberately) excludes the core concept of neo-medievalism, namely the potential role of non-state actors in providing governance. A sensible attempt to bridge the gap between the two would include adding multinational corporations (the second sector) and NGOs (the third sector) to the dense web of transgovernmental relations that Slaughter envisions. State and non-state actors alike could all work together by function area to produce the desired outcome in governance. The result of this collaborative process would see representatives from the first, second, and third sectors all join forces in a form of partnership for the provision of public goods and services.

The standard definition of a ‘public’ good in economics focuses on two dimensions: The good’s non-rivalry and non-excludability. A good is a rival good in the sense that it is subject to congestion, whereby each additional consumer of the good reduces the quantity available to others. A good is subject to exclusion if the provider of the good has the ability to distinguish between and choose among potential users. The ‘problem’ traditionally associated with public goods is that the market would tend to fail to provide them in the socially optimal quantity. Since everyone is able to consume a public good once it has been made available, individuals are not

likely to purchase it, but will instead prefer that others do so. This is the ‘free riding’ problem, in that if everyone thinks in this way, then individuals will not buy the good and it may not be provided at all (Baye, 2006, pp. 522-3). The response to this threat of market failure is that government will step in and provide public goods, taxing the population at large in order to pay for the social spending.

Importantly, though, the government provision of public goods requires the government to be both willing and able to provide them to the population, whether directly itself or by paying private actors to do so on its behalf. Some governments may fail on either one or both of these criteria. This is not to suggest, however, that public goods will never be provided when the local government does not do so. Instead, private actors may be sufficiently motivated to take on at least part of the responsibility themselves. The rationale for a private firm to provide what are essentially public goods to a local population in a developing country will be explored below, but it is worth emphasizing at this point that what the local population considers to be a public good may be viewed quite differently by the firm. The firm may simply consider the provision of these ‘public goods’ to be a potential expenditure to be made, with the larger question then becoming why the private firm would choose to make this type of expenditure.

It is normally the case in matters of a relationship between a private firm and the local government (and/or its higher level superior) that partnership agreements are established that provide clarity and predictability, such that the process of involvement is transparent, that the agreement is monitored, and that effective supra-regulatory control is established (Plummer, 2002, p. 27). These conditions lend themselves more fully to the better understood private-public partnership. Critically, however, the application of the company town model involves moving

beyond the idea of the public-private partnership, at least as it is operated in developed countries. In typical schemes, the private firm seeks to provide some type of service for the government. The price negotiated for the provision of the service will fall somewhere between what the firm believes its supply costs to be and what the government believes the costs would be for it to supply the service directly; both parties gain in the exchange. *The provision of the public service itself is the firm's goal.* Under the company town/private municipal governance model, though, the firm views the provision of public services as a cost to be incurred in order to be (better) able to raise revenues through the harvesting and subsequent sale of a natural resource. *The provision of the public service is a means to the firm's goal.* Building housing, running a school, providing access to medical care, and indeed operating a community for the company's workers may simply be costs of doing (better) business.

Perhaps the best way to conceive of the 'private municipal governance' provided by the subsidiary of the multinational corporation in the developing country is as existing at one point along a continuum. At one end of the continuum lies the fully public provision of public goods and services, while at the other end lies the fully private provision of the same items. As one moves towards the private end of the range, municipal governance is increasingly viewed as an extension of the firm; as one moves towards the public end of the range, any public goods supplied by the firm are increasingly viewed as provided on behalf of the host state. Depending on the value each side (the MNC and HDC) derives from its provision of governance and how much it can derive from the participation of the other side, an optimal outcome should typically be possible somewhere between the two extremes.

The Firm's Motivation to Provide Private Municipal Governance

In some regards, asking why a firm is willing and able to comply with the dictates of corporate social responsibility is a similar question to asking why a nation is willing and able to comply with the requirements of international law. In both cases, the actor in question is not subject to an overarching centre of political power that is capable of enforcing the relevant rules and norms. That is, firms are no more compelled in an absolute sense to internalise a sense of corporate social responsibility than nations are bound to accept international law. The reality that both firms and nations do acknowledge and, to greater or lesser extents, fully subscribe to CSR or international law, respectively, implies that there must be something else at work convincing the actors to adopt these things if there is no hegemon to do so.

Indeed, following Hurd, the three generic reasons why an actor might obey a rule are: The actor believes that obeying the rule will prove to be beneficial to itself (*self-interest*); the actor fears the punishment of an external party that would be displeased if the actor disobeys the rule (*coercion*); and the actor believes the rule is legitimate and ought to be obeyed (*legitimacy*) (1999, p. 379). Some combination of these three factors should be able to outline why each given multinational firm decides to build a company town in a developing country and subsequently endows the settlement with private municipal governance. There may be some overlap among the points slotted under each of the three broad headings; it is the combined effect of how the three broad factors fit together in each unique situation that will ultimately make the case in favour of pursuing the design.

The most important motive for the provision of private municipal governance is the confidence that doing so actually promotes the firm's self-interest. Each individual decision is

made so as to maximize returns to the decision maker. Thus the firm's decision to create a company town providing private municipal governance could be justified even under a fairly narrow viewpoint as merely part of the necessary costs incurred to properly develop the project in the developing country. That is, absorbing the costs associated with providing a limited set of public goods in the present may allow the firm to maximize its return on the resource extraction project over the longer-term.

Kobrin refers to the "obsolescing bargain" in the relationship between the MNC and the HDC. When deciding to enter a developing country in order to develop its natural resources, the multinational firm has the advantage in bargaining, and can use this to obtain concessions from the host government. However, after installation and over time, this advantage diminishes and even switches to the host; the HDC can then attempt to wring concessions from the captive multinational. Once invested, fixed capital becomes sunk; the risk associated with development diminishes as production begins; and technology matures over time and becomes available for replication. Over time, the HDC will gain through transfers of technological and managerial skill that will also serve to reduce the MNC's position (1987, pp. 611-2). If the firm attempts to become more like a government, it may be able to avoid being held to ransom by the host or otherwise slow down the obsolescence of the bargain.

Transaction cost minimization can serve as a primary consideration within the firm's assessment of its self-interest. In this way, the MNC might be willing to provide the private municipal governance related to its resource extraction project if, over the longer-term, the firm's community development efforts may have important spin-off effects that reinforce the firm's

profit maximizing self-interest, such as promoting legal, political, and social stability and entrenching property and contractual rights.

Community facilities and programs designed to improve the workers' physical wellbeing have long been a part of the design of the company town. Hospitals, sanitation, and the provision of medical care are viewed in this way as self-serving measures intended to increase productivity. Good community relations, in general, can also help the firm to become aware of unexpected difficulties, avoid unnecessary conflict, more easily recruit or retain desirable workers, and build business links with local suppliers (Nigam, 1999, p. 12).

Firms engaged in resource extraction have started to discover that good community development records can lead to governments elsewhere offering concessions based at least in part on corporate social performance in other developing countries. A successful partnership or collaborative effort with the host government of a developing country could lead to an opportunity for the firm to work with the government to lower transaction costs by identifying and then removing the fees, restrictions, and regulations that needlessly raise firm costs, lower productivity, and generally impede private enterprise in the developing country (McPherson, 2005, p. 11). Good community development records with already established projects may also make other local stakeholders more receptive to expansion plans (Nigam, 1999, p. 13). Moreover, if the firm can take on some aspects of regulation (or governance) itself and thus preclude government from doing so, the firm may be inclined to pursue this arrangement, and especially so when it views potential government involvement as burdensome or potentially troubling (Haufler, 2002, p. 168).

This self-interested rationale is sometimes referred to as ‘the business case for ethics’, in which, for example, the firm strives to avoid unethical behavior that could lead to bad publicity, alienate employees and invite additional government regulation and scrutiny. Business ethics is thus instrumental, merely a means to a desired end (Kapelus, 2002, p. 281). In Frank’s summation, firms are more than compensated for the upfront higher costs of socially responsible behavior by their ability to solve commitment problems (in this case, with customers, employees, or governments) and by improvements to both product demand and labour supply (2004, p. 65). Haufler (1998) summarizes the causes for self-interested corporate behaviour into a short list, naming concerns with efficiency, reputation, liability, autonomy, and leadership as motives for international business to alter its behaviour to emphasize self-regulation. Haufler’s focus lies with how business self-regulation can preempt government interference and regulation, but the point can be extended to cover why the firm will engage in community development in the developing country in general, and why the firm will design and operate the company town in particular.

If modern information and communication technologies have made running corporate subsidiaries as company towns in developing countries *feasible* in the sense that the corporate HQ is more able than ever before to closely monitor and guide firm activities in developing countries, then these same technologies may also be making the company town model *necessary*. This observation is seemingly increasingly true as the technologies themselves continue to develop, become more widespread and available at lower cost. The basic explanation for this holds that while it has become easier to direct operations around the world from a distant HQ, it has also become easier for others to keep an eye on these operations. In other words, it has become rather straightforward to monitor corporate deeds, both good and bad. Modern media

and courts are increasingly filled with stories based on alleged corporate action or inaction in their (subsidiaries') operations in developing nations. If MNCs want to avoid potentially damaging attention, then taking control of local governance responsibilities in a developing country might be viewed as a reasonable cost in this respect.

Cragg (2005, p. 46) recounts how the global head of mining and metals for Barclay's Capital in London (the world's largest financier of mining projects) ascribes the intention on the part of the firm to commit to high standards of ethical behaviour to an attempt to avoid 'reputational risk'. The Global Corporate Citizenship Initiative (2004, p. 9) suggests that a combination of a number of factors may serve as drivers to push the firm to consider improved corporate citizenship and social performance. Among these factors, the GCCI cites an increase in 'active ownership' and research by mainstream investors; the growing influence of socially responsible investment; new legal and listing requirements; ongoing ethical and corporate governance crises; more sophisticated activist campaigns by NGOs; and an increasing impetus provided by voluntary reporting frameworks such as industry codes of conduct and guidelines issued by intergovernmental organizations.

If the self-interested rationale might be called 'the business case for ethics', the legitimacy rationale might be called 'the ethics case for ethics'. Essentially, under this view of 'corporate citizenship', the firm, much like individuals, has both rights and duties. The firm will decide to provide local governance in the developing country because it can and because doing so is viewed as the right thing to do (Kapelus, 2002, p. 281). Business ethics is an end in and of itself; in this context, then, the multinational firm's design and operation of the company town in the developing country is the goal and not merely a means to achieving some other purpose. The

construction of the company town might arise as the firm's goal because the project is perceived as necessary for the firm to be permitted to operate in the developing country. The more transparent the process, accountable the municipal governance, extensive the inputs and open the debates, and the firmer the legal basis for the private involvement in municipal governance, the better are the prospects for the private municipal governance to become seen as legitimate (Heymans, 2002, p. 221).

Accepting the view that corporations have obligations to stakeholders other than simply pursuing profit maximization for shareholders can help to craft a response to the challenge to explain why a multinational firm, primarily interested in wealth creation by means of resource extraction, would be willing to take on the responsibilities of municipal governance. (Although, as noted above, one could alternatively believe the firm is completely self-interested yet still engage in the provision of local governance.) Mining a resource and paying the national host government for the privilege to do so may not have much meaningful impact on the lives of local residents in the developing country. Yet it should be recognized that there may be two ways for the firm to obtain a competitive advantage from its extraction of natural resources in the developing country; one is short-sighted while the other is sustainable. The first path is based primarily on competition based on cost alone; the firm seeks the lowest cost for its product and is always on the lookout for possible cost reduction (i.e. the firm will attempt to remove the natural resources from the developing country at the lowest possible cost). The second path includes the development of capabilities and strategies that can add value to the firm and its output (e.g. the company town model suggested here). If the firm follows the first path, it is likely to create only a temporary source of competitive advantage as, in fact, the firm would be doing little new from its traditional activities or those of its competitors. The second path, however, features

innovation, flexibility, and sustainability. Indeed, the second path may *also* lead to lower costs, at least in the longer-term, but it might also lead to greater productivity and the ensuing benefits would certainly be longer-lasting (Dunphy, Griffiths, & Benn, 2003, pp. 144-5).

*Case Study: Mining in Mongolia**

Mongolia, with a population less than 3 million, has a landmass more than twice the size of Texas. Four in ten Mongolians live a nomadic lifestyle. There is, however, a major push to reduce the number of nomads. The impetus is climate change: Mongolia's average mean air temperature has increased by more than 1.5 °C over the past half-century. The major significance of this is its effect on the nomad herders through its impact on grazing pastures. Mongolia's president, Nambar Enkhbayar, has argued that since the government of Mongolia cannot stop climate change, it must instead find a way to reduce the number of nomads. To date, though, Mongolia's efforts to settle its nomad herders have been less than successful. Half of Mongolia's capital, Ulaanbaatar, is Soviet-style block concrete edifices, and the other half is made up of a collection of traditional Mongolian circular felt tents ("Gers"). The displaced herders live in the Gers, always on the threshold of poverty. The Mongolian government views settlement as a precursor to civilization, with the hope now being to encourage this transition in order to tap into Mongolia's vast mineral wealth.

Mongolia's GDP is roughly one billion US dollars. The government expects that the copper and gold mine now being planned by Canada's Ivanhoe Mines will double the country's GDP within a decade. Ivanhoe has a 100 percent interest in the Oyu Tolgoi ("Turquoise Hill") project in the southern Gobi Desert. Oyu Tolgoi is about 550 km south of Ulaanbaatar and 80 km north of the border with China. The project began with Ivanhoe's discovery in 2000 of high

grade metals in Mongolia's Southern Gobi desert. The estimate has it that the Oyu Tolgoi site could produce more than one billion pounds of copper and 330,000 ounces of gold each year for at least the next 35 years. Moreover, Oyu Tolgoi still represents the largest current mineral exploration project in the world. However, before Mongolia's vast resource wealth can be accessed, some very real obstacles need to be overcome.

[Figure 1 about here]

Existing mining operations in Mongolia have an extremely poor environmental record. The largest operating mine in the country, the Erdenet copper mine (run as a Russian-Mongolian joint-venture), is reportedly fined \$500,000 per year for its abhorrent environmental practices, but simply considers the fine to be a cost of doing business rather than the more costly (in the short-term) option of cleaning up its processes. Still, the Erdenet mine and others like it elsewhere in Mongolia are widely rumored to have an even worse environmental record than is publicly known.

Ivanhoe did undertake some early steps to prove to the Mongolian government, shareholders and potential partners that it will be able to overcome the obstacles associated with the development of Oyu Tolgoi. The firm obtained the ISO 14001 environmental certification for its Mongolian operations and announced plans to commission regular external environmental audits. Ivanhoe also decided to build the mine's storage facility at a site based on the least environmental impact, even though this is the highest cost option of the alternatives considered. The most important environmental obstacle, however, is probably water: For the mine's operations alone, the need is for 500 litres of water per second. Plans call for Ivanhoe to draw

down on deep water aquifers, but only if the activity reaches steady-state equilibrium. Ivanhoe has been encouraged to invite in NGOs to facilitate, supervise and monitor its development and use of the local water aquifers, but the firm has not yet made any commitments on this point.

In October 2006, Ivanhoe announced that Rio Tinto PLC, the global mining giant, agreed to partner in the Oyu Tolgoi project and to help negotiate a crucial agreement with the Mongolian government. Ivanhoe had been actively soliciting potential partners for its Mongolian projects for three years prior to striking the deal. Under the deal, Rio Tinto would take a nearly 10 percent stake in Ivanhoe with the option to increase its interest to up to 40 percent over the subsequent five years.

Meanwhile, Mongolia passed legislation that gave the government the right to buy up to 34 percent of the private mines operating in the country. The government also introduced a 68 percent tax on copper and gold “windfall” profits – a gesture seemingly aimed directly at Oyu Tolgoi and meant to tell Ivanhoe to negotiate a better deal with the national government. The scene was set for negotiations on the long-term ‘stability’ agreement. Assuming the conclusion of a satisfactory agreement, production at the site is expected to commence in 2010.

Ivanhoe thought that it reached just such an agreement in June 2007. The 2007 draft agreement was said to have been a ‘fair agreement’, acceptable by all sides, and duly approved by all applicable levels of government in Mongolia. But although initially expected to sail through the divided Mongolian parliament, the deal has never been ratified. This might have changed with the apparent July 2008 election of a majority government for the pro-development

party. More recently, though, Mongolia has been engulfed in riots sparked by allegations of electoral fraud. Ratification of the draft stability agreement for the Oyu Tolgoi mine was the key issue of the 2008 election. Although international observers reported that the election was overall both free and fair, protesters claimed that the vote had been rigged.

Critically for present purposes, though, Ivanhoe has thus far maintained that it does not intend to create an “artificial” town at Oyu Tolgoi for the 1500-2000 Mongols it initially plans to house at the site. However, based on the scholarship presented above in this paper, it could potentially have substantial and compelling reasons for doing so. Importantly, it is noted that Ivanhoe’s operations in Mongolia will serve to accelerate the decline of the region’s ability to sustain nomadic herders. In other words, there is a ready-made body of potential employees to work in whatever facilities are constructed. An earlier (and much smaller-scale) gold mining project that lies a two hours’ drive north of Ulaanbaatar faced a similar problem in that there were some 70 families living (nominally illegally) in the area where the mine now operates. At this site in Mongolia’s north, the firm involved, Saskatchewan’s Boroo Gold, interviewed each one of the local families and discovered that they were happy to move, provided that the firm provide a school for their children in the new settlement. Today, each one of these families is said to be satisfied, with a large majority of those relocated now having jobs at the mine.

Progress, it is said, tends to come at a price. Poor people tend to be understandably somewhat short-sighted. Nonetheless, Mongolia is not desperate. Mongolia’s president Nambiar Enkhbayar makes it clear that he views mining as Mongolia’s passport to modernity. Indeed, the greatest threat to Mongolia’s viability is not thought to be economic, but rather socio-cultural. It

would be far cheaper for Ivanhoe to rely on neighboring China for Oyu Tolgoi's power and smelting needs. However, relying on China is not viewed as environmentally desirable, and it would do little for settling Mongolia's nomads. Mongolia's governing and opposition parties believe that by building a settled and modern Mongolia now through mining, the country will be able to preclude what might be otherwise inevitable: Integration into China with ensuing assimilation of the Mongols. As such, it is uncertain whether the Mongolian government will conclude the necessary agreements with Ivanhoe unless it receives adequate assurances that Mongolia and not China will be the primary beneficiary of the Oyu Tolgoi project.

There are also more self-interested reasons for Ivanhoe to consider erecting a company town at Oyu Tolgoi. As smaller scale mining projects have begun to come online in Mongolia during the last decade, so too has a new threat to the firms that run them: the 'gold ninjas'. The gold ninjas of Mongolia act as roving privateer miners, ignoring the concept of private property. With stealth under the cover of darkness, they strike in a quick and organized fashion to siphon off gold from the private firms that have the legal rights to the metal. The ninjas often end up digging themselves, claiming to know how to find the best yields. Operating in groups of 20-30, they travel in caravans of SUVs and carry mobile phones, seeking the most valuable 'opportunity' to exploit. They sell the gold they collect to the highest bidder, no questions asked, and certainly pay no taxes. At roughly 7 percent of Mongolia's GDP, they are an important part of the 'shadow economy'. The small scale mining communities scattered elsewhere throughout Mongolia have not had much success in dealing with the gold ninjas. There are two principal ways in which an Ivanhoe company town could discourage the ninjas. The first is intimidation based on size. Ivanhoe could erect a strong community with the institutions and security to match

its aspirations for its mine. Security would be much easier to control if Ivanhoe were to assume governance responsibilities for the Oyu Tolgoi community itself. The second way, and somewhat based on the first, is that with an existing community to work from as a sort of base, Ivanhoe and the ninjas could work together. Instead of acting as privateers, Ivanhoe could encourage the ninjas to become pathfinders; the ninjas could be employed for the exploration of some of the vast land areas to which Ivanhoe has discovery rights.

The mining industry in general does not have a good reputation for corporate social responsibility. Even Ivanhoe, a relative newcomer and lightweight among the mining multinationals, is no stranger to this type of controversy: It has run a mine in Myanmar as a joint venture with the Junta. Many NGOs argue forcefully that extractive industries in poor developing countries inflict more harm than whatever good they may bring, and it would seem likely that the NGOs will come out in force against Ivanhoe for its decision to pursue the minimal solution; the probable rallying cry would be that Ivanhoe could and should do much more for Mongolia and its inhabitants.

These cries will have grown louder since Robert Friedland's 2005 misstep at a conference in Florida. Friedland was addressing a crowd of potential financiers about the Oyu Tolgoi project's strong merits in an attempt to convince putative investors to provide the \$1.25 billion necessary for the first phase of the project. Friedland had impressed with his vision of the world's biggest new mine. But then he began talking about the project's expected profits: With Mongolian taxes at about 5%, "You're making T-shirts for five bucks and selling them for \$100. That is quite a robust margin." Too robust, it would seem, for many. The T-shirt comment set off

somewhat of a firestorm back in Mongolia. In his attempt to win over the financiers, Friedland had apparently taken the Mongolians for granted, and they were not pleased about it. Nevertheless, Ivanhoe's broad challenge in Mongolia essentially remains to win over a set of very diverse stakeholders, a difficult task perhaps only slightly exacerbated by recent events. Mongolia's parliament, its nomads, and its broader public must all be won over for the Oyu Tolgoi project to be successful. The company town model potentially provides Ivanhoe with a way to simultaneously deal with the varied concerns of all of its stakeholders. In essence, Ivanhoe will already be constructing a company town, including offices, accommodations, medical facilities, workshops and warehouses, water distribution systems, and roads at Oyu Tolgoi; the current infrastructure plans, however, see the company searching to adopt a minimalist position. Ivanhoe could and should do better.

Conclusion

The private provision of governance, though 'temporary', can be symbiotic: The multinational firm obtains stable access to a natural resource for export to the world market, while the host developing country also benefits from the stability the firm's governance and presence brings, using these as a crutch towards further development and progress. Due to space limitations this paper has not explored the HDC's rationale for encouraging MNCs to engage in private municipal governance, but the state's motivation too can be examined as a combination of factors including self-interest, coercion, and legitimacy. And though it remains of course possible for the firm to take a short-term view and provide what amounts to the minimum necessary level of local public services and governance (primarily due to a short-sighted profit fixation), this paper has tried to outline a possible longer-term view. Under the longer-term

perspective, the firm becomes more fully involved with the provision of local governance and services to the community.

In closing, this paper may also be viewed as intending to provoke consideration of the differences between business administration and public administration. It is frequently lamented that governments are now being run as businesses; it seems odd to note, then, that comparatively few scholars have attempted to explore the extent to which businesses (especially multinational corporations) have become government-like themselves. The possible resurgence of the company town in the developing country as a potential model for a type of private governance provided by the firm is only a case in point. Perhaps more ambitiously still, this paper might also serve to provoke consideration of the increasing ambiguity associated with trying to draw a distinction between public policy and corporate strategy.

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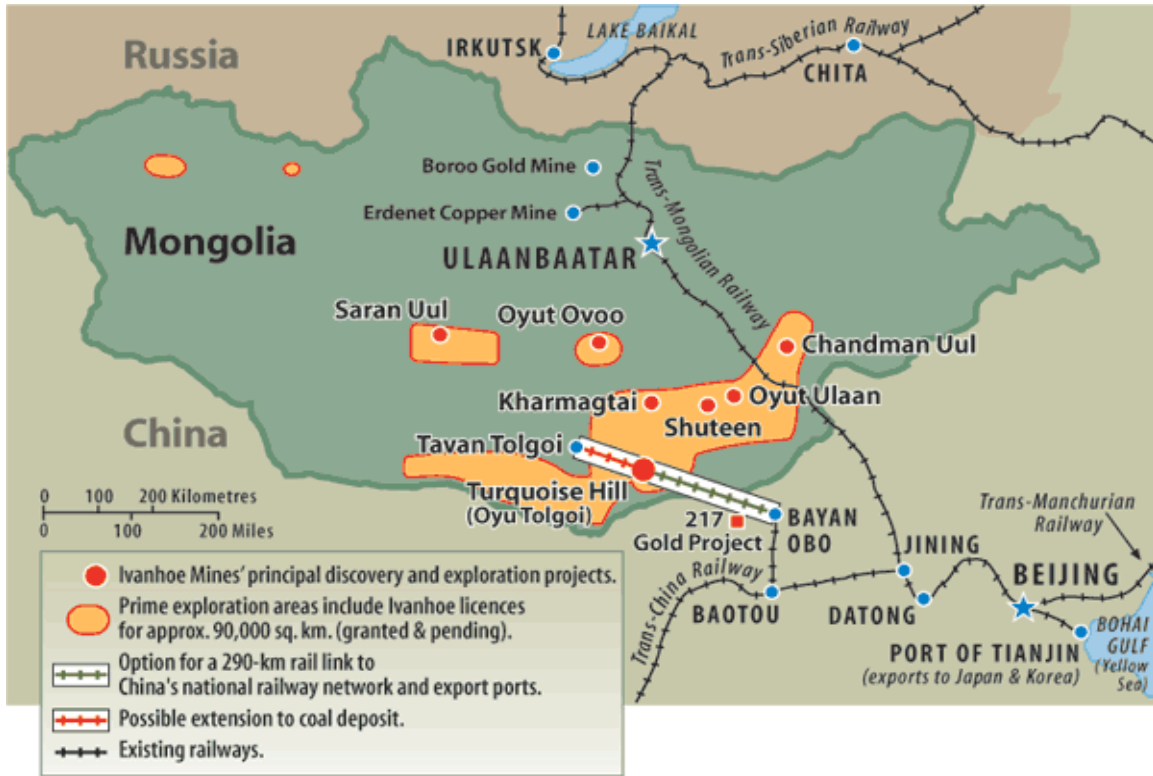
Footnotes

* All details in the Mongolia case study are taken from the following sources: *Corporate Knights* (Spring 2004), 24-9, 46; information from Ivanhoe Mines' website on its Mongolian operations, available from <<http://www.ivanhoe-mines.com/s/Mongolia.asp>>; *The Globe and Mail* (24 August 2004 and 19 October 2006); *Financial Times* (26 Feb. 2004); the *Globe and Mail's Report on Business* magazine (October 2005), 46-62; *National Post* (28 June 2007, 8 April 2008, and 2 July 2008).

Figure Captions

Source: “Ivanhoe Mines Ltd. – Mongolia”, available from

<<http://www.ivanhoe-mines.com/s/Mongolia.asp>>.



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