

Regulating Large International Firms

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Contents

Acronyms	ii
Summary/Résumé/Resumen	iii
Summary	iii
Résumé	iv
Resumen	v
Introduction	1
1. International Investment Negotiations and Global Property Rights	2
2. International Taxation Co-operation	5
3. New Proposals for Competition Rules	8
4. Codes of Corporate Conduct	11
5. The Prospects for Change	15
Conclusions	18
Bibliography	19
UNRISD Programme Papers on Technology, Business and Society	21

Acronyms

AIDS	Acquired Immunodeficiency Syndrome
APEC	Asia-Pacific Economic Co-operation
ASEAN	Association of Southeast Asian Nations
BIT	bilateral investment treaty
DFID	Department for International Development (United Kingdom)
DSU	WTO Understanding on Rules and Procedures Governing the Settlement of Disputes
DTT	double taxation treaty
EMS	environmental management system
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	foreign direct investment
FIFA	International Federation of Football Associations
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GM	genetically modified
HIV	Human Immunodeficiency Virus
ICAO	International Civil Aviation Organization
ICSID	International Centre for the Settlement of Investment Disputes
ILO	International Labour Organization
ILSA	Iran-Libya Sanctions Act
IMF	International Monetary Fund
MAI	Multilateral Agreement on Investment
Mercosur	Southern Cone Common Market
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
NGO	non-governmental organization
NT	national treatment
OECD	Organisation for Economic Co-operation and Development
TRIMs	Trade-Related Investment Measures
UNCTAD	United Nations Conference on Trade and Development
WHO	World Health Organization
WTO	World Trade Organization

Summary/Résumé/Resumen

Summary

This paper explores the existing arrangements for multilateral regulation of large firms, and makes the case for balancing strengthened global corporate property rights with more explicit and enforceable social obligations. In a democratic market-based society, investors have legally enforceable rights but must also obey laws designed to protect workers, consumers and the environment. Competition regulations are designed to counter market power and business taxes ensure the provision of public goods. Strengthened multilateral co-operation in three related areas—investment, tax and competition—is under way. Although progress is slow and contested, the distinct interests of host and home countries are clear and the “development dimension” is broadly recognized. In marked contrast, corporate conduct on labour and environmental issues is still almost exclusively regulated at the national level. Moreover, external standards of international corporate responsibility in developing countries are set by voluntary initiatives, with market incentives rather than legal requirements constituting the basis for compliance.

Codes of conduct and other voluntary initiatives, however, have two weaknesses. First, to avoid the “free rider” problem, they should cover the entire sector, which would require an element of compulsion. Second, there must exist some plausible penalty for breaking rules—these can only be applied by governments or by legislation that empowers civil organizations, such as trade associations, to apply such penalties. In other words, if they are to be effective there is a need for international standards on labour and environment to be supported by intergovernmental agreements—as are property rights, tax liability and competition rules (however imperfectly). Reliance on the presumed effect on asset (brand) value of consumer awareness of production conditions in developing countries is not sufficient.

A better approach would be a multilateral definition of the obligations of international firms that is explicitly linked to the guarantee of property rights. These obligations might reasonably include international taxation, competition rules and stakeholder issues such as employment conditions and environmental protection. The ongoing process of regional integration—particularly in Europe—could present an opportunity for such a definition.

It is clearly incorrect to regard large international firms as effectively “unbridled”. There already exist strong measures between OECD countries to regulate these firms in the fields of investment rights, tax burdens and competition rules. The problem is that these systems have not yet been extended to cover developing countries in a way that supports development. There is therefore an urgent need to define what a desirable regulatory regime might look like from the point of view of both middle-income and low-income developing countries.

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Résumé

Cette étude explore les dispositions existantes pour la réglementation multilatérale des grandes sociétés, et plaide en faveur d'un équilibre entre les droits de propriété internationaux accrus des entreprises et des obligations sociales plus explicites et plus exécutoires. Dans une société démocratique fondée sur le marché, les investisseurs ont des droits juridiquement exécutoires, tout en étant tenus d'obéir à des législations destinées à protéger les travailleurs, les consommateurs et l'environnement, tandis que les réglementations en matière de concurrence sont conçues pour contrer le pouvoir du marché et les taxes professionnelles pour assurer la fourniture de biens publics. Un renforcement de la coopération multilatérale dans ces trois domaines connexes—investissement, taxes et concurrence—est en cours. Bien que le progrès soit lent et contesté, les intérêts distincts des pays hôtes et d'origine sont clairs et la "dimension du développement" est largement reconnue. Par contraste, la conduite des entreprises pour ce qui est des travailleurs et des questions de l'environnement demeure encore presque exclusivement réglementée au niveau national. En outre, les normes externes de responsabilité internationale des entreprises dans les pays en développement sont, au mieux, fixées en vertu de démarches volontaires, avec des initiatives du marché plutôt que des exigences juridiques imposant le respect.

Cependant, codes de conduite et autres initiatives volontaires ont deux faiblesses. Premièrement, pour éviter le problème du "cavalier seul", elles devraient couvrir le secteur tout entier, ce qui exigerait un élément de contrainte. Deuxièmement, il doit exister un type de sanction plausible pour toute entorse aux règles—de telles sanctions devant être appliquées seulement par les gouvernements ou par une législation habilitée à le faire des organisations civiles telles que les associations de professionnels du commerce. En d'autres termes, pour qu'elles soient efficaces, il est nécessaire d'imposer des normes internationales en matière de travail et d'environnement qui soient soutenues par des accords intergouvernementaux—comme le sont les droits de propriété, l'assujettissement à l'impôt et les règles en matière de concurrence (bien que de façon imparfaite). Le fait de se fier uniquement à l'effet présumé, sur la valeur des biens (ou de la marque), de la sensibilisation du consommateur aux conditions de production dans les pays en développement est largement insuffisant.

Une meilleure approche serait une définition multilatérale des obligations des sociétés internationales qui soit explicitement liée à la garantie des droits de propriété. Ces obligations pourraient raisonnablement comprendre une fiscalisation internationale, des règles de concurrence et des questions liées aux parties concernées telles que les conditions de l'emploi et la protection de l'environnement. Le processus en cours d'intégration régionale—notamment en Europe—pourrait offrir l'occasion de mettre au point une telle définition.

Il est clairement erroné de percevoir les grandes sociétés internationales comme étant réellement "débridées". Des mesures musclées ont déjà été adoptées par les pays de l'OCDE pour réglementer ces sociétés dans les domaines des droits d'investissement, des charges fiscales et des règles de concurrence. Le problème est que ces systèmes n'ont pas encore été élargis pour englober les pays en développement de manière à soutenir le développement. L'accent est par conséquent mis sur l'urgente nécessité de définir ce à quoi un régime

souhaitable chargé de la réglementation pourrait ressembler du point de vue des pays en développement à moyens et bas revenus.

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Resumen

Este documento estudia la situación actual en torno a la reglamentación multilateral de las grandes empresas, y defiende la importancia de lograr el equilibrio entre un sistema que promueve los derechos de propiedad empresarial y otro que promueve las obligaciones sociales. En una sociedad democrática basada en el mercado, los inversores tienen derechos legalmente establecidos, pero deben respetar asimismo las leyes para la protección del trabajo, de los consumidores y del medio ambiente, mientras que la reglamentación de la competencia está elaborada para frenar la concentración del poder económico y los impuestos de las empresas garantizan los bienes públicos. Actualmente está comenzando una cooperación multilateral reforzada en tres ámbitos relacionados, es decir, la inversión, los impuestos y la competencia. Aunque el proceso es lento y disputado, los intereses definidos de los países anfitriones y de origen son claros y “la dimensión del desarrollo” está ampliamente reconocida. En contraste, el comportamiento de las empresas en lo concerniente a las cuestiones laborales o ambientales aún sigue regulándose casi exclusivamente a nivel nacional. Además, las normas externas de la responsabilidad internacional de las empresas en los países en desarrollo están establecidas por iniciativas voluntarias, y los incentivos de mercado, más que los imperativos legales, constituyen las bases de su cumplimiento.

Sin embargo, los códigos de conducta y otras iniciativas voluntarias tienen dos puntos débiles. En primer lugar, para evitar el problema del “beneficiario gratuito”, éstos deberían abarcar todo el sector, lo que exigiría un elemento de coerción. En segundo lugar, el incumplimiento de las normas debe ser objeto de una sanción explícita—la aplicación de dichas sanciones sólo compete a los gobiernos o a la legislación que habilita a organizaciones civiles como las asociaciones comerciales. Es decir, para que las normas internacionales sobre el trabajo y el medio ambiente sean efectivas, es necesario su apoyo en los acuerdos intergubernamentales—como en el caso de los derechos de propiedad, la obligación tributaria y las normas de competencia (por imperfecto que sea dicho apoyo). No bastan las presiones que puedan ejercer los consumidores, y los efectos que éstos puedan tener sobre los activos o la marca de la empresa.

Una estrategia más eficaz sería dar una definición multilateral de los deberes de las empresas internacionales que esté explícitamente vinculada a la garantía de los derechos de propiedad. Estas obligaciones pueden incluir, lógicamente, la tributación internacional, las normas de competencia o los problemas de las partes interesadas, como las condiciones de empleo y la

protección ambiental. El proceso continuo de la integración regional—particularmente en Europa—podría suponer una oportunidad para tal definición.

Es claramente incorrecto considerar las grandes empresas internacionales como eficazmente “desenfrenadas”. Ya se han adoptado medidas estrictas entre los países de la OCDE para regularizar dichas empresas en los ámbitos de los derechos de inversión, las cargas tributarias y las normas de competencia. El problema radica en que la ampliación de estos sistemas aún no abarca los países en desarrollo de modo que apoye el desarrollo. Así pues, reviste carácter de urgencia definir un régimen normativo conveniente desde la perspectiva de los países en desarrollo de medianos y de bajos ingresos.

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Introduction

The process of globalization has created an evident asymmetry in global factor markets: goods and capital move, to a large extent, freely, while services and labour remain largely confined within national borders. Indeed, the value of the goods and services directly delivered by international firms in foreign countries now exceeds that of global exports.¹ This means not only that large international firms have become the effective bearers of economic globalization, but also that the economic (and social) externalities of their business activities have become central to economic development. In the absence of international legal instruments to deal adequately with international firms, global intergovernmental institutions constrain governments which are then supposed to regulate firms which are located in their territories—whether headquarters or subsidiary. This creates a serious negotiating asymmetry between large firms and small countries, particularly if powerful home country governments support “their” firms.

Developed countries see little reason in principle to treat international firms² differently from any large “domestic” firms, which are, in effect, potentially multinationals. Increasingly this is also true of developing countries themselves: all middle-income countries, not only the capital exporters such as the Republic of Korea, Singapore and Taiwan Province of China, have their own international firms. Low-income countries too—from China and India on the one hand to Ghana and Nicaragua on the other—have much of their capital abroad, as well as domestically owned firms that operate across frontiers and thereby can escape the regulators and, possibly more important, the tax authorities. The case for international regulation of firms no longer rests, therefore, merely on the desire to curb the power of large multinational investors within developing countries. A wider agenda exists, which includes large domestic firms and, in principle, provides governments in both North and South with a common cause.³

Modern market regulation has been built up at the national level from the interplay of two forces: the interests of the “firm” (controlling shareholders and senior management) in the growth of asset value; and a combination of consumer pressure, stakeholder interests (employees, minority shareholders and local communities) and the objectives of the state itself. At the international level there are major complications. On the one hand, the weakness of the international political community is mirrored by the virtual absence of international commercial law.⁴ It is far from clear—even in principle—how these conflicts are to be resolved, and by whom. On the other hand, the national governments involved are of unequal influence, and in particular large states such as the European Union (EU) and the United States (that naturally reflect the interests of their firms, stakeholders and consumers) effectively define both the agenda and the progress of negotiations.

¹ See UNCTAD (2000a).

² Sometimes known as “foreign”, “international”, “multinational” or “transnational” firms—the point here being that they are domiciled in one jurisdiction and operate in another, and thus come under no distinct regulators.

³ See DFID (2000).

⁴ See Sauvant and Aranda (1994).

This paper examines four dimensions of current negotiations on the international regulation of international firms in order to throw some light on this problem: investment treaties; corporate taxation; competition law; and labour/environmental codes. As a whole they make up much of the equivalent “matrix” to domestic regulatory structures, with the possible exception of consumer protection.⁵ Section 1 looks at international investment negotiations, where the apparent conflict between “North” and “South” has been most explicit, and between the interests of “multinationals” versus “poor countries” (or even “poor people”) seems most apparent. Rather less advanced in terms of international negotiations, but none the less profoundly important for the future of international firm regulation, is international tax co-ordination, which is discussed in section 2. Section 3 explores competition rules, which have recently been taken up by the EU as the solution to abuse of international market power—despite the lack of clarity as to principles and procedures. These three are being pursued on an intergovernmental basis and presume a potential legal framework defining the rights and obligations of international firms.

The current approach to labour and environmental standards on the basis of voluntary codes is discussed in section 4, where a contrast is drawn between the use of economic incentives and statutory powers to achieve a socially desirable outcome. Section 5 addresses the problem of how obligations on international firms might be introduced to match their claim for international property rights despite the political economy of the slow and uneven progress toward the international regulation of business in general, and their activities in developing countries in particular.

1. International Investment Negotiations and Global Property Rights

The lack of a clear international legal infrastructure for investor protection continues to hamper the establishment of a global market in long-term capital.⁶ Investment issues are becoming a key element of commercial relations between states, now that the basic principles of free trade have been settled in the World Trade Organization (WTO), and the provision of services depends upon the commercial presence of an international firm in the host market. Among the advanced industrial countries, investment issues are settled under a number of (non-binding) Organisation for Economic Co-operation and Development (OECD) instruments. However, in the late 1960s, a number of European investor countries perceived a need to protect their assets in developing countries and started to negotiate bilateral investment treaties (BITs) with them.

BITs focus solely on investment issues and make binding provisions on expropriation, the transfer of payments, and compensation for losses due to armed conflict or internal disorder. These benefits may be accorded on a national treatment (NT) or Most Favoured Nation (MFN)

⁵ Although it could be argued that international agencies such as the WHO (drugs), FAO (foods) and ICAO (air transport) do represent an embryonic form of global consumer protection.

⁶ For a succinct overview of the major developments in the history of international business regulation and investor protection, see Muchlinski (1999).

basis.⁷ A broad definition of investment is used, covering direct investment, portfolio holdings and non-equity forms of investment. However, protection is only granted to investors with real links to one of the countries that are parties to the agreement. BITs usually provide for the resolution of investor-state disputes in private institutions (such as the arbitration centres of the International Chamber of Commerce) or the International Centre for the Settlement of Investment Disputes (ICSID) of the World Bank. However, in contrast to their specificity with respect to investment protection, BITs usually make few commitments about liberalizing investment restrictions. National treatment rarely extends to the pre-entry phase (i.e. the right of establishment in a particular sector) and few BITs contain provisions on investment restrictions such as performance requirements.⁸

Attempts to co-ordinate investment policies between larger groups of countries have a mixed record of success. They have been most successful where countries are highly interdependent in their trade and investment flows, the most notable example being the EU Treaty of Rome. In contrast, regional trade agreements among developing countries tend to contain only fairly rudimentary investment provisions, even in the case of ambitious integration agreements such as the Southern Cone Common Market (Mercosur). However, there are a growing number of preferential trade agreements between developed and developing countries that do incorporate investment provisions. These treaties usually include commitments on non-discriminatory treatment and disciplines on investment restrictions. The investment provisions in the North American Free Trade Agreement (NAFTA)⁹ and the EU association agreements with countries in Central and Eastern Europe are binding and considered stringent. In contrast, the agreements between rather loose and diverse groupings such as the Association of Southeast Nations (ASEAN) and Asia-Pacific Economic Co-operation (APEC) are weak and usually non-binding.

The ambitious investment protection provisions included in NAFTA served as a blueprint for the OECD-based negotiations on a Multilateral Agreement on Investment (MAI).¹⁰ The MAI talks were discontinued in October 1998 following opposition developing country governments, the failure of the United States and EU to agree on a number of key issues—and widespread protests from labour and environmental groups. None the less, US negotiators continue to use NAFTA as a benchmark for any future investment agreement negotiated at the multilateral level. Bilateral and regional investment treaties must in any case be consistent with the disciplines set out in the WTO agreements, including those on competition policy. The WTO agreements already contain important principles relating to the four main issues linked to investment (national treatment, transparency, investor protection and dispute settlement).

⁷ NT involves firms being treated at least as well (in terms of investment licences and trade restrictions, for instance, but *not* taxation) as domestic firms, “under like circumstances”. MFN involves foreign firms in a particular country being accorded conditions at least as favourable as the best enjoyed by firms from any other country.

⁸ Which typically oblige foreign firms to use a certain proportion of domestic inputs, or to export more than they import, for example.

⁹ The Mexican government was required to liberalize its investment policies significantly in order to conform to the agreement, but has subsequently extended the substantive rights (in Chapter 11:A) to foreign investors from outside North America. However, as an OECD member since 1994 it would have had to do this in any case. There are also widespread exemptions from NAFTA disciplines, including energy and transport sectors (Mexico), cultural industries (Canada), maritime transport (the United States) and agriculture in all three countries. These exemptions have set important precedents for any future multilateral negotiations.

¹⁰ See FitzGerald (1999).

There is therefore some logic in resuming multilateral investment negotiations within the WTO framework.

The existing WTO provisions on investment are scattered across a number of separate agreements. The National Treatment and Most Favoured Nation obligations imposed on governments by current WTO rules are worded in much the same way as the relevant clauses in existing investment accords.¹¹ The treatment of foreign firms can only be materially different from that of national firms if the situation of foreign firms is not comparable (as is the case in many service industries and above all where domestic firms are small and/or using traditional techniques). However, the next round of negotiations will have to decide whether to modify the existing WTO rules so that the NT obligation applies to the pre-entry phase (i.e., right of establishment), which would go well beyond most bilateral and regional investment agreements. Any future investment agreement would also need to contain provisions requiring host governments to make and enforce rules in a transparent way.¹² However, the right of national governments and central banks to intervene in pursuit of monetary and exchange rate stability is explicitly recognized under most bilateral investment treaties, and under the rules of the International Monetary Fund (IMF). In a payments crisis, the WTO commitments to provide foreign exchange for firms to repatriate profits, pay royalties or service loans are not considered to be binding.

The new trade round is thus likely to consider investment issues, but WTO members are divided in their attitudes. The rudimentary WTO disciplines could be codified and strengthened, but the WTO's inability to hear disputes between states and private investors will remain a problem for the latter. Unlike NAFTA (and the MAI draft) where firms can bring such cases, under bilateral agreements foreign investments may only be expropriated for a public purpose on a non-discriminatory basis and compensation must be prompt, adequate and effective. The draft MAI would have extended these safeguards (following the precedent set by NAFTA) to include measures taken by governments, which have an "equivalent effect" to outright expropriation. In US commercial law, this language has been interpreted to encompass government actions that have reduced the commercial value of investments. The inclusion of such broad language contributed to the failure of the MAI talks because in many jurisdictions it would have provided a higher level of protection to foreign investors than that available to their domestic counterparts. Environmentalists and labour rights activists argued that such terms would prevent national governments from taking any action to uphold or introduce social and environmental safeguards if doing so would reduce the value of foreign investments.

Any eventual WTO treaty on investment would thus be much less ambitious than the failed OECD-based multilateral agreement, but the negotiations are nonetheless likely to be difficult and prolonged. The aim of the negotiations would be to establish a common set of multilateral rules providing a simplified, secure and predictable legal environment for international

¹¹ For example, the clause on "like circumstances" in GATS Article XVII is similar to that in NAFTA Article 1102.

¹² Article X of the General Agreement on Tariffs and Trade (GATT) requires governments to disclose all relevant provisions affecting investment. Article 6 of the Agreement on Trade-Related Investment Measures (TRIMs) and Article III of the GATS both contain notification requirements for investment rules.

investment. This is intended to be a binding multilateral framework encompassing existing bilateral agreements and practices; it would replace existing international agreements on investment issues. Negotiating an MAI is likely to be extremely complicated. The substantive provisions are unlikely to go beyond requiring national treatment for foreign investors and compensation for expropriated property.

The EU and Japan are keen to negotiate a WTO-based investment instrument, but the United States appears to be less so, as it does not feel as free to achieve its own interests (and those of US firms) through a potential multilateral agreement as it already is through bilateral arrangements. Many developing countries remain opposed, as the main effect would be to require developing and transition economies to liberalize their foreign investment regimes. However, any such agreement would need to be both flexible and gradual, as is already the case in the investment-related aspects in the GATS.¹³ It does not prevent countries legislating in favour of certain domestic regions or targeting support for specific sectors or firm categories, provided it did not discriminate between domestic and foreign investors. And, in particular, it does not limit government regulation on social, health and environmental issues.¹⁴ In fact, most middle-income and small poor countries have already opened up radically in recent years. However, the two large low-income countries of most interest to investors (India and China) continue to maintain considerable controls on investment. Among the developed countries, Japan will also come under pressure (particularly from the United States) to open up its commercial and banking sectors.

The United States itself will also come under pressure during the negotiations to accept some disciplines on its use of investment rules to secure the extraterritorial application of US laws. The EU and Canada will presumably continue to oppose the extraterritorial application of US laws under the Cuban Liberty and Democratic Solidarity Act (the Helms-Burton law) and the Iran-Libya Sanctions Act (ILSA). EU and Canadian officials will be reluctant to conclude an investment agreement that leaves the US investments of their own companies liable to be expropriated for extraterritorial breaches of unilateral US trade embargoes. However, any multilateral investment treaty will have to be ratified by the US Senate, so the room for a compromise on extraterritoriality may be limited.¹⁵

2. International Taxation Co-operation

Current international capital income taxation arrangements pose particular problems for poor countries for three reasons: first, need for a fair share of potential fiscal resources generated by trans-border firms (both foreign and domestic) to service debt and supply basic social services; second, the socially inefficient consequences of tax competition between developing countries in order to attract foreign investment, leading to declining rates and revenues; and third,

¹³ General Agreement on Trade in Services at the WTO.

¹⁴ For instance, it permits the over-riding of patent rights ("compulsory licensing") in order to provide generic drugs for HIV/AIDS treatment.

¹⁵ Washington will probably also demand a blanket exemption for national security policies, as it did in the draft MAI.

difficulties in taxing income from overseas assets held by domestic residents, tax avoidance stimulating capital flight and loss of vital resources to poor countries. Developing countries also face the issue of how to balance between maximizing their share of revenues and maintaining a climate that attracts inward investment (and retains their own investors). This involves implicit agreements on the sharing of revenues between host and home countries as well as explicit agreements on the methods to be adopted (including the definition of “permanent establishment”).¹⁶

Pressure for effective international co-operation to facilitate income tax collection is growing. The increasing mobility of capital across national borders poses serious problems for national fiscal authorities committed to taxing income from wealth. Co-operation between tax officials could reduce some of these problems, but jurisdictional disputes and bank secrecy laws in tax havens have so far blocked it. For developing countries capturing tax revenue on the income of their own residents who have assets overseas is also a major problem. In consequence, closer international collaboration (even within the existing extensive network of double taxation treaties) by sharing information and permitting joint actions could increase the fiscal resources available to developing countries dramatically.¹⁷ Further benefits would stem from this, including disincentives to capital flight, increased fiscal and macroeconomic stability, and greater resource availability for poverty alleviation.

Standard theories of international taxation suggest that the tax burden should fall most heavily on those factors of production which are least mobile, in order to maximize the government’s revenue. The process of globalization has resulted in a significant liberalization of cross-border capital flows over the last two decades, but there has not been a corresponding relaxation of the stringent rules covering the movement of natural persons. Capital has therefore become relatively more mobile and there has been a corresponding shift in the incidence of taxation from capital to labour as governments have tried to maintain their income levels.¹⁸

There are two main principles that underlie the jurisdictional basis of national tax systems, although most countries employ a mixture of them. The source principle relates jurisdiction to the source of income or the site of economic activity. A country will tax all income earned from sources within its territory, whether it accrues to residents or non-residents. Income earned abroad by residents is not taxed. The residence principle relates jurisdiction to the residence or fiscal domicile of the earning entity. A country will tax the worldwide income of persons

¹⁶ Reducing regulatory uncertainty is more important to investing firms than the particular concessions or incentives that a treaty may contain—which appear to be regarded as a “windfall gain” rather than the basis for long-term investment decisions. See UNCTAD (1995).

¹⁷ See Frenkel et al. (1991).

¹⁸ As a result, corporate taxes account for only 8 per cent of fiscal revenue in OECD member countries, equivalent to just 3 per cent of gross domestic product (GDP). The most recent data published by the US Department of Commerce show that the rate of income tax paid by the overseas subsidiaries of US corporations declined sharply between the mid-1980s and the mid-1990s. On a worldwide basis, the tax rate paid on gross corporate income declined from 42 per cent to 28 per cent. Since US overseas assets increased from \$236 billion in 1983 to \$778 billion in 1996, the tax rate relative to these assets declined even more sharply, from 13 per cent to 6 per cent. This trend has been common to all firms. The tax rate on income declined from 40 per cent to 29 per cent among the industrialized countries of the OECD, while the rate in developing and transition economies declined from 45 per cent to 27 per cent. See FitzGerald (2001).

(natural or corporate) resident or domiciled in its territory. Income earned domestically by non-residents is not taxed.

Developed countries tend to adopt the residence principle, since they usually have a net positive foreign asset position and the residence principle maximizes their tax takings. Developing countries typically favour the source principle because they host significant amounts of foreign direct investment (FDI); although a number of emerging markets such as Mexico and Argentina have moved from source to residence taxation in an attempt to stimulate foreign investment and capture income from their residents' overseas assets. The resulting clash of jurisdictions and principles leads to severe problems for multinational corporations operating in more than one jurisdiction, since they may be taxed more than once on the same income.

Double taxation treaties (DTTs) attempt to counter this problem by allocating tax rights between the country in which an individual or corporation is resident and the country which is the source of their income or capital gains. Most DTTs are modelled on either the OECD Draft Taxation Convention/Model Tax Convention or the United Nations Model Double Taxation Convention between Developed and Developing Countries.¹⁹ The model conventions are broadly similar, the main difference being that the OECD convention favours residence taxation while that of the United Nations gives more weight to source taxation. The number of DTTs has increased rapidly, and there are now some 1,700 in existence. DTTs were originally between developed countries, but the recent expansion, clearly following the course of bilateral investment treaties, is both with and between developing countries: a third of all DTTs are between developed and developing countries, and a further sixth between developing countries.

From the point of view of developing country revenue authorities, DTTs are the only way to cover intra-firm transactions and thus overcome the problem of transfer pricing.²⁰ These, however, become ineffective if offshore centres are used as transfer pricing points as well as for tax avoidance. In consequence, short of a comprehensive multilateral tax agreement, reconsideration of tax credits²¹ within existing DTTs would be desirable; as would the application of the US "pass-through" principle to tax havens. Indeed, a number of developing countries play a key "offshore" role in the international investment process where tax avoidance is of particular importance. No system of international tax administration—whether multilateral or bilateral—has much meaning unless these offshore centres are included.

Either the source or the residence principle could provide a basis for an effective system of international tax co-operation, if it were applied uniformly. However, many of the advanced

¹⁹ See OECD (1997) and United Nations (1980) respectively.

²⁰ That is, the situation where a firm charges prices in transactions between its own subsidiaries such as to increase the income accruing in one tax jurisdiction as opposed to another. This is usually done in order to reduce tax payments in the group as a whole, but can also be done in order to move funds out of a country with capital controls, or in order to make a subsidiary seem less profitable and thus avoid regulatory interference. See Plasschaert (1994).

²¹ Corporation tax paid overseas can be credited against a firm's domestic tax bill if there is a DTT in place. The higher the proportion credited, the greater the incentive to pay tax overseas. This system thus has an important potential for generating fiscal support to developing countries.

industrial countries operate “worldwide” taxation systems that combine elements of both principles. An international taxation system where each jurisdiction applied a single principle (source from the point of view of most developing countries) and tax rates were equal would be simpler for both tax administrators and multinational firms, requiring less information and avoiding double tax problems. However, it is difficult to see how such a solution could be implemented in practice. The United States is unlikely to change its own tax system simply to increase the tax take of other countries. Prospects for reform are somewhat greater in the EU as a result of current efforts to harmonize corporate tax rules within the single market and the emerging agreement on the prevention of tax competition and tax evasion between member states—though even these efforts do not provide much of a basis for international tax reform.

The most promising prospect for reforming tax administration may be provided by the drive for better co-ordination among national tax authorities to tackle organized crime and money laundering. Both banks and regulators have come under strong pressure to share information on financial transactions as part of this crime-fighting effort and, in the process, divulge the overseas assets of residents in a particular tax jurisdiction. The problem of tax evasion (in the sense of the failure to declare taxable income) through the use of tax havens will not be fully eliminated until the legislative status of these havens is reformed (especially their strongly defended secrecy rules). Most tax havens are vulnerable to political pressure from their larger “guarantor” states. The OECD is already generating such momentum by pressure for the enactment of “blacklists” of tax havens, which fail to meet basic disclosure and co-operation requirements vis-à-vis other tax and criminal jurisdictions. Investors reporting trade or financial transactions through blacklisted jurisdictions would be required to produce detailed information and satisfy other requirements for other tax authorities.²²

A multilateral tax agreement would not only improve the fiscal revenue position of developing countries and reduce the attractiveness of tax incentives to foreign investors. It would also strengthen the effort to combat money laundering and financial fraud. However, the likelihood of an agreement on a comprehensive system of multilateral tax administration is low. Thus the application of DTTs in support of developing countries (possibly as a joint EU initiative) and the extension of agreed OECD principles to non-members (such as those on administrative assistance or harmful tax competition) are probably the only viable basis for investment-related tax co-operation.

3. New Proposals for Competition Rules

In a globalizing world, where single companies may have a very large market share in certain sectors, there is a clear need for more effective national and international arrangements to reinforce competition.²³ Regional laws and framework agreements on competition policy can be an important option for smaller states, both in terms of administrative cost and economic circumstance. Small countries may only be able to sustain one firm in a sector or even in large

²² See OECD (1998).

²³ See Graham and Richardson (1997).

areas of economic activity, and thus rely on external competition to ensure a competitive domestic market.

A multilateral framework agreement on competition principles could help reinforce effective competition by increasing predictability and strengthening confidence in the stability and fairness of the market system. There is a growing consensus that these issues need to be addressed in an international context.²⁴ The EU and many other governments believe that the WTO is the most appropriate forum for negotiation of an agreement, which could identify principles and modalities for co-operation on cross-border and international matters, in particular on international cartels and restrictive practices by multinational enterprises. The interaction between inward investment and market structure was recognized in the services negotiations of the Uruguay Round.²⁵

However, the Marrakech Agreement establishing the WTO and the associated agreements, understandings and declarations do not provide any generally applicable rules for national competition policies; although a number of WTO accords make reference to competition policy and related issues in specific contexts.²⁶ The EU has proposed that negotiations on competition policy should form part of any new round of multilateral trade talks. However, this suggestion was strongly resisted by US officials at the WTO Third Ministerial Conference in Seattle, on the grounds that the market inefficiencies, which a competition policy agreement might solve are not yet well defined. The existence of hard-core international cartels could, in principle, provide the foundation for a WTO agreement on competition issues. However, discussions of this subject in the WTO Working Group on the Interaction Between Trade and Competition Policy have been notably short of concrete examples and, when real examples are produced, they tend to be based on actions against international cartels launched by *national* competition authorities.

The United States and the EU established a bilateral agreement on the application of competition law in 1991. However, the EU-US bilateral agreement does not provide a hopeful precedent for an effective WTO-based system. Only its procedural provisions are binding, not the substantive ones. It does not contain binding rules on jurisdiction and it does not preclude extra-territorial action.²⁷ The EU has sought to negotiate binding rules in these areas, but its proposals have been rejected by the United States.

In the event of a merger, multinational corporations often need to obtain clearance in several different jurisdictions. The companies would prefer to deal with one authority rather than several.²⁸ There is arguably a good case for an arrangement among national competition

²⁴ See OECD (1999).

²⁵ Article VIII of the GATS stipulates that monopolies and exclusive service providers must not act in a manner inconsistent with WTO member obligations under the agreement. Article IX provides for consultations over restrictive business practices. The Agreement on Basic Telecommunications Services implemented these GATS safeguards in the telecommunications sector when WTO members undertook specific commitments with respect to competition policy.

²⁶ See WTO (1997a).

²⁷ Where the United States acts against alleged breaches of US antitrust law even though the breach occurs outside the United States and all the relevant parties are foreign.

²⁸ The so-called "one-stop shop" approach—see WTO (1997b).

authorities that would allow multinational firms to seek worldwide clearance from just one, which would then be recognized by others. Initially, a plurilateral accord might cover only a few major economies, but other WTO members would be free to join if they are able to do so and see advantages in it for themselves. However, this is not what the EU is proposing: the European Commission wants a fully multilateral agreement, which all WTO members would be obliged to sign.

About half of the WTO member countries, mainly developing ones, do not have any competition law at present.²⁹ The EU believes that many of these countries would benefit from the adoption of competition disciplines, helping them attract foreign investment and improve the allocation of domestic resources. A fully multilateral agreement would require them to introduce and enforce effective competition policies. In this sense, the European view is that a multilateral pact would force developing countries to act in their own best interests. However, this confuses the case for persuasion with the case for compulsion.

The provisions of the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) would seem to be a fairly effective mechanism for ensuring compliance with current and future competition decisions. Where a complaint is made and the respondent fails to comply with the recommendations of a dispute settlement panel, the complainant may be authorized to withdraw a commensurate amount of concessions from the respondent. The prospect of cross-retaliation (and the possibility that several aggrieved WTO members would take action in concert) would be a very effective sanction against non-compliant behaviour if international investment rules were brought within the WTO system. However, the WTO could not offer dispute resolution in investor-state as opposed to state-state disputes—unlike NAFTA. WTO provisions are only binding on governments, which are the only parties with legal standing in dispute settlement proceedings. Even though private rights of litigation might be desirable in extreme circumstances, it is unlikely that WTO proceedings would or could be altered to accommodate this.

The EU proposals go far beyond the restraint of extraterritorial action (principally by the United States) in holding that all WTO members should adopt a comprehensive competition law. There would be common approaches on anti-competitive practices with a significant effect on international trade and investment—such as “hard-core” cartels, criteria for assessment of “vertical restrictions” on suppliers or distributors, or abuses of dominant market positions, principles for co-operation of export cartels and international mergers. There would also be provisions on notification, consultation and surveillance in relation to anti-competitive practices with an international dimension as well as exchanges of non-confidential information. The WTO dispute settlement provisions would be used to ensure that domestic competition law and enforcement structures are in accordance with the provisions agreed multilaterally.

Japan and a number of developing countries (mostly in East Asia) support the EU position, but the countries in this group may have very different reasons for supporting competition

²⁹ See UNCTAD (1999b).

negotiations. Moreover, US officials remain deeply hostile. The US Department of Justice fears that a multilateral compromise would take a lowest common denominator approach, diluting its own rigorous stance toward antitrust enforcement. In contrast, the US Department of Commerce and the Office of the United States Trade Representative are opposed to the idea of multilateral negotiations on competition policy because they believe that Japan and several other Asian countries would use the talks to re-open the related issue of anti-dumping law, which has been extensively used by the United States to protect its own industries from international competition. The United States will try to ensure that this subject is kept off the agenda of any new round of negotiations.

4. Codes of Corporate Conduct

In the 1960s and 1970s, most of the pressure to regulate the business practices of firms with global operations came from developing countries. However, the current corporate responsibility movement, and the renewed popularity of codes of conduct and other voluntary arrangements, are driven by constituencies in the advanced economies.³⁰ International norms and declarations aimed at protecting the human and labour rights and the environment include the Universal Declaration on Human Rights, various protocols drawn up by the United Nations and the International Labour Organization (ILO)³¹, and the OECD Guidelines for Multinational Enterprises. However, none of these instruments is directly binding on companies.³² They do impose binding obligations on governments in some instances, but few governments have tried to enforce these undertakings on private firms.

Moreover, the social and environmental dimensions of international investment have become intensely controversial in recent years, mainly owing to the activities of non-governmental organizations (NGOs) in campaigning against the alleged abuses of multinational corporations.³³ It is a relatively uncontroversial proposition that transitional and developing countries should not use the relaxation of labour and environmental standards to attract or retain foreign investment. However, it remains far from clear how to make obligations relating to labour and green standards binding, or subject to dispute settlement procedures. Many countries have also expressed concerns about WTO intrusiveness into the affairs of sovereign governments, particularly in the environmental and health and safety areas. Nonetheless, in both the United States and, to a lesser extent, in the EU there is strong pressure from domestic legislators and labour unions to ensure that any future agreement contains some form of safeguards in these areas.

In contrast, developing countries are determined to resist any linkage between trade liberalization and social issues, for both good and bad reasons. On the one hand, small firms (which provide the bulk of employment) in developing countries would find international

³⁰ See Fatouros (1994).

³¹ See United Nations (1988) and ILO (1991).

³² An exception is the US legislation on bribes paid abroad to public officials by US corporations, although the enforcement mechanism seems to be fiscal in nature insofar as "agency fees" may not be set against tax.

³³ See UNCTAD (1999a).

standards too expensive and thus be forced to close down, while many poor households rely on child labour to make ends meet. On the other hand, large firms and employers' associations in developing countries have a clear financial interest in not applying modern labour and environmental standards even if they could afford them, and are eager to cite developmental reasons to support their position. They will press to keep labour and environmental issues outside any multilateral investment agreement. WTO agreements that will have a substantial impact on the internal economies and regulatory policies of member countries therefore need a strong justification—either in terms of their benefits to the trading system or in terms of gains that they will create for members which could not be obtained unilaterally.

The governments of developed countries have encouraged self-regulation by the private sector as part of a broader effort to reduce state intervention in the economy and cut the burden of regulation on business. Officials are also keen on private sector initiatives as a means of countering a political backlash against globalization and deflecting pressure to advance social and moral agendas more forcefully through international institutions with proven enforcement powers—notably the WTO dispute settlement mechanism. For the business sector, voluntary undertakings to improve environmental and social practices are not so much proactive measures as a defensive move to forestall emerging demands from social groups for governments to step in with mandatory regulation.³⁴

The OECD has recently completed a revised version of its 1991 **Guidelines for Multinational Enterprises**, which contain standards and principles of good conduct for international businesses.³⁵ The 1976 Declaration by the Governments of OECD Member Countries on International Investment and Multinational Enterprises was intended to improve the climate for inward investment. It also sought to encourage multinational enterprises to make a positive contribution to the countries in which they operate. All OECD members, as well as some non-OECD countries and the EU, have subscribed to the declaration. It consists of four elements each underpinned by an OECD Council decision. The Guidelines for Multinational Enterprises are one of these elements (others deal with the treatment of foreign enterprises by governments and the avoidance of conflicting requirements on multinational firms).

However, observance is voluntary and not legally enforceable. The 2000 guidelines cover a range of issues, including employment and industrial relations, disclosure of information, science and technology, and environmental protection. The relationship between business and the environment received only limited attention in the 1991 version of the guidelines, which were drawn up at a time when the nature of the relationship was not thought to be particularly problematic. Enterprises were simply advised to “take due account of the need to protect the environment and avoid creating environmentally related health problems”.

³⁴ Corporations often feel compelled to offer voluntary commitments in the wake of accidents, scandals and other negative publicity, such as the accidental release of toxic chemicals from a Union Carbide subsidiary plant in Bhopal (India) in 1984, the massive Exxon Valdez oil spill in 1989, and allegations that Shell Oil was complicit in environmental and human rights abuses in Nigeria.

³⁵ See OECD (2000).

The 2000 version illustrates just how far the business and environment debate has moved in the last ten years. The proposals have been influenced by international negotiations, growing public concern about the environment and possible future environmental problems. The second draft emphasizes the importance of sustainable development, in both the general introduction and the specific section on the environment. The guidelines argue that multinational enterprises have a vital role to play in achieving this goal: they are encouraged to adopt an environmental management system (EMS), reflecting the growing interest throughout the 1990s in EMS standards such as ISO14001. The overall message is that environmental responsibility is good business practice and makes financial sense, so there is no fundamental conflict between the activities of multinational enterprises and environmental protection.

However, a more detailed reading of the guidelines reveals major problems. The OECD commitment to the interests of multinational enterprises is clear in the draft guidelines, and although consultation is endorsed, a wider agenda of participation is not. It is clear that in this area the OECD has not engaged with those campaigners who have been arguing that companies should involve a wider variety of stakeholders meaningfully in decision making. The draft is equally cautious in the area of scientific and technological risks. It suggests that decision making should be based on “foreseeable” impacts and a “scientific and technological understanding of risks”. Where there are potential risks, it argues that multinational enterprises should “not use the lack of full scientific certainty as a reason for postponing cost-effective measures to prevent or reduce such damage”. This is a very weak version of the precautionary principle.

The damage to a firm’s reputation, the need to improve community relations in host countries and the prospect of more stringent government regulation can all provide companies with a powerful incentive to overhaul their business practices.³⁶ Nevertheless, businesses hope that such commitments will reduce the pressure on governments to regulate industry directly, or use trade sanctions, enforced by the WTO, to underpin labour and environmental rights. Corporations with international operations remain strongly opposed to attempts to make international trade conditional on the observance of minimum standards of environmental protection and labour rights. Voluntary codes are not considered to be a substitute for legislation at the national level, but may be attractive to large international firms at the international level in order to reduce pressure from international activists. The main incentive appears to be the protection of brand value.

However, until companies that make commitments to socially responsible production can point to more tangible rewards, the business community’s attitude toward such commitments will remain somewhat ambivalent. Private approaches to social regulation try to work through the market mechanism by providing companies with a financial incentive to improve working and

³⁶ For example, the International Federation of Football Associations (FIFA) negotiated a code of conduct with the International Textiles, Garment and Leather Workers’ Federation covering contractors and subcontractors in the soccer industry, after the sports body was confronted with evidence that children under the age of 14 were being employed in Pakistan to stitch soccer balls. Adidas, Mattel and other well-known producers of toys, apparel and sporting goods have also made enhanced commitments about labour standards after being implicated in child labour and sweatshop scandals in developing countries.

environmental conditions in developing countries. The assumption is that if demand and consumption patterns can be changed in favour of goods produced or sourced in a socially responsible way, the marketplace will induce manufacturers to provide what consumers want. The actual impact of private regulation initiatives (such as labelling schemes) on the market depends thus on the general level of issue awareness among consumers and investors, and their willingness to make respect for human rights, labour standards and environmental protection relevant criteria in their purchasing decisions.

Activism by NGOs, calls for product boycotts by consumer associations and media coverage of corporate misbehaviour have all contributed to a higher level of consumer awareness and helped mobilize the public to use its purchasing power in favour of socially responsible conduct. Activists have also begun to use sanctions against companies that have subscribed to social and environmental principles and then failed to implement them in practice. In addition to generating negative publicity and organizing consumer boycotts, activists have forced the exclusion of member companies from trade associations and even instituted legal proceedings under laws protecting consumers from false advertising. Nonetheless, this activism has had much less market impact than the mass consumer reaction to concerns about the safety of genetically modified (GM) organisms, which has had a major adverse impact on the sales of companies that produce GM foods or retailers that put GM produce on their shelves.

There is only limited empirical data comparing the performance of socially responsible companies with their more conventional counterparts. Empirical studies suggest that socially responsible behaviour can be translated into a competitive advantage more readily in countries where there is a generally high level of awareness among the population about social and environmental issues. In countries like Sweden, where there is strong support for environmental protection, products carrying an environmental label seem to have gained market share at the expense of unlabelled ones. Labels presumably help companies capitalize on their environmental responsibility and turn it into market share because they allow consumers to identify and recognize environmentally friendly products quickly and easily. However, in some countries, labelling schemes have not had any discernible effect on market share. Even in countries where labelling schemes have a significant effect, eco-labelled products still have only have a niche position.³⁷

A small but rapidly growing number of US investment funds now screen companies for their corporate environmental practices and how they treat their employees worldwide (a practice usually referred to as ethical or social screening).³⁸ Socially responsible investing has also attracted attention in Canada, the United Kingdom and other European countries. Funds that

³⁷ The market share for “fairly traded” goods (usually commodities and craft items carrying a logo certifying that they are sourced directly from poor producers in developing countries) is also relatively limited. In Europe a small market share has been established, but is mainly based on solidarity rather than quality; while in North America, these products are only slowly making their way into supermarkets.

³⁸ In the United States, the inflow into ethical investment funds has risen by more than 80 per cent since 1997: about 20 per cent (some \$2 trillion) of all investment fund assets took this form in 1999. In Japan, the first investment trust specializing in firms with high environmental management standards was introduced in August 1999, and attracted more than 100 trillion yen in just three months.

pick companies on ecological and other ethical criteria have generally performed well, but they seldom show higher returns than unspecialized ones. Shareholders have become more active in demanding greater transparency and accountability about labour and environmental practices. However, there is no sign that ethical investors have reached the critical mass and level of organization that would enable them to influence equity prices, either by forcing down the stock prices of companies with poor practices, or rewarding socially responsible companies with a higher market valuation.

5. The Prospects for Change

In sum, codes of conduct (and by implication all voluntary initiatives) have two weaknesses. First they should cover the entire sector to be effective, in order to prevent the “free rider” problem, and this must contain an element of compulsion. Second, there must exist some plausible penalty for breaking rules – and such penalties can only be applied by governments or by legislation that empowers civil organizations, such as trade associations, to put them to use. In other words, there is a need for international standards on labour and environment to be supported by intergovernmental agreements—as are property rights, tax liability and competition rules (however imperfectly)—if they are to be effective. Reliance on the presumed effect on asset (brand) value of consumer awareness of production conditions in developing countries is hardly sufficient.

There is thus no doubt that some form of international regulation of international business is necessary. However, the process of constructing a global regulatory system is slow and lopsided. The interests of corporations are backed by major states, which are also under pressure also from their own consumers, unions and NGOs. Any progress will be the result of conflictive negotiations between the United States and the EU, with developing country interests (particularly those of smaller poor countries) being marginal. The voice of developing countries could be stronger, with a clearer view and united front, although they, too, respond to domestic conflicts between business and other interests.

Property rights are likely to be strengthened through future WTO rules, although these are unlikely to include the right to establishment or the right to appeal directly to international tribunals. A reasonable basis for approaching this topic is that if property rights are to be guaranteed internationally, then “property obligations” should be as well. The EU initiative to include investment in the Millennium Round with an explicit “development dimension” thus presents a vital opportunity to define what would be in effect a “global social contract”, rather than merely negotiating a set of concessions on transition arrangements for developing country accession to agreed investment disciplines.³⁹ The linkage to the accepted need for co-operation on tax and competition issues should be made explicit. However, the logical step of establishing multinational corporations as judicial persons under international law is still a long way off, despite the institutional reality of the global economy.⁴⁰

³⁹ As was the case in the Uruguay Round.

⁴⁰ Not least because international private law does not, of course, exist.

The danger, of course, is that not only are these property rights not balanced by obligations as they are at the national level, but also that some of these rights may in fact be undermining social, labour or environmental standards—that is, rights claimed by other groups in society.

Tax co-operation is driven by the need of OECD states to maintain their fiscal base on the one hand, and the desire to combat international crime on the other. However, developing countries have much to gain from a multilateral system, in terms of both greater income from multinational firms and the effective taxation of their own capital base. The negotiating problem here is how to adapt a developed country initiative to a development objective. In the longer term, international tax rules would help to regulate transnational firms, through both the collection and exchange of information, and the potential for the design of developmental incentives. Here again, the process of fiscal harmonization and co-operation *within* the EU has led to both the political initiative and the administrative model for wider international tax co-ordination, from which developing countries could benefit substantially.

International competition rules are at an early stage, although they are clearly needed for highly concentrated global sectors such as telecommunications, airlines or even banking. The interest of developing countries (particularly the larger ones) is not entirely clear, as competition rules would expose their own companies to more competition. However, if they are obliged to open up their domestic markets to foreign firms, then they would benefit more from the comprehensive approach proposed by the EU (particularly as they would be included in the negotiations) than by the present *de facto* unilateral pressure from the United States. For the smaller developing economies, a set of clear and binding international competition rules (including “like circumstances” conditions) would enable them to deal more effectively with foreign firms that enjoy effective local monopolies. Again, the dynamic for such rules is provided by negotiations between the United States and the EU, with key developing country players such as India and China still taking a bilateral rather than multilateral approach to the issue.

In this light, the present “voluntary” approach to codes of conduct on labour and environmental issues is somewhat anomalous. The fear of loss of asset value may be an effective constraint on companies with significant brand image and a large consumer base in the United States or the EU, but it cannot be used as a general principle. In particular, this does not seem to be an appropriate basis for regulating large national firms in developing countries. Moreover, relying on consumers in Northern markets to ensure the compliance of all international firms in the South would mean that the pattern of enforcement would be variable over time and inconsistent between sectors and countries.

Voluntary approaches even *within* developed countries have a number of drawbacks from a public policy perspective. The most significant problem with using voluntary instruments is that it is not possible to guarantee the desired outcomes. For this reason, voluntary instruments are unlikely to be used in situations that involve serious public health issues or where urgent action is needed and targets must be reached quickly. Moreover, free-riding firms that benefit

from the scheme without bearing its costs can undermine the integrity of most voluntary instruments. Covenants between industry sectors and public authorities may thus only be useful where there is a strong trade association that can deliver the involvement and compliance of its members, or where a sector comprises a small number of large firms and peer pressure can achieve the same objective.

An alternative to multilateral regulation of firms that is often proposed by activists is that *domestic* legislation in OECD countries should be introduced in order to require multinational firms headquartered there to observe certain standards of conduct.⁴¹ The only advantage of this approach would be that local lobbying might produce results in the short term. However, there are at least three serious disadvantages to this approach. First, this would lead to different legislation in each home OECD country, and thus to varying standards applied by the corresponding foreign firms in any one host developing country. Second, multinational firms could easily avoid such domestic legislation by moving their legal head office offshore. This problem underlines the need for fiscal action against offshore centres discussed above. Third, there seems no reason to apply high standards to the affiliates of multinational firms in developing countries, but not to apply them to domestic firms of similar size, which usually have much more impact on local stakeholders—and often apply even lower standards. In sum, the logical approach would be to adopt multilateral legislation, and then to exempt small firms on a national basis under the “like circumstances” principle⁴² where appropriate.

The necessary linkage between private property rights with social obligations to both the state (i.e., taxation to provide public goods) and local stakeholders (workforce and local community) is recognized and applied in all modern democratic market economies.⁴³ Construction of a similar international linkage is still a long way off and would have to overcome the hurdle of recognizing the existence of firms as juridical persons under international law. None the less, there are some signs of progress in the recognition of international firms as subjects of international law. This is most apparent in the area of corruption and narcotics, where extraterritorial legislation implies the recognition of foreign firms. There is also a precedent in the access of firms to intergovernmental dispute procedures in a number of plurilateral treaties. Finally, some elements of international customary law also place obligations on corporations in areas such as the abuse of human rights.⁴⁴

The importance of the EU to this debate is that these issues have to be defined explicitly *between* member countries as economic, social and policy integration proceeds and even accelerates.

⁴¹ See, for instance, Mayne (1999).

⁴² At the core of all investment agreements is the principle of national treatment, which in turn implies non-discriminatory treatment of foreign and domestic investments “in like circumstances”. This would limit the application of the national treatment obligation to investments that are alike in legal and factual terms with respect to the characteristics of the investment, the sectors involved and the circumstances in which the investments were made. See, for instance, GATS Article XVII, where the treatment of foreign firms can be materially different from that of national firms if the situation of foreign firms is not comparable, as is in fact the case in many service industries.

⁴³ Indeed, under the feudal system ownership of land was conditional upon the provision of military service to the crown and of justice to the local population.

⁴⁴ See ICHRP (2001), which argues that corporations are explicitly subject to recent international human rights law arising from war crimes legislation.

There is then a presumption that these international principles should be applied more widely, to the benefit of developing countries. In the coming decade, the economic recovery of the EU and Japan relative to the United States on the one hand, and the increasing regional co-operation with Europe, Asia and the Americas on the other, should create opportunities for this type of discussion.

Conclusions

It is clearly incorrect to regard large international firms as effectively “unbridled”. There already exist strong measures between OECD countries to regulate these firms in the fields of investment rights, tax burdens and competition rules. The problem is that these systems have not yet been extended to cover developing countries in a way that supports development. There is thus an urgent need to define what a desirable regulatory regime might look like from the point of view of both middle-income and low-income developing countries.

There are sufficient elements already in place to support a practical argument for a comprehensive multilateral approach to the regulation of international firms. This would balance the interests of large international firms in the protection of property rights and simpler merger procedures on the one hand, with those of governments in tax and competition policy, and those of local stakeholders in labour and environmental standards, on the other. This would be of particular benefit to the least developed countries that are still effectively excluded from international investment flows.⁴⁵

In terms of the international political economy of change, much depends upon the response of the major powers to globalization itself. The EU in particular has had to work out the cross-border regulatory rules (“mutual recognition agreements”) and social obligations (the *aquis*) that affect corporations within the single market, and is thus in the best position to take this issue forward—albeit slowly. Meanwhile, thinking about what type of international business regulation would be in the interest of developing countries in general, and poor households in particular, is a worthwhile exercise. The ability to draw on ongoing progress in the three fields of global regulation based on international law would provide a far more realistic basis for debate than voluntary initiatives based on business ethics and brand image.

⁴⁵ See UNCTAD (2000b).

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