RESEARCH NOTE

International regulation of transnational business: providing the missing leg of global investment standards

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The regulatory framework for transnational corporations (TNCs) is changing as national laws become less restrictive and bilateral and multilateral negotiations attempt to coordinate legal standards and practices. The international system, however, still lacks an agreed set of investment principles to shape and guide this evolution. Proliferating partial agreements can result in a confusing regulatory kaleidoscope, leading to greater conflict between Governments and TNCs. Developing a broad framework for international investment would help stabilize the global economic system while giving direction and coherence to the regulatory environment facing transnational business.

Scholars have long recognized that the emergence of TNCs in the post-Second World War era posed unique challenges for national Governments. These enterprises were directly subject to each nation's authority where they operated, yet appeared fully controllable by no single political sovereign. Multinationally located and transnationally integrated operations yielded resources and options unavailable to solely national firms, giving TNCs more independence from a local government's policy direction. During the 1960s and particularly the 1970s, clashes arose between TNCs and national authorities, and between the "host" and "home" Governments of these enterprises, over a range of regulatory issues affecting TNC operations.

A multilateral resolution of investment controversies proved elusive without a firm international agreement on global investment principles. The 1948 Havana Charter and its proposed International Trade Organization foundered on a dispute over compensation for expropriated foreign properties. The post-war international economic order was therefore con-

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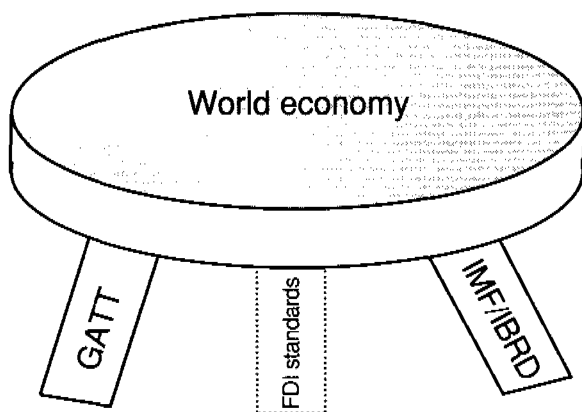
This article is based on a presentation given by the author at the Scanticon III Seminar, organized by the Transnational Corporations and Management Division and the Friedrich Ebert Foundation for the United Nations Second Committee Delegates, in Princeton, New Jersey, on 18-20 June 1992.

structed around the International Monetary Fund and the International Bank for Reconstruction and Development (The World Bank) to manage financial cooperation, and remnants from the International Trade Organization were gathered into the General Agreement on Tariffs and Trade to cover trade issues. This post-war structure can be represented as the two-legged stool depicted in figure 1. The missing third leg, needed to achieve true system balance and stability, reflects the absence of international agreement on foreign-direct-investment (FDI) issues.

Figure 1.



The 1980s radically altered the international economic scene, expanding the role and importance of FDI. Foreign direct investment grew faster than merchandise exports or average gross domestic product, with total FDI stock reaching $1.9 trillion by 1991. Investment decisions also increasingly influenced world trade flows. For example, 80 per cent of United States trade is undertaken by TNCs, while one third occurs on an intra-firm basis, within the same TNC organization (UN-TCMD, 1992, p. 200).

Financial crises and global recession in the early 1980s left most developing countries struggling under an unprecedented external debt burden, increasing their need but decreasing their attractiveness for FDI. Transnational corporations concentrated new investment in the "triad" of Western Europe, North America and Japan, but FDI flows shifted from their traditional pattern. Japan's FDI outflows accelerated, while European TNCs alternated between investing abroad and turning inward to prepare for the European Community's internal market reforms. The United States attracted massive FDI inflows, becoming the world's largest host nation as well as

remaining the largest home nation for TNCs. As the decade ended, communist regimes collapsed throughout Central and Eastern Europe, altering many nations' ideological hostility to private foreign investment and injecting a new factor into the growing competition for FDI.

Regulatory trends of the 1990s

Three trends mark the present evolution of international investment regulations: less restrictive national laws; proliferating bilateral investment treaties (BITs); and expanding regional and multilateral negotiations on FDI issues.

The passage of less restrictive national laws governing FDI is the most obvious and widespread change in the regulatory climate for TNCs in the early 1990s. Countries throughout the world now actively compete for the productive growth opportunities that accompany private foreign investment. In particular, developing countries are dismantling restrictive measures that discourage or discriminate against foreign investors, creating a more open and facilitative investment climate. Formerly communist nations are similarly rushing to formulate modern FDI regimes to attract private capital previously excluded for ideological reasons from centrally planned and controlled economies. The shift in both these regions is from highly statist economies with protectionist, import-substitution development strategies to open, freer market policies that emphasize export-led growth. This change magnifies the potential benefits from foreign affiliates that can link up with the firm's globally integrated distribution and marketing system.

Some commentaries depict the United States as an ironic exception to this liberalization trend. The longtime champion of open FDI policy has struggled recently to adjust to political, economic and social strains resulting from its new role as a major FDI recipient. Despite vigorous public debate and numerous proposed restrictions on FDI, however, the only new measures actually adopted are national security review mechanisms that are not uncommon in most other countries for foreign mergers and acquisitions (Wallace and Kline, 1992, pp. 34-44).

A related but less discussed element of national FDI policy is the potential for home country Governments to place restrictions on capital outflows. Economic slow-downs and increased international competition multiply domestic pressures to keep capital, technology and employment at home.

Although some Governments have created incentive programmes to encourage domestic-oriented research-and- production activities, few have resorted to overt distortions such as prohibiting or severely penalizing FDI.

The second significant regulatory change is the proliferation of bilateral investment treaties (BITs). These instruments are expanding in number and scope as a complement to less restrictive national laws. Initially negotiated in the 1960s between European nations and their former African colonies, these treaties more than doubled during the 1980s to over 400 (UNCTC and ICC, 1992). Most recent activity has involved Latin America, Central and Eastern Europe and the United States. United States BITs also introduced new commitments regarding entry and access conditions and proscriptions on trade performance requirements (UN-TCMD, 1992, pp. 77-78). Perceived as an important symbolic as well as substantive step in building an attractive FDI climate, bilateral treaties are likely to expand further. However, the different concerns, priorities and relative bargaining positions among treaty partners ensure that the resulting pattern of bilateral agreements lacks the overall coherence and consistency desirable for transnational business.

Third, FDI issues are also central to an expanding set of regional and multilateral negotiations. Regionally, the European Community's transformation from a common trade area into an internally integrated market involves forging common regulations on investment as well as trade and monetary issues. Although not intended as a fully integrated regional market, the United States–Canada Free Trade Agreement as well as the pending North American Free Trade Agreement both incorporate provisions addressing FDI standards and regulations.

Multilaterally, the Uruguay Round of Multilateral Trade Negotiations broached a number of investment issues for the first time. Trade performance requirements figure prominently among topics discussed as trade-related investment measures, while negotiations on trade in services and on intellectual property rights relate as much to FDI as to traditional trade debates (UN-TCMD, 1992, pp. 74-75). The outcome of these negotiations, including possible progress on investment-related topics, remains unclear in early 1993. Final results, however, will certainly not represent more than a first step in formulating a multilateral accord and expanding cooperation on these issues. Additionally, although GATT includes most of the world's trading nations, new agreements are increasingly limited in their coverage

by the shift from traditional most-favoured-nation principles to conditional reciprocity as the basis for inclusion in an agreement.

The Organisation for Economic Co-operation and Development (OECD) has the most successful record in forging multilateral agreement on international investment issues. An initiative now under consideration envisions developing a broad new investment instrument that incorporates and builds on OECD's early capital-liberalization codes, as well as its 1976 Declaration on International Investment and Multinational Enterprises. These accords mix binding multilateral obligations with statements of policy goals and include a governmentally-endorsed set of voluntary guidelines for TNC behaviour. Further progress by OECD is desirable.[1] Nevertheless, the relatively similar perspectives and objectives of that organization's industrialized country members, compared with those of the full global community, limits any likely accord's utility for addressing the complete range of TNC issues.

In 1992, the Development Committee of the World Bank undertook a new effort, studying existing legal instruments governing FDI at the national, bilateral and regional levels. The Committee then considered a draft set of "Guidelines on the Treatment of Foreign Direct Investment". These guidelines focus on the legal treatment of FDI, with the objective of improving the investment climate and encouraging greater FDI flows. The Development Committee has called these guidelines to the attention of member Governments. The World Bank's Multilateral Investment Guarantee Agency (MIGA) and the International Center for Settlement of Investment Disputes (ICSID) also provide practical services useful in structuring the relationship between foreign investors and host Governments.

The United Nations addresses TNC issues, most generally through the work of its Commission on Transnational Corporations, but also in topical actions taken by organizations including the United Nations Conference on Trade and Development (UNCTAD), the International Labour Organisation (ILO), the World Health Organization (WHO) and the United Nations General Assembly's consideration of issues such as consumer protection. The mandate of the Commission on Transnational Corporations included the most comprehensive international attempt to formulate a Code of Conduct that would address both government and corporate rights and responsibilities on FDI issues. Begun in the virulent atmosphere of the mid-1970s, this

[1] See, Guertin and Kline, 1989. See also OECD Secretariat Note, "Feasibility study of a wider investment instrument", 19 November 1992.

exercise was judged politically deadlocked in 1992, despite achieving substantive agreement on most elements of a possible code.

Failure to break the political impasse on the Code leaves the United Nations system and, indeed, the world community, without an umbrella set of FDI principles to connect and shape the diverse and still-growing array of particularistic accords emerging from bilateral, regional and multilateral settings. This lack of progress in the United Nations also tends to disenfranchise many (particularly developing) countries, leaving them isolated at the margins of discussions on FDI issues that will nevertheless importantly influence their future development potential. Equally troubling, the resulting international regulatory environment for transnational business threatens to become a morass of binding and non-binding partial instruments that overlap on some issues while leaving broad areas of FDI policy and transnational business activity uncovered by effective regulations or guidelines.

The regulatory environment for transnational corporations

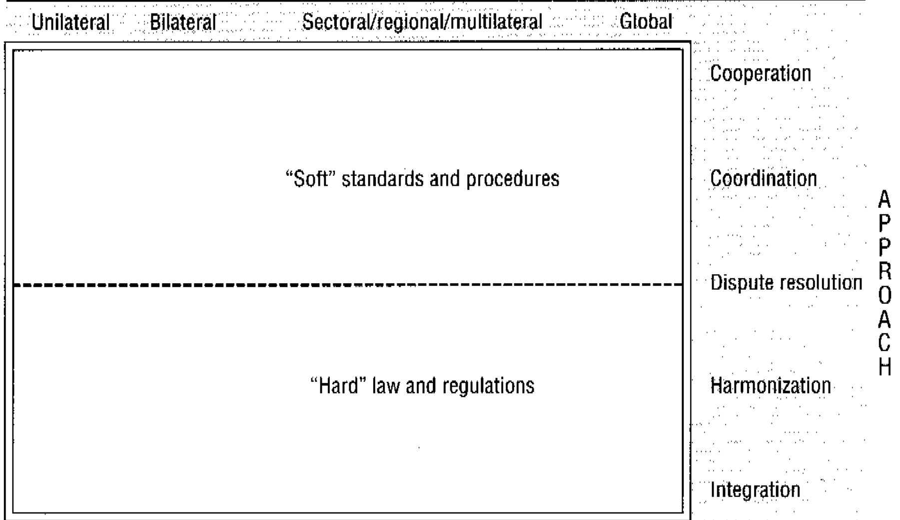
The term "regulation" generally implies the use of legally-binding rules enforceable by governmental authority. Transnational business, however, operates in a regulatory environment populated by both "hard" (binding) laws and regulations, and a variety of "soft" (non-binding) standards and procedures.[2] As depicted in figure 2, these measures can be arrayed along a horizontal dimension based on their scope of geographic coverage, beginning with unilateral national actions and running through bilateral and regional accords to truly global agreements.

On the vertical dimension, "soft" and "hard" approaches divide roughly along a middle axis. Binding instruments typically specify the detailed basis for actions ranging from dispute settlement to policy harmonization to full economic integration. Non-binding measures encompass a class of more general agreements. These instruments outline broad standards or processes to enhance cooperation and coordination among concerned parties, up through arrangements providing for dispute settlement procedures.

This concept is elaborated in figure 3, which identifies selective agreements or groups of regulatory measures that populate the international business environment. For example, national laws are binding unilateral instruments that provide the basis for a country's economic integration. The European Community is the most advanced example of regional regulation

[2] See Adelman (1988), especially chapters 1, 2 and 10.

Figure 2. Regulatory environment: type of coverage

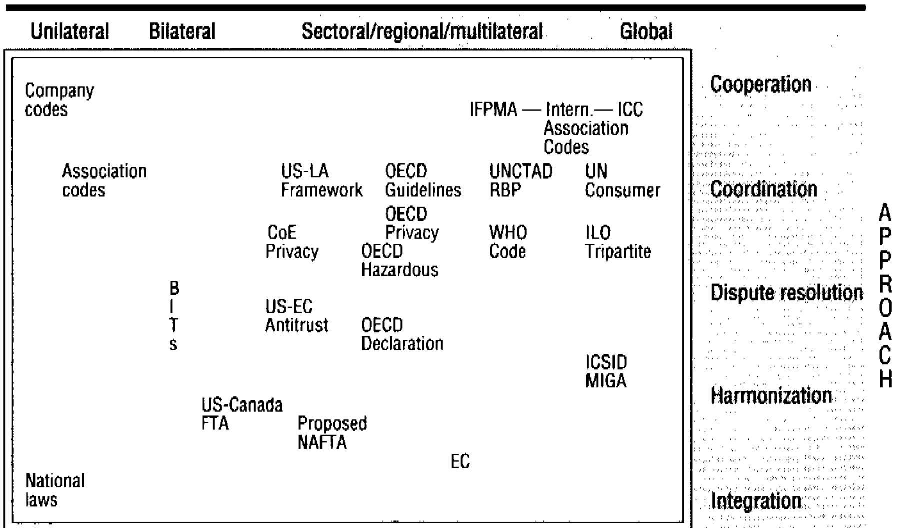


that has moved from policy harmonization towards full economic integration, most recently through enactment of the 1992 internal market reforms.

The United States–Canada Free Trade Agreement provides a contrasting example, restricted geographically to a bilateral instrument and focused on a more limited range of policy harmonization. In comparison, the pending North American Free Trade Agreement (NAFTA) is a regional accord that addresses a somewhat expanded issue agenda but still falls closer in approach to dispute resolution than to the European Community's example of economic integration. On the other hand, most BITs barely reach the dispute settlement line, dependent on a limited range of agreement on FDI policy principles. The United States–European Community antitrust accord aims to reach dispute settlement procedures on a multilateral scale, while ICSID and MIGA provide global mechanisms that help ameliorate or resolve investment disputes.

The 1976 OECD Declaration combines several agreements that build on earlier accords but is probably best described as advanced multilateral policy coordination rather than substantive policy harmonization. The OECD and Council of Europe's accords on privacy and the OECD agreement on the transport of hazardous substances are more limited, function-specific examples of procedural coordination on a multilateral scale.

Figure 3. Regulatory environment: coverage by instruments



Regionally, recent framework agreements between the United States and Latin American nations suggest policy cooperation and coordination, but in reality constitute little more than a commitment to discuss policy issues and problems in an amicable manner.

In addition to traditional international accords, a host of new soft law standards appeared beginning in the mid-1970s. Sparked by the rise of TNCs, these instruments often outlined voluntary standards for corporate good conduct as well as governmental policies towards TNCs. The OECD Guidelines for Multinational Enterprises, a part of the 1976 OECD Declaration, remain the most extensive of these instruments. Aimed at improving TNC policy coordination and cooperation among the industrialized countries, these multilateral Guidelines break with tradition by addressing themselves directly to TNC behaviour rather than dealing solely with national regulation of corporate activity. Although not meant to supersede national law, they do call for business conduct exceeding corporate legal obligations in areas where insufficient political consensus exists to support a binding multilateral accord. The Guidelines depend on voluntary adherence backed by public suasion to influence corporate behaviour.

A number of other multilateral and international agreements adopted a similar approach. Included among these instruments, which address specific

areas of corporate conduct, are the UNCTAD Code on Restrictive Business Practices, the United Nations Consumer Protection Guidelines, the WHO Code on the Marketing of Breast-Milk Substitutes, and the ILO Tripartite Declaration on TNCs and social policy.

Along with governmentally-endorsed voluntary standards, self-regulation plays an important role in framing the regulatory environment for international business. Several international business associations promote codes of conduct, including those adopted by the International Chamber of Commerce (ICC) and by sectoral associations such as the International Federation of Pharmaceutical Manufacturers Associations (IFPMA). National business and professional associations also formulate codes of conduct for their membership. Finally, individual company codes constitute the most applied form of unilateral, voluntary self-regulation by TNCs.

These selected instruments, arrayed around the regulatory environment depicted in figure 3, illustrate the expanding maze of mandatory and voluntary mechanisms that confront contemporary transnational business. A single TNC's operations can be affected simultaneously by many, if not most of these measures, as well as by numerous other regulations not specifically cited in this article. Both gaps and overlaps appear throughout this regulatory fabric because the various instruments lack consistency and coherence. No agreed global framework on FDI principles exists to help gather and channel these disparate elements into a supportive structure for transnational business policy.

Assessing an evolving regulatory picture

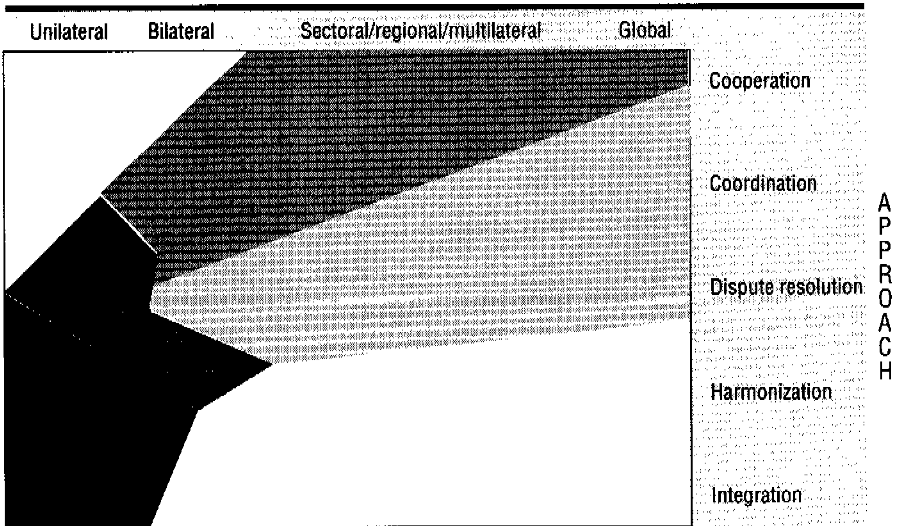
Figure 3 usefully locates selected examples of regulatory instruments within the global environment, but it does not give an accurate reflection of their prevalence. The shading in figure 4 depicts the relative frequency and scope of these instruments' use, with the darker areas representing the more numerous examples. National laws, of course, still comprise the bulk of business regulation. These measures are adopted unilaterally, aimed at controlling corporate actions within an integrated national economy. Although their numbers are increasing, regulatory instruments become more scarce as the spectrum shifts towards global coverage, concentrating in non-binding approaches as coverage becomes more general.

In figure 4, the bottom right corner (binding regulations providing for global integration) will remain empty unless some form of successful world

government arises. The opposite upper left corner contains at least several hundred individual corporate codes adopted by major TNCs during the late 1970s to early 1980s. Considering, however, that an estimated 35,000 TNCs now engage in international commerce, this instrument is still rather sparse in its coverage. The major interplay now seems to occur in the middle to the upper right corner, with the proliferation of devices from BITs through multilateral coordination mechanisms that address particular aspects of FDI-related policy.

Clearly no single regulatory approach will suffice for the foreseeable future. Policy harmonization can only proceed on a regional or multilateral scale as specific issues mature to the point where sufficient political consensus exists to reach a mutually agreeable outcome. As suggested by the slow pace of discussions on investment-related issues in the Uruguay Round negotiations, progress in this respect cannot be rushed. True policy harmonization requires substantive binding agreements on applied details. Until that point is reached, the world community must place renewed emphasis on practical mechanisms to reduce intergovernmental frictions and resolve disputes over particular policy differences.

Figure 4. Regulatory environment coverage



Corporate self-regulation can play an important role in this effort. Currently, the momentum appears to have dissipated from the drive to establish and apply voluntary business codes, either individually or through collective associations. This development is understandable given current global competition for FDI and concomitant governmental efforts to attract TNCs. Unfortunately, this conducive environment for FDI contains the seeds for its own demise.

Larger, traditional TNCs that were associated with controversies in the 1970s now generally operate in a more open and publicly-sensitive manner, consistent with their adopted corporate codes and a substantial, long-term commitment to the global economy. On the other hand, thousands of new, smaller TNCs have less accumulated stake in overseas locations and are under greater pressures to produce quick results. This scenario may lead enterprises to opt for short-term gains that can result from unresponsive or even abusive behaviour in relation to public policy goals and needs. Lacking an applicable set of transnational business standards, disappointment and frustration from unmet or misplaced expectations could again make national policy makers suspicious of TNC actions.

Extending effective corporate codes of conduct to cover these myriad of new players is a daunting but essential task for the international business community. The most practical way to accomplish this goal may be for the corporate community to work with governmental authorities to formulate a comprehensive voluntary code for transnational business. The OECD Guidelines could provide a good starting point for such a document, but a new exercise must be more inclusive, both in its geographic coverage and in the scope of issues considered. Many new TNCs come from non-OECD nations, and the countries most susceptible to potential controversies over TNC activity are developing nations and former central market economies that also lie outside OECD. Likewise, the range of issues relevant to contemporary transnational business demand a comprehensive approach and forum for their resolution, including matters such as environmental protection, product and worker safety, and the security of global financial markets.

The United Nations provides the most comprehensive, inclusive forum for reaching agreement on FDI principles and TNC operations. Unfortunately, the institution is burdened by the history of the politically deadlocked debate over the TNC Code of Conduct. Concern over "ghosts from the past" prevents involved parties from focusing on the new shape of global TNC activities and the FDI issues associated with them (UNCTC, 1990).

Despite the currently conducive climate for FDI, a framework of global principles is needed to guide investment relationships and TNC activities into the next century. Both public and private sector participants will be better off if the missing leg of global investment standards can be added to stabilize the regulatory structure that supports the world economy. An inclusive framework accord on FDI principles and TNC conduct standards could help meet this need. Such a goal is worth a new look and a new effort. ■

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