Rules for Multinationals: The Latin American Context

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At the present moment there seems to be a worldwide agreement that conflicts between multinationals and host countries do exist, that they are bound to increase in intensity in the near future, and that something must be done about it. Speaking on U.S.-Latin American relations earlier this year the U.S. Secretary of State singled out multinational enterprises as one of the key hemispheric problems. A senior economist from the Brookings Institution said last fall that the likelihood of international conflict on the issue of multinational corporations is growing sharply, and the clash of the national interests involved could become in the near future a central problem of world economics and politics. In Latin America and elsewhere in the developing world similar preoccupations are expressed by an increasing number of policy-makers, policy advisors, and public opinion-molders.

On the other hand, major home countries continue to disagree not only with developing but also with some developed host countries about the origin and the nature of conflicts and the ways to cope with them on the international level. In consequence, multinationals have become lately the subject of detailed studies and debates in many international meeting places. In all of these discussions host countries and many independent experts state directly or indirectly that there must be worked out some new "rules of the game" for multinationals, be they "principles of behavior," "guidelines," or a "code of conduct."

At the United Nations, after a Group of Eminent Persons had released last fall a report on "The Impact of Multinational Corporations on the Development Process and on International Relations," the U.N. Economic and Social Council set up the Commission on Transnational Corporations for the purpose, among others, of evolving recommendations that might lead eventually to a code of conduct for multinationals, protecting the interests of host countries, particularly developing countries. The United States, the largest home country for multinationals, expressed the most serious reservations about the content and recommendations of that report, and about its fundamental assumptions. The U.S. does not seem to share the opinion of the U.N. report that there is basically an adversary relationship between multinationals and the host countries, especially in the developing world, in which the economic power of the former is affecting seriously the weaker sovereign power of the latter. Neither, it seems, does the U.S. accept proposals of the majority of the U.N. Group of Eminent Persons that governments and the international community should redress this imbalance by taking steps to increase the bargaining power of developing host countries vis-à-vis multinationals.

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Within the hemispheric "new dialogue" there seems to be deadlock on the subject of multinationals between the U.S. and the Latin American and the Caribbean region. The latest U.S. position in this respect was officially presented by Secretary Kissinger in his Houston address in the following terms:

The U.S. is ready to adopt the following measures in respect:

Adopt a new declaration of principles that would regulate the treatment of multinationals and the technology transfer.

Create intergovernmental systems that impede and resolve the investment disputes and the problems that might emerge from these conflicts.

Establish new measures of cooperation for the purpose of facing the legal and jurisdictional problems related to the multinational enterprises.

Stimulate the private enterprises so that they make political and economic necessities of the countries in which they operate.

Latin America does not share the U.S. attitude that new intergovernmental systems are needed to resolve the investment disputes. It wants, on the other hand, to go beyond a mere declaration of principles that would regulate the treatment of multinationals and considers that new measures of cooperation should take the form of an international agreement spelling out a coherent set of rules of conduct for multinationals. Finally, Latin Americans postulate that general principles on multinationals included in the Charter of Economic Rights and Duties of States should form the basis for the hemispheric relations in that field.

The respective article of the Charter declares that each State has the right to regulate and supervise the activities of transnational enterprises that operate within their national jurisdiction and to adopt measures to assure that those activities are adjusted to its laws, regulations, and dispositions and that they are in accord with its political and social policies. The transnational enterprises shall not intervene in the internal affairs of the host State. Each State should, taking fully into account its sovereign rights, cooperate with other States in the exercise of the rights to which reference has been made....

The Latin American preoccupation with adverse political and economic implications of multinationals for the host countries and with the uneven distribution between host countries and home countries of economic costs and benefits arising from their operations precedes the initiation of the "new dialogue" and the adoption of the Charter of Economic Rights and Duties of States by the U.N. When in the fall of 1973 Latin American countries asked for the inclusion of multinationals in the agenda of the "new dialogue" they defined their position in the following terms:

There exists a deep concern in the group of Latin American countries because of the attitude of the transnationals that have intervened in internal matters of the countries in which they carry out their activities and presume to exempt themselves from the legislation and the jurisdiction of the competent national courts.

The transnationals constitute a suitable factor in Latin American development so long as they respect the sovereignty of the countries in which they operate and adjust themselves to the plans and programs of development.

Latin America considers it necessary to have the cooperation of the United States for the purpose of overcoming the resulting difficulties and frictions and of avoiding such difficulties and frictions that might originate from the conduct of the transnationals that may violate the principles of the sovereignty of the host countries.

The discussions held last year within the framework of the "new dialogue" clarified considerably the substance of the Latin American general viewpoint on multinationals. In that dialogue one can discern four basic considerations:

1. Issues arising from the activities of multinationals in the host countries are not limited to the hemisphere but are worldwide.
2. Since the issues are not only economic but also political, they must be treated jointly and at the same time.
3. These issues do not lend themselves to bilateral arrangements between multinationals and host countries. While multinationals—the same as other foreign investors—must accept the sovereignty of the host countries and their legislation and jurisdiction, it is left to host countries and home countries to work out through negotiations certain "rules of conduct" to be observed by multinationals.
4. Home countries must give host countries assurances that they will see to it that the agreed "rules of conduct" will be in fact observed by multinationals.

It is easy to perceive the very large gap between the U.S. and Latin American viewpoints on the "rules of conduct." The U.S. places the issues involved exclusively in the hemispheric framework; takes the position that conflicts and difficulties are mainly, if not completely, of an economic nature; insists upon the establishment of intergovernmental mechanisms for settling investment disputes; and while admitting the joint-responsibility of the U.S. and the Latin American host countries for the elaboration of the "principles of conduct" for multinationals, takes the position that U.S. Government power over multinationals of U.S. origin is so limited that at best the U.S. could commit itself perhaps to use the power of persuasion in respect to the
implementation of the agreed "principles of conduct."

The gap grows even larger when one looks closer at the Latin American postulates. The "rules of conduct," if and when spelled out in joint hemispheric negotiations and independently from their legal form, would have to reflect, according to Latin American governments, the following set of principles:

1. Multinationals shall be subject to the laws and regulations of the host country and, in case of litigation, should be subject to the exclusive jurisdiction of the courts of the country in which they operate.
2. Multinationals shall abstain from all interference in the internal affairs of the host countries.
3. Multinationals shall abstain also from interference in relations between the government of a host country and other states, and from disturbing those relations.
4. Multinationals shall not serve as an instrument of the external policy of another state or as a means of extending to the host country provisions of the juridical order of the home country.
5. Multinationals shall be subject to the national policies, objectives, and priorities for development of the host country and should contribute positively to carrying them out.
6. Multinationals shall supply the government of the host country with pertinent information about their activities in order to assure that these activities are in accordance with the national policies, objectives, and priorities of development of the host country.
7. Multinationals shall conduct their operations in a manner that results in a net receipt of financial resources for the host country.
8. Multinationals shall contribute to the development of the scientific and technological capacity of the host country.
9. Multinationals shall refrain from restrictive business practices.
10. Multinationals shall respect the sociocultural identity of the host country.

The argument that these ten principles contain implicit unfounded accusations that multinational corporations have indulged on occasion in political and economic activities contrary to the political sovereignty and economic interests of the host developing countries can be answered rather easily, because there is considerable evidence to that effect in Latin America. Moreover, it is not necessary to argue that multinational corporations are either bad or amoral, since the issues do not involve moral values. Multinationals, like other economic units, are as such neither moral nor amoral. They have their own goals—power, growth, and profits. These goals may or may not, according to a particular situation, coincide with, or contradict, the political, social, or economic goals of the countries in which they operate.

The possibility of conflict between private and societal goals on the national level was admitted long ago by all advanced market-economy countries. Otherwise there would be no point in public regulatory actions of private activities, actions which, in the case of the U.S., go back to the nineteenth century. The problems with multinationals that have arisen lately derive from the fact that these powerful private units operate internationally, that their private goals and objectives do not necessarily coincide with those of host countries, that the distribution of costs and benefits of their operations is biased in favor of home countries, and that the better balancing of these costs and benefits is hampered by the historically conditioned "unequal partnership" between multinationals and most of the host countries.

The validity of this diagnosis can be easily substantiated without recourse to radical literature. Neither is it necessary to raise the ghost of the allegedly growing nationalism in the developing host countries, because conflicts with multinationals arise also in developed home-host countries like Canada, France, or Australia. Moreover, this nationalism has always been present in the developing world. If it is perceived more clearly now as a worldwide phenomenon, the two reasons are perhaps: first, the communications revolution has brought to the attention of the advanced societies multiple manifestations of the nationalism all over the planet; and second, the role of multinationals in the world total production, trade, and financial transactions increases constantly. In respect to the growing role of multinationals in the world economy plenty of evidence is available from the most reliable sources, including voluminous reports of the U.S. legislative branch.

Running a risk of repeating what has been said many times, one is forced to recall that the modern multinational enterprise differs from a traditional firm, based in a highly developed country and involved in international trade and investment activities, not only in its size and the geographical scope of its operations. Contrary to some definitions still in vogue, the majority of multinational companies are not just very large companies with manufacturing units around the world established to achieve least-cost production to serve world markets on an integrated basis under a centralized policy determined by the parent. They are not any longer manufacturing companies, mining com-
panies, or banking enterprises per se, but rather huge conglomerates or parts thereof, integrated both vertically and horizontally. Vertical integration means that a multinational firm engages very often not only in a series of activities from the raw material stage to that of producing final goods, but is active—under the same or a different name—in other activities, such as international trade and international financing. Horizontal integration is reflected in the pursuit by a very large firm of numerous activities distributed in nonhomogeneous sectors in many countries at the same time. In such a situation a single activity in a single country is of importance to a multinational firm only within the framework of its global strategy. More often than not a single activity in a single developing host country is of marginal importance for a multinational system. While it may be marginal and expendable, it will be defended, however, by the system in case of a challenge or a danger, because the power of the whole system and not only its economic viability is at stake in each instance.

A multinational company may thus choose to stay in or to withdraw from the host country, may continue to produce or stop production, may buy or import goods or services, may provide or withdraw financial resources from the affiliate. It enjoys a large degree of independence from what the host country might expect from its operations. To use a literary comparison, the host country viewed from the heights of a multinational firm is very often just a railway station or a port of call through which foreign trains or ships owned by the central system pass, stopping or bypassing the particular point, loading or unloading goods and passengers, staying over for repairs or refueling, according to the decisions of the center. It is not difficult to imagine why the developing host countries, which for many decades did their utmost to incorporate into their productive systems and put under their jurisdiction foreign economic enclave-type activities, do not look with equanimity at the recent development of operations by multinationals. While presumably incorporated into the local productive and legal systems, such operations—in terms of basic decisions—are outside the reach of the host country.

The first Latin American proposition—that multinationals shall be subject to the laws and regulations of the host country and, in case of litigation, should be subject to the exclusive jurisdiction of the courts of that country—is not radical at all. While no one as yet has proposed that the operations of Japanese multinationals in the United States should be subject to Japanese laws and regulations, some influential people seem to have difficulty in accepting the Latin American position on jurisdiction when operations of affiliates of the U.S.-based multinationals are involved. The only explanation of these conceptual difficulties that comes to mind is that they have their roots in the legal thinking of some social groups in the advanced countries, inherited from the nineteenth century.

The proposition subjecting multinationals to national jurisdiction and legislation has been extended to litigation arising from the application of this jurisdiction because of the persistence of private agreements stipulating the resolution of conflicts by the courts of the home country. It is postulated in Latin America that only the state can accept international arbitration mechanisms and that no private party can claim the recourse to extranational jurisdiction.

The second principle—calling for the abstention by multinationals from all interference in the internal affairs of the host country—is based upon Latin American historical experience with both foreign private investment and its particular modern form, multinationals. It is not an act of faith but a fact of life that multinationals do interfere in the internal affairs of the host countries if they can get away with it, particularly if the host countries attempt to change long-established rules of the game governing foreign economic activities within the area of their jurisdiction. The question arises whether the act of a state attempting to change the antiquated "rules of the game," very often imposed unilaterally from outside, represents aggression or self-defense. There are at least two answers to this question.

The internal interference of a large multinational may be direct or indirect in accordance with the relative power of the parties involved. The U.N. Report of Eminent Persons, mentioned earlier, indicates that "the action of multinational enterprises in the political field may assume less direct and less obvious forms. In the countries of origin it may be possible for them to influence foreign policy and domestic policy by recourse to their great financial power and to their relations, which are frequently close, with high officials of government. They may exert pressure in support of or against the governments of the receiving countries, according to whether or not they receive specially favorable treatment."

The third principle extends the scope of the previous one to direct intergovernmental relations. There are instances, not only in history but in the recent past, in which multinationals have successfully requested the government of a home country to intercede with the host government by actions of a political or economic nature. These cases, managed often by lobbying organizations in the home countries, seem to be quite frequent, although they violate those constitutional provisions of the host country that prohibit the foreign investor from invoking the protection of his government when there exists local legal machinery for the solution of controversies involving foreign investors. There are cases in which the government of the home country has imposed economic and other restrictions or sanctions upon the host country in order to defend the interests of a multinational company. Similarly, through international financial and other agencies
economic pressures are applied from time to time. In the U.S. statute books two legislative measures exist to impose sanctions on host countries deemed to be inimical to the interests of the U.S. investors—the Hickenlooper and the Gonzalez amendments to the Foreign Assistance Act.

It has been admitted officially recently that such punitive measures have serious political drawbacks. Nevertheless, the exclusion of Venezuela and Ecuador from preferential access to the U.S. market for manufactured goods (because of their allegedly unfriendly attitude toward the U.S. under the OPEC agreement) indicates the persistence of conflicts on an intergovernmental level as a result of pressure some multinationals exert upon their home countries. These conflicts are often exacerbated when the host country proceeds to nationalize the property of a multinational firm and a controversy arises about the terms of what the affected foreign private party might consider "prompt, adequate, and effective" indemnification.

The fourth principle enjoins multinationals from serving as an instrument of the external policy of another state. This principle is related to, and frequently runs counter to, the extraterritorial application of legislation of the home country that prohibits affiliates of a multinational firm, incorporated in foreign countries, from engaging in activities that may be considered illegal or contrary to the national interests of the home country. Such extraterritorial application of the domestic legislation of the home country may create serious conflicts between a multinational firm and the host country. For that host country may have never been party to, may have abandoned, or may consider irrelevant the international arrangement upon which the home country action has been based.

A case in point is the invocation by the U.S. of the Trade with Enemy Act for the purpose of trade embargo against a third country. Another case of which Latin Americans are highly conscious is the extraterritorial implications of certain provisions of the anti-trust legislation affecting directly or indirectly the activities of foreign-based affiliates of multinational firms.

The fifth—asking the multinationals to abide by the national policies, objectives, and priorities for development and to contribute positively to their implementation—raises the issue of an existing or potential conflict between corporate global strategy and the development goals of the developing host country. Latin American countries consider that their economic autonomy as measured by their ability to implement development goals is endangered by certain activities of multinationals in the field of foreign trade that are both important and difficult to control—for example, finance and capital movements, production and distribution cartel agreements, human resources allocation, and technology transfer policies. This fear is not limited to Latin America and other underdeveloped regions. It is also present, in perhaps different forms, in some advanced countries where multinationals are blamed, with growing frequency, by experts and laymen alike, for the present international economic instability, the serious worldwide "stagflation," and the inability of the Keynesian fiscal and monetary policy mix to deal with the serious cyclical downturn taking place simultaneously in all major industrial economies. Although there seems to be a lack of consensus about how multinationals should be treated by the home countries, Latin Americans postulate that the economic autonomy of a nation-state has priority over the economic autonomy of a multinational firm.

According to the sixth principle, the economic autonomy of a developing host country cannot prevail over global goals of a multinational firm unless the host country has at its disposal sufficient information about the activities of multinational enterprises not only in general and aggregate terms but in terms of their country-by-country activities. Without such direct and detailed information effective supervision and regulation of multinationals by the host country is not possible; that country will lack the necessary elements for evaluating the activities of multinationals and for verifying their tax, fiscal, financial, credit, foreign trade, and balance-of-payments implications. Here again the Latin American position follows rather than contradicts the lines of thought rapidly developing in the advanced home countries, which are also emphasizing the key importance of the disclosure of corporate information for establishing objective quantitative standards for measuring both private profitability and the social costs and benefits of multinational firms. A developing host country is very much handicapped not only by the nondisclosure policy of multinationals, but also by the differences between the accounting systems as well of different countries.

The seventh principle, which calls for multinationals to make continuous contributions to the net transfer of financial resources to the host country, reflects the increasing conviction in Latin America that such net transfer occurs as the exception rather than as the rule. The fact that repatriated profits very often exceed new investments is not
considered a part of the evidence. Latin American economists know the difference between stocks and flows of financial resources and reject that simple and incorrect way of handling the problem. What is objected to, however, are those overall accounting practices of a multinational at the host-country level that allocate a large part of profits of the system as costs to the affiliate. Because of extended practices of manipulating the prices of imported items and exported products through administered transfer-pricing and swollen and rapidly growing payments abroad for interest, royalties, and technical services, few people in Latin America, starting with fiscal authorities, take very seriously the annual balance sheets of local affiliates of a multinational firm. Even fewer look to the balance-of-payments figures as a guide for the foreign-exchange cost of operations of a multinational.

While the presence of the dummy intermediaries in the offshore financial centers makes any inquiry into the subject particularly difficult, it has been discovered in many Latin American countries in the past few years that unregistered profits of a multinational from its local operations are perhaps several times larger than profits registered in the annual profit-and-loss statements that may be formally correct. It should be noted that, using in a masterly way their accounting skills, multinationals succeed in showing profits of their affiliates to be much lower than those that accrue to domestic enterprises. It is difficult to accept this low profitability profile if one assumes that multinationals are supposed to know how to do business at least as well as domestic firms, if not better.

Whenever the financial disclosure has been forced upon multinationals in respect, for example, of technological transactions between their local affiliates and other members of the system elsewhere, it has been proven that a considerable part of the related payments represents, in fact, the transfer of profits to the parent company. It is not necessarily done for tax purposes, but perhaps involves other considerations—it may be considered good for a multinational to show large profits to shareholders at home, but it may be considered politically dangerous to show these profits in a host country. Whatever the reason, the net financial contribution to the host country becomes negatively affected.

Moreover, the nature of the external relations of local banking systems, even in the presence of all sorts of restrictions on lending to foreign-owned firms or in the absence of foreign-owned banks, is such that it offers multinationals very easy access to local credit facilities. Such preferential access pays handsome dividends both in inflationary situations, when the real banking rates in the host country tend to be close to zero or negative, and during the deflationary periods, when domestic credit may be just unavailable to weaker local firms.

The eighth principle—calling for the multinationals to contribute to the development of the scientific and technological capacity of the host country—is based upon the growing Latin American evidence that multinationals use technology imported from the parent system and do not engage in any serious R&D activities in the developing host countries. The statistics on R&D expenditure in major countries of the region show that some 90 per cent of these expenses are paid by the respective states. While the lack of R&D efforts by locally owned enterprises can be explained by their technological weakness, multinationals are not technologically weak. It is rather that they find technology imports not only good business for the system but a risk-averting practice.

Such technological policies have several drawbacks from the viewpoint of the developing host country. First, since imported technology is transplanted with few, if any, adaptations to local conditions, its contents are highly capital-biased in the economies where capital is a scarce production factor. Second, contrary to many beliefs, technology transfers take place mostly within individual multinationals, and their spillover or demonstration effect upon the rest of the economy is small. Third, the absence of adaptive efforts affects negatively the growth of local technical skills. Fourth, most imported technology can be classified as consumption-technology and not production-technology, as suggested by the fact that the two largest technology sellers in Latin America, in terms of registered payments, are two industrial sectors almost completely dominated by multinationals: pharmaceuticals and motor vehicles—in neither sector in Latin America do substantial technological innovations involving the change of production processes take place. And fifth, the mechanical reproduction of imported technologies for the purpose of catering to consumer preferences—allegedly autonomous but, in fact, manipulated through commercial propaganda—has very serious social consequences. Consequently, traditional technology transfers through multinationals are far from unmixed blessings for the Latin American host countries.

The ninth principle related to restrictive business practices points to the fact that multinationals operating in Latin America often limit the activities of their affiliates to respective national markets through the restriction of exports and the control of distribution, import supply, and external finance. These practices, followed particularly by multinationals long established in many Latin American countries, are difficult to deal with, since they usually adopt the form of informal arrangements at the parent company level for the division of markets. This not only affects the prospects of individual countries for regional exports, but also limits their access to the developed countries' markets. Once again the host countries' export decisions and policies are limited by outside forces.
Finally, the tenth principle draws attention to the often forgotten disruptive social consequences of importing through multinationals, their production patterns, commercial propaganda, and consumption patterns. These may perhaps be appropriate to high-income industrialized countries, but distort the local social and cultural distinctiveness and introduce social tensions and feelings of alienation among masses of the local population. While it is widely recognized that negative social and economic effects flow from displaying in developing countries the consumption patterns of the rich countries, it is not clearly realized that in their search for profits at any social price multinational companies are the agents most responsible for these displays.

Once the Latin American position is presented in detail it is difficult to be optimistic about the prospects for bridging the gap between the "unequal partners" in the hemispheric dialogue on multinationals. Perhaps the first ray of hope arises from the U.S. recognition—if such recognition exists—that the subject of multinationals should be treated jointly with that of technology transfer. It has been long recognized in Latin America that multinationals are the main source of technology in today’s world. Although for circumstantial reasons the two subjects were treated separately in the "new dialogue," they must now be considered together, so that the U.S. understands why Latin Americans object to the present unsatisfactory technological role of multinationals in developing countries.

On other major points it is difficult to see much progress. It is difficult to imagine, first, that Latin America will abandon its pressure for some sort of international regulation of multinationals on a worldwide scale and not only in the hemispheric framework. Some people in Latin America believe that through negotiations of "principles of conduct" within the "new dialogue" the U.S. expects to get some kind of preferential access to the region for U.S.-based multinationals. But it is highly doubtful whether such a proposition would be acceptable to Latin America, considering that for two affiliates of U.S. multinationals there is one European or Japanese affiliate in the area and that, moreover, most Latin American countries would like to diversify further the origin of foreign private investment.

Neither does it seem that Latin America would be willing to participate in new intergovernmental systems to impede and resolve the investment disputes. While systems of this sort exist in international agencies, Latin America decided some years ago to abstain from joining them. As far as new measures of cooperation are concerned, Latin America favors them as long as such measures will take into consideration the changes occurring in relations between the advanced and the developing countries. In respect to multinationals, Latin America presented its position and expects the most serious considerations of the ten basic principles. Contrary to some interpretations, there is no desire for confrontation on the part of Latin America on this or any other point. There is, however, an expectation that discussions and negotiations step down from the level of generalities to that of real issues. It is difficult for Latin America to accept the validity of general statements of the sort that "foreign private investment is unconditionally good because foreign investors believe that it is unconditionally good" or that "technological contribution of multinationals is great because multinationals believe it is great." The power of multinational firms affects not only the national interests of weaker host countries but the national interests of large home countries. Eventually, one may hope, the U.S. will come to a conclusion that placing multinationals within some international order is not only in the interest of host countries but of home countries as well. If any demonstration of this fact has been needed, it was provided to all parties concerned during the so-called energy crisis of 1973-74. My point of reference in that respect is what I read daily in the New York Times and Washington Post. It is because I happened to be born a short-term pessimist but a long-term optimist that I have here presented the Latin American case for international regulation of multinationals.