

# Multinational Corporations: Balancing Rights with Responsibilities

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# Multinational Corporations

- Have brought enormous benefits, including to developing countries
  - Movement of capital
  - Transfer of technology
  - Training of workers
  - Access to markets
- Why then are Multinationals subject such vilification?

# Problems with multinationals

- Some problems are shared by domestic corporations
  - Taking advantage of limited liability
    - Mining companies take out resources, distribute profits, leaving no money to clean up mess
  - Use of economic power to get favorable legislation
    - Campaign contributions
    - Distorted information (cigarette companies, oil companies)
  - Massive cheating in hard-to-detect ways
    - Even in U.S.—Exxon in Alaska and Alabama cases
      - Required extra-ordinarily sophisticated detection, beyond capability of most developing countries
      - If this happens in U.S., what must be happening elsewhere?

# Special Problems with multinationals

- Powers—to get special legislation and treatment that benefits themselves, regulations, short circuiting environmental, health, worker regulations
  - Economic power often greater than that of country
    - Revenues of GM greater than GDP of more than 148 countries
    - Walmart’s revenue larger than combined GDP of sub-Saharan Africa
- Sometimes they seek, and get, special tax and tariff treatment; sometimes simply persuading governments not to enforce existing regulations
  - —unlevel playing field, disadvantaging domestic businesses
- Sometimes special treatment is above board—necessary to induce corporation to come; but sometimes based on corruption
  - Developing countries particularly susceptible
    - Race to the bottom—e.g. in transparency initiatives (B.P. and Hydro examples not followed)
    - Until recently, effective subsidy on corruption (tax deductibility of bribes)
    - Even now, Western governments refuse to do anything about secret bank accounts
  - But even after corruption exposed, “sanctity of contracts” is insisted upon
    - Enron energy contract
    - Suharto mining contract
    - Close role of ambassadors, who are afterwards rewarded

# Special Problems with multinationals

- Leverage economic power with political power
  - Pressures against governments which issue compulsory licenses (even when fully WTO compliant)
    - Threaten withdrawal of GSP, other actions
  - Governments demanded renegotiation of contracts when there is overbidding, but not symmetrically
    - Argentine water concessions
- Hiding behind frontiers
  - Union Carbide/Dow in Bhopal
- Lack of “moral sensibilities” (or weaknesses in public pressure)
  - Engage in practices abroad that they would not engage in at home

# What multinational companies want

- Strong protection
- Favorable treatment
- Low taxes
- Low regulation
- Right to establish, without burdensome red tape
- Right to move employees in and out, to move capital in and out
- Uniform standards across countries—makes it easier to conduct business

# What others want of multinationals

- Make a contribution to national development efforts
- In ways consistent with domestic laws and regulations
  - No special treatment
  - Level playing field in taxes or regulations
- To be good citizens

# Basic perspectives

- Hard to think of a successful American economy with only state laws, with no way of dealing with cross-border disputes
  - But Federal law subjected to strong democratic political processes
- In recent years, gap has begun to be filled in by a series of investment agreements (bilateral investment treaties, investment agreements part of trade agreements)
  - Following failure to achieve a multilateral investment agreement

# B.I.T.s

- Increasing concern about these agreements
  - Both in protections provided
    - Foreign investors provided more protection than domestic investors
  - And in enforcement provisions
    - Rights to sue states
    - Procedures

# Basic Questions

- Is there a need for international economic agreements concerning the regulation of multinational corporations?
- If there is, what should be the scope for such multinational corporations, and what global institutional arrangements might be most effective?
- If these global institutional arrangements can not be created (at least in the short run), what can individual countries do?

# Why is there a need for international laws regulating commerce?

- Why can't we simply allow each country to adopt its own laws?
  - Focusing solely on the enforcement of contracts and property rights?
  - Let Adam Smith, aided by Ronald Coase, do their wonders: societal well-being promoted by invisible hand; problems of externalities “solved” by parties negotiating among themselves
- Coase “theorem”: all that is needed for economic efficiency is well defined property rights, strongly enforced
- Tiebout “theorem”: competition among communities results in efficiency (in the public provision of goods and regulations)

# If market fundamentalism principles were correct...

- Principles which underlay much of the drive for liberalization, bilateral and multilateral trade and investment agreements
- Then there would be little need for these agreements
  - Fundamental logical inconsistency
  - Countries would have incentive to provide good “investment climate” on their own, *without treaty*
  - And those that did so would attract more investment

# Neither Coase nor Tiebout were correct

- Coase “conjecture” requires zero transactions costs, perfect information
- Tiebout result is even more restrictive
- Markets, by themselves, are not efficient, whenever there is imperfect information and incomplete markets (that is, *always*) (Greenwald-Stiglitz, 1986)
  - Externalities are pervasive

# Legal Framework should reflect modern economic science

- Stockholder value maximization does not result in Pareto efficiency (Grossman-Stiglitz)
  - Other stakeholders interests need to be taken into account
- Take-over mechanism, by itself, may not ensure stockholder value maximization
  - E.g. ability of managers to subvert
  - General problems of free riders/public goods (Grossman-Hart)

# Overall framework

- There is a role for government
  - In setting the rules of the game (regulations concerning conflicts of interest, take-overs, corporate governance)
  - There may not be a *single* best set of rules
    - Distributional consequences
    - Different countries may make different choices
  - Implies extreme caution in making international rules to govern corporations and the rules that nations might adopt

# Added complications of cross border economic relations

- Lack of trust of companies in foreign governments
  - Regulations designed to discriminate against foreigners
    - Foreigners are not voters
  - In judicial proceedings—home court advantage

- Symmetrically, lack of trust of foreign governments in companies
  - Companies do things abroad that they might not do at home
    - Can get away with it
    - Absence of social sanctions
    - Treat foreigners as “lucky” to have their investment (particularly severe problem in colonial mentality)
  - Power of foreign companies aided and abetted by leverage from strong foreign governments
    - Threat of trade sanctions, eliminating GSP
    - Demanding live up to corrupt contracts (Suharto—with U.S. ambassador ending up serving on mining company board)
    - Demanding renegotiation of contracts when contracts lose money (Argentina)
    - But resisting symmetrical demands by governments for renegotiation (Bolivia)

- Foreigners may not be able to get *favorable* treatment that they can get at home
  - Laws against making campaign contributions
  - Lack of voting power
- Assignment of income (for taxes)
  - Companies try to shift income to low tax jurisdiction
- Problems of enforcement of judgments beyond borders
  - “Bad” firms, like bandits of old, retreat across state line
    - With insufficient wealth in original state to enforce judgments
    - With inability to make individuals criminally responsible
    - “Defense”: can’t trust foreign courts

# Investment agreements

- Supposedly to protect interests on investors—to redress asymmetries of adverse treatment of foreigners
- Reality: provide foreigners with more rights than domestic investors
  - Using non-democratic, non-transparent negotiation processes to get what domestic political processes would never have granted
    - E.g. regulatory takings provisions of Chapter 11 of NAFTA
    - Rights of investors to sue states, with damages paid by national governments
    - No debate in the White House
    - Even though Administration was forcefully fighting against regulatory takings provisions in Congress
    - If the U.S. signed on to agreement without knowing what it was agreeing to, what does this say about other countries?
    - Some demands in recent bilateral agreements are even worse, giving pre-establishment rights

- Asymmetries—more concerned with rights than responsibilities
  - E.g. protection of environment
  - Ability of governments to recover environmental damages
  - Without adequate extradition procedures for those guilty of corporate crimes (India Bhopal)
- Remedy for lack of confidence in judicial procedure use of arbitration panels
  - Without transparency
  - Without necessarily adequate deference to long tradition of development of procedural safeguards
  - Without clarity of principles of precedents
  - Without safeguards of adequate appellate procedures
  - Without clarity of principles of interpretation of language
  - ***Without deference for national priorities***
    - Social agenda
    - Emergencies/force majeure (Argentina)
  - Hardest problems are always balancing of rights, conflicting claims
    - No confidence that these arbitration panels do that in appropriate way
  - With in some cases little confidence in choice of judges/arbitrators
    - Part time judges with clear conflicts of interest

- Every government carefully balances commitments to the future (e.g. with respect to regulatory provisions and tax rates) and need for flexibility
  - And insists on maintaining a high level of discretion for *each* successive government
  - ***But when protections are part of a treaty, there is little scope for flexibility***

# Balancing benefits and costs of standardization

- Benefits of standardization
  - But also costs
  - One size fits all policies don't work
  - Not single best regime appropriate for all countries
    - In looking at variety of contractual arrangements across countries, one has to ask
      - Do differences reflect differences in circumstances
        - » Implying a loss in efficiency in standardization
      - Or are there multiple equilibria, one of which is Pareto superior to other—need for government intervention to ensure efficient equilibrium emerges (contrary to market fundamentalism position)?
        - » Structural inefficiencies
        - » Marginal inefficiencies even more pervasive
      - Or are there multiple equilibria, both efficient, with different distributional consequences—need care in government intervention
    - Question: Have the B.I.T.'s done appropriate balancing?

# These investment treaties have not been “balanced”

- Negotiated behind closed doors
- Pushed through Congress in fast track process
- Without adequate debate either in Administration, Congress, or the Public
- Special interest legislation
  - Attempting to get through “back door” what they could not get in open democratic debate
    - Taking advantage of deficiencies in the democratic processes by which such agreements are made
- US did not know what it was getting—even more so for developing countries
- Need for roll back

# Legal framework should be determined by a set of principles

- Recognizing rights to regulate
- Rights to control the right to establishment
- The obligation of governments to obtain for public purposes a fraction of the value of the economic activities in the form of taxes
- The obligation of governments to guarantee to future citizens protection of the environment *in an enforceable way*
- The obligation of government to guarantee to their current citizens protection of their health and worker rights
- The obligation of governments to guarantee to their citizens fair and open procedures to be used in the adjudication of disputes with foreigners.

Many of the current agreements do not seem to accord with these and other principles that should guide their construction

# Rights to Regulate

- Every country has the right to impose, e.g. health and worker regulations
- Every country has right to have regulations concerning corporate governance, bankruptcy, etc
  - One set of transactions (contracts) may adversely affect others
    - Value of claims of other (reason for bond covenants)
    - Inefficient signaling equilibrium (bankruptcy)
  - Incomplete contracts—impossible to (and undesirable to) protect against all possible contingencies
    - Government provides a set of defaults
    - Uniformity across countries not necessarily desirable
      - Balancing protection of creditors, debtors
      - Exemplified by controversy in recent U.S. bankruptcy law

# Right to Establishment

- Question is often not just right to establishment, but terms
- Quite different from rights of movements of capital and labor (and, from perspective of global efficiency, free movement of labor is far more important than free movement of capital, and it would improve distribution of income)
- Any firm operating in a country subject to environmental, labor laws, etc.
- Firms can do business in another country by establishing wholly owned subsidiary
  - So what difference does it make? Why might domestic law be relevant?
    - Rules concerning decision making—role of other stakeholders
    - Rules concerning what happens in event of bankruptcy
      - Countries should have the right to determine priority of workers in the event of bankruptcy (part of protecting rights of workers)

# A Modest Proposal

- Given problems in bilateral investment treaties (and similar provisions in regional trade agreements)
  - And almost inherent difficulties in democratic processes by which they are arrived at
- Such agreements should be limited in scope
  - Principle invoked by Charlton and Stiglitz for trade agreements
  - E.g. Only those instances where standardization is needed for the conduct of business
  - With presumption that standardization is *not* needed

# Key provisions

- Protection limited to *non-discrimination*
  - Foreigners not be taxed or regulated in ways which are worse than taxes imposed on domestic firms
    - In standard economic theory, there are reasons why one might want to tax them more (or less) heavily
    - But difficulty of determining whether there is valid reason typically too greats
- Rights accompanied by responsibilities
  - To protect the environment, workers
  - With the posting of bonds, deposit substantial fraction of dividends into escrow account, when firms have limited assets in the company (e.g. mining companies, to ensure clean-up at the end)
  - Extradition agreement for corporate officials that violate certain laws
    - Corporate financial obligations may not suffice to ensure good behavior
  - Corporate social responsibility movement has recognized these responsibilities, with many corporations playing constructive role
    - But with competition, there is a race to bottom
    - Firms that spoil the environment have a competitive advantage over those that don't
    - Which is why increasingly, firms committed to Corporate Social Responsibility have recognized the importance of having regulations—to create a level playing field between those who want to be responsible and those that are not

# Anti-bribery laws

- Strong anti-bribery laws/conventions
  - Enforced by both sides
  - Enforcement against facilitating *institutions*:
    - Secret bank accounts
    - U.S. vetoed OECD initiative in August 2001
    - U.S. has shown that it can be enforced
    - Chosen not to do so for corruption, tax evasion—because it is in the interests of special corporate and financial interests in the United States
- Transparency requirements
  - Sunshine is the strongest anti-septic
  - Transactions between oil/mining companies and governments should be “published” if they are to tax deductible

# Dispute Adjudication

- Current system should be viewed as intolerable
  - If arbitration behind closed doors with no precedents, etc. were *desirable*, would have been chosen within countries for resolving disputes
  - Legal procedures developed over centuries to ensure procedural justice should not be short-circuited
  - Need for creation of an “Intergovernmental” judiciary, like federal judiciary, but with all of protections (International Court of Commercial Claims)
  - *labor standards, or other mode of conduct) of the two countries*

# Extra-territoriality

- Counter-worry: Citizens of developing world are afraid if they sue in their home country and win, judgment cannot be enforced. Some worry that domestic courts will be intimidated not to grant a judgment, because the fear of losing a job. PNG was induced to pass law not allowing individuals to sue. Corporations fear can't get fair judgment
  - International investor agreements need to provide alternatives
  - Alternative: parties could agree to be tried by courts of the investor country, on the condition that the Court uphold *the higher standards of the treatment of the environment (or labor standards, or other mode of conduct) of the two countries*
  - Extended alien torts act—need protections provided by class action suits, and those injured should be able to file case in home country

# Extra-territoriality

- Anti-competitive behavior can have global effects in global market
  - Countering it in single market (U.S.) may be insufficient to offset global benefits, unless penalties taken into account global consequences
  - Filing separately in large number of countries administratively costly, excessively burdensome on plaintiffs
  - Need to create Global Competition Authority, with criminal and civil (treble damage) action
  - Short of that, national courts (U.S) should provide for damages of those outside their boundaries
    - Even necessary to protect American consumers against risks of monopolization and anti-competitive behavior (Epigram case)

# The current system is unfair to developing countries in the short run

- But is even worse in the long run
- For it undermines confidence in the rule of law
- The rule of law is seen as a game by which one party takes advantage of another
  - Not to promote economic efficiency
  - Not to protect those who might otherwise not be able to fend for themselves







