

Governing Multinational Corporations in the Pacificⁱ

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Introduction

The increasing prominence of multinationals is a well-known feature of today's increasingly globalized international economy. The forces of globalization accentuating the role of multinationals have operated especially powerfully in the Asia-Pacific region, characterized by market-driven integration based on intense trade and investment linkages. These linkages have facilitated the fragmentation of regional production in a number of sectors through the development of extensive production networks and integrated value chains.

Governments of the region have endeavoured to reinforce the market-driven integration of the region through cooperative activity in APEC, and more recently and more controversially through a proliferation of preferential trading arrangements (PTAs), but have largely refrained from establishment of supranational institutions to undertake economic governance functions on behalf of national governments. The region in fact exhibits a wide diversity in political systems and economic governance institutions, reflecting wide differences in levels of development as well as a range of historical, cultural and economic factors. These factors have also led to the evolution of several distinct models of multinational structure and operation. North American multinationals, Japanese multinationals, multinationals owned by overseas Chinese, and mainland Chinese multinationals each have their own distinctive features. These and other features of the Asia-Pacific region create a distinctive policy context for economic governance issues raised by multinationals, but perhaps also help to explain why an analysis of these issues adapted to the specifics of the Asia-Pacific regional context has been slow to

emerge.

The economic governance issues relating to multinationals are complex and many-sided. In illustration of this point the chapter will focus on four areas of economic governance where the role of multinationals has particular importance: competition policy, taxation, investment agreements and corporate social responsibility. It will review policy issues raised by multinationals in each of these areas, and discuss how distinctive features of the Asia-Pacific region affect the ways in which these issues are addressed. It will endeavour to highlight some of the differences in disciplinary perspectives toward analysis of these issues, as well as differences in perspective between theorists and practitioners.

The extended discussion of competition policy in the next section is the principal focus of the chapter. This is followed by shorter sections on investment agreements, corporate social responsibility, and taxation. A final section of the chapter discusses the outlook for disciplines on governance of multinational corporations in the region.

Competition Policy

One consequence of the growing importance of multinationals is to accentuate the importance of addressing anti-competitive practices that are cross-border in their operation and/or effects, of which international cartels are perhaps the exemplar with the highest profile in recent times. It also implies an increasing need to consider competition issues in the context of foreign direct investment (FDI), particularly in the case of mergers and acquisitions. There is both a national and an international dimension to action on cross-border competition issues. National governments need to have the capacity to protect themselves against anti-competitive practices originating beyond their borders. There is also a growing understanding of the role that international cooperation can play in enhancing the effectiveness of action in such cases.

A wave of successful prosecutions of international cartels by the US Department of Justice in the late 1990s drew attention to the potentially enormous scale of the international cartel problem. Klawiter (1999) lists eighteen corporations that pleaded guilty and were fined in international cartel cases between 1996 and 1999, with a further 30 active investigations under way. Connor (2002) identifies 31 international food-and-feed-ingredient cartels and 14 non-agricultural cartels that were discovered between 1996 and 2002, leading to “overcharging” of customers estimated at over US\$200 billion. Evidence from these investigations contradicted arguments that cartels are generally unstable and as a result largely ineffectual. US Assistant Attorney General Joel Klein noted that these cartels are “by no means transient or unstable. They are powerful and sophisticated and, without intervention by antitrust authorities, will often go on indefinitely” (Klein 1999a). Klein (1999b) also notes that ongoing discovery of new cartels indicates that the full scale of the problem has not yet been fully revealed.

In the majority of cases to date the US antitrust authorities have prosecuted international cartel members on the grounds of damage to US interests. Klawiter (1999) notes that the majority of companies prosecuted were foreign, including companies from Japan, Germany, Switzerland, the Netherlands and Belgium. Klein (1999b) emphasizes the effectiveness of US anti-cartel enforcement as the principal factor behind the successful prosecutions, but notes also that “many of our international cartel cases would have been much less successful if we had not had the assistance of foreign law enforcement agencies”. The European Union and Canada have also been increasingly taking successful action against international cartels.

While action against international cartels has been largely limited to a handful of countries concerned with damage inflicted within their own borders, the damage caused by international cartels almost certainly spreads across the entire global economy. Klein (1999b) notes that international cartels “don’t just hurt consumers in the U.S. or any other single country. Almost by definition, they hurt consumers worldwide”. This implies that all Asia-Pacific economies have an interest in effective anti-cartel enforcement. This is

reflected in the ongoing spread through the region of formal antitrust legislation and anti-cartel enforcement, including extra-territorial enforcement, noted by Paul (2006).

There is also likely to be an Asia-Pacific dimension to some, if not many, international cartels. One example is the lysine cartel, led by US firm Archer Daniels Midland and Japanese firm Ajinomoto, with two Korean firms as junior partners. Cooperation in anti-cartel enforcement has however been slow to spread among Asia-Pacific economies, although Paul (2006) notes that Australian and Japanese antitrust authorities have now demonstrated a willingness to cooperate in international cartel investigations. Further indication of a growing trend to involvement of Asia-Pacific economies in international cooperation efforts comes from recent reports of investigations by US and European regulators into a possible international cartel of manufacturers of liquid crystal display monitors, in which probes by Japanese and Korean authorities have apparently played an important role, with support also sought from authorities in Chinese Taipei (Sydney Morning Herald 2006).

The extent of international cooperation in international anti-cartel enforcement should not however be overstated. Jenny (2002) concludes that international cooperation against cartels “remains quite limited”, and is “the exception rather than the norm”, even though competition authorities have found cooperation useful in cases where it has been used. It appears that most cooperation is of an informal nature, and that limitations on the exchange of confidential information are an important constraint.

Jenny (2002) does note that international cooperation has been more extensive in the area of mergers. Once again however cooperation has been developed furthest between the US and the European Union, where it has been facilitated by an increasing degree of convergence in approaches to merger issues, and where cooperation nevertheless remains primarily of an informal nature. Cooperation across the Asia-Pacific region is again much less in evidence.

The apparent preference of competition authorities for informal rather than formal cooperation is one factor suggesting that establishment of formal international frameworks, especially multilateral frameworks, for competition law enforcement is unlikely to occur in the near future. There are other important practical obstacles to the development of a global or even regional approach to competition law enforcement. Significant differences in legal traditions, both in general and in relation to competition law, different weightings given to the competing considerations underlying the competition policy approach to mergers, and different weightings to be given to related issues for vertical restraints outside the “hard core” cases are all factors that would contribute to the very considerably difficulty if not impossibility of reaching agreement on a common approach to some key issues. Differences may also exist in the value traditionally attached to competition and competitive markets. Lall (1997) points out that approaches to competition policy have been developed mainly within western traditions. In many Asian economies on the other hand there has traditionally been rather a fear of “destructive competition”, which is only slowly giving way to convictions on the overriding benefits of competitive markets. Aghion et al. (1997) introduce a further differentiation, based on firm behaviour rather than culture and tradition. Focusing on effects on technology adoption, their model shows that effective competition policy will reduce the incentive of profit-maximizing firms to adopt new technology, while having the opposite effect on “conservative” or “satisficing” firms characterized by considerable organizational slack.

Wijckmans (2003) points out further that many developing economies lack the capacity to implement and enforce competition law. He makes the obvious point that competition law is of little no value in the absence of the ability and willingness to enforce it. This point is of course fundamental to efforts at international cooperation, since the effectiveness of any arrangements for international cooperation, whether formal or informal, binding or non-binding, must depend on enforcement at the national level. Evenett et al (2002) also emphasise the importance of capacity across the full spectrum of competition policy. They note, for example, that “if aggressive prosecution of cartels (is not) ... complemented by vigilance in other areas of competition policy,firms will

respond to the enhanced deterrents to cartelization by merging or taking other measures that lessen competitive pressures”.

In the face of these many obstacles, it is perhaps no surprise that the most ambitious attempt to date at establishing a multilateral framework, the proposal to introduce competition policy into the WTO agenda and rules, as one of the so-called “Singapore issues”, had to be abandoned in the face of widespread opposition from WTO members, especially among developing countries.

Consensus on competition issues within national jurisdictions has also at times been problematic, even in developed countries. Jenny (2002) notes that when privatization and regulatory reform movements swept through Europe and elsewhere, competition officials found themselves facing a fierce and often losing battle “to retain jurisdiction over the regulation of competitive relationships in markets newly opened to competition”. To cite another example, the WTO negotiations on competition policy tended to highlight a cleavage between competition authorities and trade officials, with the former manifesting a deep-seated resistance to the intrusion of the latter into international competition policy matters.

The factors mitigating against the evolution of a common international approach to competition law are very much in play in the Asia-Pacific region, with its wide differences in legal traditions, capacities and business cultures. Recognition of this led PECC to propose an alternative “principles-based” approach in its “Competition Principles” (PECC 1999), later picked up in modified form by APEC in its “Principles to Enhance Competition and Regulatory Reform” (APEC 1999).

The PECC noted that APEC economies are “at different stages along the economic development and policy spectrums”, with “different levels of institutional capacity, different access to policy instruments, and different views with respect to optimum policy sequencing” that “cannot be ignored. In addition to providing flexibility to allow for these differences, the PECC Principles are also noted for their strong advocacy of a move

away from approaches such as the so-called “efficiency approach, based on a welfare calculus”, in favour of an approach to promote the competitive process itself, rather than the “welfare of competitors”. This emphasis on the competitive process is based in turn on an underlying conviction of the value of well-functioning competitive markets in contributing to the achievement of economic efficiency and rising living standards.

PECC highlighted four “first level core” principles as fundamental to promotion of the competitive process: comprehensiveness (in the sense of ensuring a competition dimension to all economic policies with impacts on globalizing markets), transparency, accountability, and non-discrimination (in the sense of assuring “competitive neutrality in respect of the different modes of domestic and international supply”.) These principles are argued to offer appropriate guidance for the approach to competition in all APEC economies, regardless of level of development and perspective on competition law and policy issues.

Meantime competition agencies have been following an approach to the international dimensions of competition policy that is perhaps more pragmatic than but not necessarily incompatible with the principles-based approach. With competition policy now off the WTO agenda for the foreseeable future, interested competition agencies have formed an International Competition Network (ICN)ⁱⁱ of competition authorities (Monti 2004). The ICN is a vehicle for sharing of views and experiences on the improvement of the interface between competition policy and international commerce, possibly leading for example to consideration of more efficient procedures for parallel investigations by authorities of different economies into international mergers. Efforts such as these to improve efficiency in process, using international cooperation to eliminate unnecessary costs and delays, cohere strongly with the views of Wijckmans (2003) who argues that they are much more important and useful than any effort to achieve harmonization of approaches to merger control, which he sees as problematic and possibly doomed to failure. In the area of vertical restraints Wijckmans argued that the greatest gains will come from improvements in information-sharing, taking care at the same time to give due

weight to legitimate business interests in protecting their business secrets. The ICN is in fact taking steps to strengthen inter-agency cooperation against international cartels.

The clearest convergence between the ICN and principles- based approaches is seen in the ICN project to develop sets of “Guiding Principles” and “Recommended Practices” for control of multi-jurisdictional mergers. Monti (2004) foresees the gradual emergence of a “collection of authoritative best practices.”

In addition to the practical issues discussed above, the analytical literature also provides some warnings against too readily assuming an easy coincidence of interests between countries in competition matters. In competition policy frameworks where both consumer and producer interests enter into assessment of the effects of anti-competitive practices, especially in frameworks based on the so-called “efficiency” criterion, it cannot be assumed that conclusions reached in relation to impacts on the domestic market will coincide with assessments of impact on the global market. For example, in the case of mergers that lead to both lower costs and higher prices, the assessment of the overall impact will depend on the relative weight of consumer and producer interests in the market being assessed. It is possible that a merger that would be approved in a jurisdiction covering a relatively small proportion of the world’s consumers would be rejected in a jurisdiction covering a larger share of the world’s consumers. Head and Ries (1997) cite the example of the proposed acquisition of the Canadian firm de Havilland by a consortium led by French and Italian firms, which was favoured by the Canadian, French and Italian governments but was rejected by the European Commission, representing a larger proportion of the world’s consumers. Conversely, as Head and Ries show, it is possible that a jurisdiction covering a relatively small share of the world’s consumers might approve a merger that reduces global welfare. This obviously raises the possibility of a strategic use of competition policy, designed to maximize domestic welfare gains at the expense of partner economies. Ironically, in the analysis by Head and Ries the risks of such an outcome are likely to be highest in competition decisions by jurisdictions in small economies with powerful producer interests but a relatively small share of the world’s consumers.

The possibility of divergence between domestic and global welfare outcomes is a general point not limited to the case of mergers. Zweifel and Zach (2003) show that vertical restraints practised by multinationals are likely to have more unambiguously adverse effects in foreign markets than in the multinationals' home market. This again raises the possibility that practices that reduce global welfare might be approved by the domestic jurisdiction of a multinational.

A recent article by Tay and Willmans (2005) highlights a further dimension of these issues. They model cross-border mergers in a way that once again assumes that global and domestic welfare effects do not coincide. The relative impact of domestic competition policy on domestic and global markets depends on the proportion of consumers in each market. Tay and Willmans examine first the case of non-cooperation between competition authorities, both in the case of "territoriality", where authorities make decisions only on mergers that are under their jurisdiction, and "extra-territoriality", where they can also take decisions on mergers taking place outside their jurisdiction. Under territoriality, the resulting global competition policy regime is too lax, in the sense that too few mergers are blocked to maximize global welfare, while under extra-territoriality the regime is too strict, in the sense that too many mergers are blocked.

For present purposes the most interesting results in the Tay and Willmans paper are those derived when they analyze the outcome of a cooperative approach where a global competition authority is established to make decisions on merger proposals on the basis of their impact on global welfare. The economies comprising the global economy are assumed to be of equal size and power. The global welfare gain under this scenario exceeds that under the two non-cooperative scenarios. The global authority internalizes the trans-border externalities and achieves a "first-best global competition policy." This case is then contrasted however with an "asymmetric regime", where the global economy is divided between one country that exercises extra-territorial powers and a "fringe of smaller countries" that are unable to do so in their own right. Thus the powerful country

can block every merger that harms its interests, while the “powerless” can block only those mergers under their own jurisdiction. It is therefore no surprise that the outcome for the powerful country dominates the outcome for the powerless, and more particularly that the outcome for the powerful country in this asymmetric case dominates the outcome it can expect in the cooperative case of the global competition authority. In theory the powerless could induce the powerful country to adopt the cooperative approach with the global competition authority by making side-payments, but Tay and Willmans regard this, no doubt correctly, as unrealistic.

Tay and Willmans suggest that their conclusion provides one possible explanation for the current situation, where the major players in the global authority, notably the US and EU, clearly “prefer bilateral cooperation over a truly global arrangement”. In the Tay and Willmans model, the US and EU have no incentive to move from the current situation to the global arrangement, because such a move would harm their economic interests. “Benign neglect” is harmful to the interests of small and powerless countries, while serving the interests of the major players.

This discussion of competition policy issues leads in the end to some uncomfortable questions. Abuses such as cartelization and anti-competitive mergers have potentially damaging effects throughout the global economy, including the Asia-Pacific region. The increasingly cross-border character of these abuses means that countries are vulnerable to these damaging effects regardless of where the perpetrators of the abuses are located. Yet the ability to effectively combat these abuses is confined, both globally and in the Asia-Pacific region, to a relatively small group of countries, and these are in general the same countries that have been able to develop modalities for cooperation, primarily informal, in addressing the cross-border dimensions of the abuses. There is little incentive for this group of countries to extend cooperation to the “fringe” of less well-equipped and generally smaller countries outside their “inner circle”. The theoretical analysis of Tay and Willmans suggests one reason for this. At a more practical level, Jenny (2002) points out that cooperation between the two groups of countries would tend to be a “one-way street”, since it is much more likely that “fringe” countries” will want to

investigate large international firms from the “inner circle” operating in their territories, where they may well have achieved a degree of market dominance, than that large countries in the “inner circle” will want to investigate firms from the “fringe countries” operating in the “inner circle”, which are much less likely to have a dominant market position. Cooperation between countries in the two groups would thus be likely to result in extensive requests for assistance from the “fringe countries” to those in the “inner circle”, while the latter would derive very little benefit from cooperation with the former.

In these circumstances some “fringe countries” may be left with little effective defence against anti-competitive abuses, especially those originating outside their borders. It is possible that in some cases effective enforcement in the “inner circle” countries may as a side effect counteract the effects of abuses in the “fringe countries” as well, but these side effects are likely to be accidental rather than systematic.

Jenny (2002) asks whether this situation is sustainable: in his words, “whether international co-operation on anti-trust can remain largely an informal process initiated on a selective basis by a small group of competition authorities for their own benefit or for the benefit of firms in their jurisdiction”. He concludes that change is probably inevitable, for several reasons. First, the incidence of cross-border anti-competitive practices is likely to increase in parallel with the progress of globalization. Second, the number of countries seeking to combat these practices through their own effective competition regimes and through cooperation with other countries will continue to increase. Third, and as a consequence of the first two reasons, informal cooperation at a bilateral and even regional level will increasingly be seen as inefficient and unnecessarily cumbersome. Fourth, a situation where many developing countries are effectively excluded from the benefits of competition policy and are unable to enforce their own competition laws against foreign firms will increasingly be seen as unfair and unacceptable. Fifth, increasing understanding of the scale of international cartels and their damaging effects will fuel a growing demand for effective action against this form of abuse at both the regional and global levels.

It may perhaps be reasonable to conclude that the outlook for the Asia-Pacific region is for the gradual evolution of a region-wide approach to competition policy, facilitated by the implementation of effective competition regimes by those economies currently lacking them, and featuring a steady growth of international cooperation in terms of both the intensity of cooperation and also of the number of economies participating. In the immediate future it is likely that this evolution will continue develop through informal contacts among the region's competition agencies, facilitated by networks such as the ICN. At some point however, a demand may crystallize for more systematic or even more formal cooperation efforts. If and when that occurs, APEC appears ready-made as a suitable vehicle for these developments.

Investment Agreements

The development of international investment agreements has a long and chequered history. An attempt from within the OECD to establish a Multilateral Agreement in Investment (MAI) was famously stillborn, and more recently investment had to be dropped from the agenda of the WTO's Doha Development Agenda (DDA) as part of an effort to remove blockages to progress in the negotiations. Provisions on investment remain scattered piecemeal through the existing WTO Agreements, including the Agreement on Trade Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS).

Meantime there has been a proliferation of bilateral investment treaties (BITs) and there is also a growing trend for investment chapters to be included in the preferential trading arrangements (PTAs) that have also been proliferating in recent years, driven in no small part by competition among developing countries in particular to attract foreign direct investment (FDI). There is of course an extensive literature on the effects and effectiveness on international investment agreements, reviewed for example in Banga (2003). Here however the focus is on their possible role as instruments for the governance of multinational corporations.

An inspection of the typical content of these arrangements shows that in practice they are primarily concerned with removal of restrictions on FDI, through provisions on non-discrimination and national treatment, and with protection of the rights of investors, through provisions requiring transparency of laws, regulations and administrative guidelines as well as adherence to agreed fair and minimum standards of treatment, stipulating availability of full repatriation and convertibility of funds relating to investment, restraining host economies from practising direct or indirect expropriation, and requiring the availability of an enforceable investor-state dispute settlement process. In many cases there are also provisions designed to discourage if not proscribe the use of incentives.

All of these measures are important for fostering an environment in which investment can move freely across international borders and thus contribute to the efficient allocation of the world's capital. Measures to protect the rights of investors are particularly important for developing countries engaged in fierce competition to attract FDI. Recognizing the relevance of these considerations to its Bogor goals, APEC sought in its Non-Binding Investment Principles, adopted in 1994, to promote the inclusion in the investment regimes of its members of each of the types of provisions enumerated in the preceding paragraph.^{iii 1}

These typical provisions of a BIT or the investment chapter of a PTA stop short however of imposing standards of conduct on the foreign investors. On this issue APEC's Non-Binding Investment Principles merely state that "acceptance of foreign investment is facilitated when foreign investors abide by the host economy's laws, regulations, administrative guidelines and policies, just as domestic investors should." The not unreasonable presumption is that regulation of foreign investor behaviour is a matter for the domestic legislation of the host economy and, where relevant and appropriate, of the home economy.

Nevertheless the upsurge of interest in corporate social responsibility (CSR), discussed further in the next section of this paper, has been reflected in proposals that CSR provisions should be included in bilateral investment agreements. For example, the International Institute for Sustainable Development (IISD) has incorporated obligations relating to CSR in the draft investment agreement that it is promoting as a suitable model for bilateral investment treaties (BITS) between developed and developing countries (Mann et al, 2005).

Proposals for inclusion of CSR obligations in international investment agreements have been contentious. On the one hand, if they are to be enforceable, it could be argued that they will be perceived as onerous by potential investors and thus act to discourage FDI, in contradiction to the purpose of the agreement. On the other hand, if they are to be included only on a “best efforts” basis, and thus non-enforceable, as is the case with most of the provisions in the draft agreement proposed by Mann et al. (2005), they may be criticized for lacking any real practical effect. In any event, while provisions such as those in the draft of Mann et al. (2005) are known to have been proposed in some bilateral negotiations, they do not so far appear to have met with ready acceptance, particularly by home country governments.

Corporate Social Responsibility

The expanding role of multinationals has coincided with a rapid growth of interest and concern in corporate social responsibility (CSR). One index of the extent to which CSR has penetrated the policy debates surrounding multinationals is that World Bank now contains its own Corporate Social Responsibility Practice.

CSR is defined by one member of that practice as “socially minded behaviour such as respecting human rights, refusing to pay bribes, caring for local communities, and adhering to environmental standards”. It is generally seen by its proponents as filling a vacuum resulting from the inability of formal international institutions to keep pace with

the global economy by developing enforceable rules dealing with these issues. Where enforceable rules do not exist CSR advocates seek to secure voluntary adherence to codes of conduct or standards that reflect acceptable or desirable practice. These codes and standards are typically voluntary in practice, but they could in principle be incorporated into mandatory instruments. The inclusion of CSR obligations in the draft investment agreement proposed by Mann et al. (2005), discussed in the preceding section, is one example of this.

Companies can, and in some cases no doubt do, adopt and implement CSR standards in the absence of any form of coercion. They may do so because they value social responsibility objectives for their own sake, or because it is profitable, for example to improve their energy efficiency. However CSR is most often discussed in the context of concerted campaigns by NGOs, trade unions and others to pressurize multinationals to behave according to desired standards or principles. When pressure has to be exerted in this way, the incentives for multinationals to comply are essentially reputational; the firms are encouraged to conclude that compliance will elicit a favourable response from customers, suppliers, employees, and other stakeholders including even governments, and that this in turn will have a positive effect on profitability.

The term “civil regulation” has been applied to the techniques used to encourage firms to practice CSR. Newell (2001) provides an extensive discussion of civil regulation and gives many examples of its various manifestations. One side of civil regulation involves the techniques for exerting pressure on the multinationals. Consumer boycotts and the dissemination of adverse publicity are the techniques that have received the greatest amount of publicity. Shareholder activism, where activists purchase shares in order to gain access to company meetings, at which they seek to embarrass the company and its directors, has also been used in a number of countries. Some NGOs have engaged in litigation to seek judgments requiring the target firm to modify its behaviour. The other side of civil regulation involves the instruments used to formalize any bargain that may be struck. Codes of conduct have been popular instruments for this purpose, and some

NGOs have also established “stewardship regimes” with their multinational adversaries/partners.

Klein and Harford (2004) discuss the condition in which pro-CSR campaigns are likely to be effective. First and foremost the target firms must operate on a long time horizon, otherwise the reputational incentive will not be strong. Second, the pressure must be relatively easy to apply. For example, boycotts are likely to be easiest to implement when the target firm operates in competitive consumer markets where the customers can easily switch to alternative products, but will be more difficult to operate against firms that produce intermediate goods. Third, the offenders must be easily identified, so that firms can be reasonably sure that their adversaries will be aware whenever they “step out of line”. Finally, the cost of compliance should be light compared to the cost of the reputational damage that can be inflicted on the company. Voluntary standards will often be appropriate on these grounds, since a firm will generally look for ways to satisfy their critics in ways that are not excessively expensive. If the cost of compliance is too high on the other hand, the firm will obviously have an incentive for non-compliance.

There may well be questions as to the quality of the outcome of CSR campaigns. As Klein and Harford (2004) point out, targets may be chosen for their high profile or because they are relatively easy to get at, rather than because they are the worst offenders. In that case the worst abuses will go uncorrected. The choice of issue may also be problematic. Generally the issues chosen will be high profile and with a high emotive content, since support is easier to mobilize in such cases. These issues may not necessarily however correspond to the direct areas of need, whether the objective be poverty reduction or environmental protection. Social groups or issues with the most urgent need for action may be by-passed if they do not appeal to the activists that mount the CSR campaigns. A mismatch between action and need may be especially a risk when the activists are rich NGOs in developed countries while the intended beneficiaries are marginalized people in poor developing countries. If the objective of the campaign is not carefully and appropriately established, unintended results may follow, the classic case being campaigns to eradicate child labour that may have led to increases in child

prostitution. Inserting CSR obligations into investment agreements also needs careful consideration. If the effect is to increase the perceived costs of investing in the country concerned, investment may be diverted to other more hospitable destinations. On the other hand there is anecdotal evidence for example in Cambodia, of investment being attracted precisely because of the existence of acceptable labour standards or the willingness to institute them. Presumably the reputational considerations underlying this choice would reflect the success of past campaigns.

Ward (2004) argues that there is a role for the public sector in developing countries to build capacities and institutions that can help to ensure that CSR demands are generated in those countries as much as or more than from stakeholders in rich countries. It is obviously desirable that CSR is promoted in a way that reflects priorities in the recipient communities. On the other hand it must also be conceded that public policymaking in developing countries, including policies toward trade and investment promotion, can also at times fail to give adequate regard to those priorities. Likewise there can be no doubt that good governance in the public sector is a very desirable if not essential complement to CSR in the private sector, and in many developing countries there is much to do in this area. Corruption in the private sector is generally closely connected to corruption in the public sector, for example, and it is much easier for private firms to be environmentally responsible if the public sector is pursuing sound environmental policies.

Taxation

Taxation of multinationals is a highly complex and technical subject, with an extensive literature, a full survey of which is beyond the scope of this paper. Here a brief discussion is provided of recent contributions to an issue that has perhaps drawn more attention than any other issue relating to the taxation of multinationals, namely the choice of taxation strategies to combat transfer pricing by multinationals. It is interesting to note that the potentially competing interests of governments, that appeared in the earlier discussion of competition policy, also features prominently in this literature.

Transfer pricing is a well-known stratagem whereby multinationals adjust the prices at which intra-firm trade takes place, so as to distribute their profits between the various countries in which they operate in the way that minimizes their overall tax burden. The ability of multinationals to take advantage of transfer pricing is naturally of concern to governments because of its potential impact on their tax base. If the use of transfer pricing is unconstrained, governments become powerless to sustain independently set tax rates, and a “race to the bottom” in tax rates ensues. This is consistent with the well-known finding on the consequences of capital mobility

In the case of transfer pricing however there is a defense available to governments. In order to combat this profit-shifting behaviour by multinationals governments can endeavour to monitor transfer-pricing behaviour so that they can assess the appropriateness of the prices used, and adjust where necessary for their impact on the multinationals’ tax payments, or even impose penalties where transfer-pricing for the purpose of tax avoidance is detected. The typical rule against which the appropriateness of transfer-prices has been assessed is based on the “arm’s-length” approach, whereby the transfer prices used are compared with the price that would be agreed by two completely independent units. Significant differences between the “arm’s-length” price and the transfer price actually used would be corrected by the tax authorities so as to cancel out the effect of the transfer-pricing in reducing the firm’s tax liability. This “arm’s length” approach is endorsed by the OECD.

Governments however became increasingly sceptical of the effectiveness of the arm’s length technique, and began to switch from this price-oriented approach to a profit-oriented approach whereby the profits declared by companies may be adjusted for tax purposes in cases where the firm’s profitability is shown to be significantly lower than the profitability of comparable firms in the same situation over a defined time period. The comparable profit method (CPM) introduced by the United States in the 1990s is an example of a profit-oriented approach. It seeks to align the profits for tax purposes of multinational subsidiaries operating in the United States with the average profits for tax

purposes of comparable US firms. It was aimed especially at Japanese multinationals operating in the United States.

An interesting paper by Eden et al. (2005) endeavours to assess the effectiveness of penalties for inappropriate transfer-pricing behaviour by estimating the effects of US penalties for transfer price manipulation (TPM) on the stock market valuation of Japanese companies with US subsidiaries. They find that the penalties appeared to result in a very substantial drop in the cumulative market valuation of the companies concerned, indicating that the penalties are indeed very effective. They note that tax authorities of other governments have been following the United States' lead, and portray multinationals as "caught in the middle, facing penalties at home and abroad" as governments "strive to retain what they see as their fair share of corporate profits."

This leads to an obvious question as to whether cooperation between governments might produce a more favourable outcome. Papers by Raimondos-Møller and Scharf (2002) and Mansori and Weichenrieder (2001) address the issue. Raimondos-Møller and Scharf note that when governments intervene with regulation to curb profit-shifting by means of transfer pricing, the "race to the bottom" is likely to be replaced by a "race to the top", resulting in reduced production and trade. This result is also obtained by Mansori and Weichenrieder who find that tax revenue is also depressed. Both papers suggest that cooperation could deliver a more favourable outcome. Raimondos-Møller and Scharf demonstrate the existence of cooperative solutions whereby harmonization of transfer pricing rules leads to a Pareto improvement, but find also that harmonisation based on the "arms-length" principle may not in fact be Pareto-improving. Raimondos-Møller and Scharf do not however address the question of whether governments have an incentive to cooperate in this way.

Schjelderup and Weichenrieder note a possible downside of the search for more effective ways to curb profit-shifting behaviour. They develop a model in which switching from the price-oriented approach to the profit-oriented approach to curbing transfer pricing will reduce imports, although it may not change transfer prices. This leads them to

suggest that a shift to the profit-oriented approach such as CPM may be supported by protectionist interests as a possible instrument for protection and strategic trade policy.

Transfer pricing is not the only activity that can give rise to concerns over the international distribution of tax revenue. In the Asia-Pacific region there has recently been considerable controversy over profit realizations from asset sales by foreign private equity funds, for example in Korea and Japan. Whether tax on such profits accrues to the host or home governments has important implications for the welfare effects of the investments concerned.

Outlook for Disciplines on Governance of Multinationals in the Asia-Pacific Region

The economic governance issues relating to multinationals are complex and multi-dimensional. While cooperation can lead to improved outcomes it is not always clear that compelling incentives for cooperation exist. In some cases there appears to be a clear incentive for key economies not to behave cooperatively, as in the Tay and Willmans analysis of competition policy.

Trade policy faces analogous problems of non-cooperative behaviour. In this case however the WTO provides a payoff to cooperation in the form of a multilateral institutional framework for the operation and enforcement of rules for the conduct of international trade. No comparable framework yet exists for competition policy, investment and taxation, and the analysis of Tay and Willmans suggests that large powerful countries may in fact have incentives to block the establishment of such a framework on a global or even regional basis.

There is also little prospect of a comprehensive regulatory framework being established for these issues at the regional level in the near future. While many of the region's new PTAs include provisions on competition policy and investment, their membership structure is for the most part bilateral or at best plurilateral, and many studies have

highlighted the obstacles standing in the way of establishing broader regional groupings. Furthermore, as highlighted for example by Trewin and Scollay (2006), the provisions of the region's PTAs on issues like competition policy and investment vary greatly in the extent to which they impose substantive enforceable obligations, and in most of them the obligations tend toward the "soft", non-enforceable end of the spectrum, especially in the case of competition policy. Provisions on investment often appear to be carefully designed to avoid any requirement for policy change on the part of member governments. Development of an institutional capability to regulate the behaviour of multinationals at the regional level would require deep integration of a kind that has to date only been achieved by the European Union, and Asia-Pacific economies are still very far from contemplating, let alone having the capacity to implement this degree of integration at the region-wide level.

The conclusion is inescapable that for the foreseeable future the formal regulation of multinationals in the region will depend on the maintenance and enforcement of the standards, rules, norms and regulations for corporate governance at the national level in their home and host countries.

Nevertheless scope exists for cooperation at a level below formal regulation to make a significant contribution to the improvement of corporate governance arrangements in the region. Regular consultations based on the sharing of information, experiences and ideas, and the development of "best practice" guidelines can work to gradually lift national standards region-wide, and can also lead to useful cooperative initiatives between agencies of the region's governments. Some of these consultations occur within institutions centred outside the region that involve subsets of the region's economies, such as the OECD and the ICN, and some take place in a subregional context, for example within the ASEAN, NAFTA or ANZCERTA frameworks. At the region-wide level APEC provides the obvious institutional framework for consultative activity of this kind.

Investment and competition policy are already included within APEC's trade and investment agenda, while taxation in principle lies within the competence of APEC finance ministers. APEC's principles on investment and competition policy, adopted respectively in 1994 and 1999, were high-points of APEC's work in these areas, and a concerted effort would be required to recover momentum, as well as to develop a work programme on taxation issues. Some adaptations to APEC's structure might need to be made as well. Competition policy and taxation in particular tend to be the jealously-guarded territory of their own bureaucracies, and it is likely that a process independent of trade officials and ministers would need to be established if these subjects are to be pursued energetically and effectively within APEC. A formal regulatory role for APEC will however be precluded as long as APEC members are unwilling to move in the direction of binding, enforceable commitments at the APEC-wide level.

There are also other institutions that play an important role in disciplining multinationals, in particular the region's financial and capital markets. As these markets become more efficient and more integrated, so does the probability increase that poor standards of corporate behaviour and governance will be punished while sound behaviour and governance are rewarded. The need to establish and maintain sound reputations among the investors in these markets leads to pressure for improved quality of domestic corporate regulation and improved transparency in corporate governance, including through the adoption of best-practice accounting standards, and other indicators of sound corporate practice such as ISO accreditation.

Disciplining of multinationals in areas of corporate social responsibility remains largely outside the domain of financial markets, despite the development of concepts such as triple bottom line accounting. In this area the "watchdog" role of non-governmental organizations (NGOs) is more important, along with competition in product markets characterized by increasing consumer awareness associated with rising levels of education.

In summary, for the foreseeable future formal regulation of multinationals in the Asia-Pacific region is likely to remain largely the province of the governments of home and host countries, with processes of international consultation and cooperation providing both a stimulus and support for improving the quality of domestic regulation. Competition in international financial and capital markets generates pressure on both governments and the multinationals themselves for improved standards of governance, while multinationals can also expect growing pressure for improved governance from both product market competition and NGO activity.

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Endnotes

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ⁱⁱ Membership of the ICN is by agencies, not by economies. Included among the members of the ICN are agencies from all APEC economies except Brunei Darussalam, China, Hong Kong China, Papua New Guinea, Russia and Viet Nam.

ⁱⁱⁱ As with competition policy, the PECC provided the antecedent to APEC’s investment principles, in this case with their proposed Pacific Investment Code. After finalisation of the investment principles APEC’s agenda focused more on investment promotion than on investment liberalisation or regulation. Recently there has been an effort within APEC to revitalise its investment liberalisation agenda.