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The Practical Implications of International Economic Regulation of Multinational Corporations and Business as Seen from Capitol Hill

Shortly before his death, Arnold Toynbee said "our age will be remembered, not for its horrifying crimes or its astonishing inventions but because it is the first generation since the dawn of history in which mankind dared to believe it practical to make the benefits of civilization available to the whole human race." Obviously today if such fundamental changes are in the process of taking place, we must accept a great deal of friction, both nationally and internationally.

As the Secretary General of the United Nations observed recently, when he was discussing corporate citizenship in the World Community,

> it would indeed be remarkable if global stratagies which are evolved by companies and directed from a central headquarters in a major industrialized nation and whose basic objective is to maximize global production and profits, would in all circumstances coincide with the national plans, policies, aspirations and sensitivities of many nations, especially those that are in an early stage of their development. Particularly in such countries, substantial new investments usually have a very considerable impact on the societies into which they are introduced.

There is often a wide gulf between the basic philosophies of large corporations and those of nations in which they operate. Reconciliation between their objectives and disparate styles of development is very often possible; and given the universal desire for rapid development and the potentialities offered to this development by transnational enterprises, areas of joint advantage may frequently be discovered. But, obviously, the conditions of association must be very carefully pondered by both parties.

Now, some of the more hard-nosed corporate bottom-liners may see in this

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approach an effort to clip the wings of the golden goose of the multinational enterprises (MNE) without scaring the bird enough to reduce its egg production. Small wonder there is growing concern today about potential domestic legislative aspects of the increasingly exposed position of the MNEs. It is not just some wild-eyed Marxists in host countries that are objecting, but many congressional leaders in both parties. In addition to questions on balance of payments and export of jobs, criticism seems to center on whether or not there are revenue implications of overseas production without some reasonable restraints. Some congressmen are critical that roughly six percent in taxes on income from foreign-earned sources are being returned to this country at a time when some of the same people are, in other forums, alleging a serious domestic shortage. However, before we review current congressional perceptions, let us consider just how the all-important image of the MNEs has eroded over the past few years to the extent that they now find themselves facing regulation both at home and abroad.

About twenty years ago, it was more or less accepted in academic circles that the remarkable growth of the total output in the developed countries since, say, 1800, was attributable to four basic factors which had operated powerfully and persistently: entrepreneurship; innovations and technical change; capital accumulation; and increasing specialization in exchange between persons and regions nationally and internationally. All four were of course linked together in complex patterns rather than in a simple linear cause and effect relationship. Without innovation and technical change certainly capital accumulation would have been far less than it was. Without entrepreneurs acting to mobilize, recombine and reorient existing productive resources, innovation and capital accumulation would not have augmented total output as they did. Indeed they might not have occurred at all. Without the spread of the market that permitted specialization and exchange, the effects on output of the other three factors would have been much diminished.

By 1960 when many of us began to talk about "the revolution of rising expectations," Barbara Ward had already written about the ambivalent attitude of many host countries to most MNEs, saying that they were viewed with equal parts of desire and distrust. She explained this attitude by saying that developing countries looked at the process of development in basically two ways, e.g., (a) that foreign investments led to a quickening of economic growth "only if local people share widely in the wealth created if it initiates manufacturing, if it leads to a transformation of local agriculture from static to market patterns, and if a large, trained professional and middle class begins to emerge as a consequence of gathering momentum."

Or, (b) "In other circumstances," Lady Jackson continued, "foreign investments can degenerate into pockets of great wealth and generally impoverished economies. Then it is not too difficult for communist propaganda to identify the

foreign investments with the Leninist definition of imperialism and arouse both nationalist and revolutionary anger against the local government for tolerating the co-existence of such extremes of well-being and misery." A couple of years ago during the international oil crisis, this second point of view gained a great deal of momentum. Now, looking back at that crisis, together with its concurrent international monetary distortions and the bribery exposures that followed, although they were not really related in the causal sense, it is somehow ironic that the image of the multinationals suffered as it did. Suddenly many MNE critics began to find a wider audience for their iconoclastic prose. It was not just the Archie Bunkers who were looking for a scapegoat after those interminable hours spent waiting in the gas lines.

An example of that denigrating and distorted appraisal is served up by Barnet and Mueller's "Global Reach" in which the authors alleged (in 1975) that much of the technology transferred to the developing world by the MNEs is second-rate and overpriced; and that the corporations are uninterested in adapting this technology, originally designed for advanced industrial societies, to local needs. Instead of bringing in new capital, miltinational corporations are charged with preempting local savings, undercutting smaller entrepreneurs who are unable to compete for local credit against the dazzling security offered by the world balance sheets of the giants. Yet, curiously, it was not so long ago when foreign investors were castigated by the undeveloped countries for milking away their natural resources and doing nothing to institute production and processing capabilities in these poorer areas.

Typically, Professor Galbraith has a different perspective on this, although scarcely more flattering. A year or so ago, he asserted that the multinational firm really enters a country to become part of the wage and price making process of that country, in order to protect itself from the wage advantage of domestic producers or to be part of the price equilibrium that insures it against disastrous price competition.

> Its protective and affirmative purposes are the same as those of domestic firms. It does not in consequence exercise an independent authority on either wages or prices. The exercise of such independent authority, with its damage to protective purposes, is precisely what its intrusion is designed to avoid.

As Senator Javits observed during the recent investigation of MNEs in Congress,

> the abuses committed by MNCs as disclosed have greatly weakened their standing in the public mind. A recent Gallup poll shows that big business has dropped to last place in public confidence. There exists a strong tendency for the public to believe that the MNCs have little to recommend them and thus to ignore their beneficial aspects that clearly exist in spite of the flurry of charges about the harmful aspects.

The United States, he added, will require a willingness at home to deal with the abuses of multinational corporations abroad.

Now this important business challenge will not be met by just writing and reading articles, like the one in the July 1976 issue of FORTUNE, *An Underscandalized View of Those Bribes Abroad.* The article by Walter Guzzardi, Jr., sounds as if it is the SEC rather than bribery-paying companies that are the illegal actors.

In order to preserve one's perspective on this issue, it is essential to examine the basic problem and to recall what our government's attitude has been as the problem has developed. In the post-war era, "think tanks," foundations, and numerous scholarly reports, had a great influence in the development of the MNEs. The foundations that were particularly operative were Ford, Rockefeller and 20th Century Fund. The series of reports offered by assorted conclaves of seers started in 1950. There were the Gray Report, the Bell Report, the Paley Report, the Rockefeller Report, the Douglas Report, the Maffery Report, the Randall Report, the Fairless Report, the Johnson Report, the Straus Report and the Boesenstein Report and then the Roth Report, which was issued in 1969. All of these reports stressed the importance of foreign investment to the United States and laid the foundation for the basis for the constructive growth of multinational enterprises.

The Roth Report in January, 1969, was the first one that expressed concern over the emerging problem, and that addressed itself to the MNE problem which J.J. Servan-Screiber had first publicized the year before his international best-seller, *The American Challenge.*

A few months after the conclusion of the Kennedy Round GATT negotiations, somewhat shaken by the adverse congressional reaction, President Johnson instructed his Special Representative for Trade Negotiations, William Matson Roth, to study the future of the United States trade policy. A committee, which this writer chaired in the executive office of the president, held two months of public hearings preparatory to the issuance of its report, which included many prescient comments by the president's distinguished Public Advisory Committee on Trade Policy. On page 71 of that report, the following very clear warning flags were hoisted. The following significant paragraphs must be noted:

> The effective operation of the Trade Expansion Act Advisory Committee will require more data, in particular, on the specific effects of investment on United States trade and employment. In the area of trade, for example, not enough is known of the extent to which investments abroad have generated exports that would not otherwise have been made. Moreover, little is known of the extent to which sales from the U.S. foreign subsidiaries displace U.S. exports or generate additional imports.
>
> Another important question concerns the specific impact of U.S. foreign investment upon domestic employment. Such investment can facilitate the rapid transfer of production, technology, and managerial skills abroad. In contrast, labor typically has little if any mobility across national borders. This creates the possibility that, whatever its value to the United States economy as a whole, investment abroad may displace individual workers—either by replacing exports or by generating additional imports. To

> the extent that this displacement may occur, it will have a direct bearing on the need for a more adequate adjustment-assistance program.
> American and other companies making foreign investments are often subject to the laws of more than one country that are not only different but may be in conflict. As business firms become increasingly international, such conflicts in the regulatory and other policies of countries affecting foreign investment will tend to increase. Efforts will be needed to establish an international institutional framework for settling the conflicts that may result. The first step in this direction should be to begin to explore with other countries the problems arising from the internationalization of business activity, particularly where they have implications for international trade.

Had these warning flags been heeded much of the present trouble might have been averted by alert corporate management. What may be another seminal study which has been going on and which should be completed by year-end, is that of the Federal Advisory Committee on National Growth Policy Process. This committee was established by the National Commission on Supplies and Shortages in accordance with Public Law 93-426, to begin developing recommendations "as to the establishment of a policy making process and structure within the Executive and Legislative Branches of the Federal Government as a means to integrate the study of supplies and shortages of resources and commodities into the total problem of balanced national growth and development." It is clear from several meetings which they have held that many of the problems which concern MNEs are directly relevant to their deliberations. The committee feels that most people still are thinking in terms of our yesterdays, when we had water to waste, oil to spill, and forest to raze. They are concerned that:

> We have brought the world to our dinner table and share with it the fruits of our lands as well as the technological fruits of our scientists and educated populace. We have been the arsenal of democracy, and the land of the almighty dollar and like a huge, dynamic, brawling young man, we have been able to work all day, dance all night and spill our energies and treasures all over the world. But the world has changed and so must we. We no longer own or economically dominate the vast natural resources we once did in our own and in foreign lands.

Most of the committee members recognized the obvious fact that we are using energy year after year, at a rate faster than we are replacing it, *while at the same time we have been becoming increasingly dependent upon and losing economic control over,* foreign sources of production.

It is interesting to note that there is an increase in output in the last few years from the halls of academe on the negative aspects of multinational business enterprises. Meanwhile, there is an increasing flow of articles and congressional testimony from the unions, principally, the AFL-CIO. One should not be surprised at the rising crescendo because it has been building up slowly but surely for some time. In 1962, the unions supported the Kennedy Trade Expansion Act, and considerable time and motion are required for a large bureaucracy to turn around on a fundamental policy issue. Yet turn around they surely have, as the media have attested. The typical union perception has been that the

multinationals' overseas income receives a much better deal from Uncle Sam than income from within the United States; that the Internal Revenue Service offers MNEs untaxable money in the bank on the condition that they further expand their overseas investment, which of course unions consider as an interest free loan that is never paid back and is, therefore, a gift. From their point of view, it therefore follows that one result of this discrepancy, as they see it, is that American business is encouraged to move its production profits overseas.

Unionists are fond of quoting Harry B. Henshel, president of the Bulova Watch Company, who said in an unguarded moment, "[W]e are able to beat foreign competition because we *are* the foreign competition." This brings to mind the opening of a recent ITT Annual Report, which describes itself as "constantly at work around the clock in 67 Nations and on six continents . . . and quite literally from the bottom of the sea to the moon."

Between 1948 and 1973, United States corporate investment abroad increased from $9 billion to an estimated $107 billion book value. The unions never tire of pointing out that this phenomenal growth was not wholly the ineluctable consequence of international efficiency, but that it was speeded along by tax incentives. Union witnesses exploited the oil crises. Gus Tyler, Assistant President of the Ladies Garment Workers, wrote, "[F]oreign investment was the easy way to do it, the easy way for corporate expansion, the easy way to get energy, instead of spending money on energy research, instead of looking for ways to use coal, we invest in Arabian oil wells" . . . in the short term this made sense: You could make a lot of money by investing abroad. But now we have had a shift of power not just to the Arabs, but to the Russians. Suddenly we are in a vulnerable position politically and economically. In roughly the same context, Senator Frank Church stated that many basic facts were:

> obscured by a bewildering superstructure of subsidiary corporations, complicated dividend and investment arrangements and arcane jargon which kept the Internal Revenue Service sufficiently befuddled that it could never disentangle the substance of the transaction from the form. Like the proverbial shell game in which the hand is faster than the eye, the government tax experts could not follow the financial pea as it was moving around the various corporate shells created by the most ingenious and imaginative Wall Street legal talent that money could buy.

A more recent twist to the union argument is that the burgeoning overseas operations of United States MNEs carry the export of comparative advantage to its logical limit. The multinationals export, not only the most sophisticated machines for making new products but also the whole plant, the most efficient, integrated production in organizational technology we have to offer. Little wonder, then, they say that we find ourselves losing out in foreign trade, we are competing with the most advanced sectors of American industry operating

overseas with tax preference from the United States Government and lucrative incentives granted by the countries in which they now reside.

Against this background, it must be remembered that the Office of Management Budget and other builders of the Budget as well as legislators concerned with taxes have been peering more closely into what they call some of the new "words of art"—tax expenditures; and that some of this reaction found its way into the 1976 Tax Reform Act.

The Congressional Budget and Impoundment Control Act of 1974 requires that the budget committees and the Congress examine tax expenditures as part of the overall federal budgetary policy. This requirement stems from a recognition that numerous provisions of federal tax law confer benefits on some individuals and institutions which are comparable to direct federal spending, but that these tax law benefits are seldom reviewed in comparison with direct spending programs. The United States Senate Committee on the Budget published on March 17th of 1976, a committee print on tax expenditures. This analysis shows that there are the following tax expenditures in connection with LDCs:

> exclusion of gross-up on dividends of less developed country corporations estimated revenue loss, 1976, 55 billion dollars . . . deferral of income of domestic international sales corporations, estimated revenue loss, 1976, 1 billion, 340 million dollars . . . special rates for Western Hemisphere trade corporations, 1976, 50 million dollars . . . deferral of income of control foreign corporations, estimated revenue loss, 1976, 525 million dollars.

Now obviously, whether these are considered "loopholes" by labor leaders, "tax expenditure" by government economists or equal "competitive international terms" by MNEs, they will be under increasing analysis in the years to come.

If one could look in the crystal ball for a moment and try and predict some battles that may be lost in the not too distant future by the multinational enterprises, the first one would probably be the argument over the repeal of tariff schedule items 807 and 806.30. Not too long after that, it would not be surprising to see the disappearance or at least the incrementalization of the domestic international sales corporation, which was sold to the Congress in the '60s as a way to help the balance of payments when we had an apparently chronic balance of payments problem. More disclosures may be required of MNEs, both by the United States Government and host countries, over the next few years. At present, the executive branch position is broadly, that the United States objective is a liberal requirement for international direct investment—as it always has been. But the Ford administration considered that the approach required "to sustain this objective in current environment is no longer laissez-faire but rather the creation of multilateral structures for cooperation and restraint on unilateral action." That quotation from Mr. Bocker, then Deputy Assistant Secretary of State for Economic and Business Affairs, also reflects a

change in thinking in the executive branch.

It can be expected that the Justice Department will continue bringing cases like *United States v. The National Lead Company,* or *United States v. Imperial Chemical Industries Limited,* which as you know were landmark cases challenging international market allocation by major American and foreign corporations. On Capital Hill, there will be more concern over foreign expropriations which could result in congressional acts not always pleasing to the executive branch. I am thinking of things like the Hickenlooper Amendment in 1962 to the Foreign Assistance Act and the Gonzales Amendment in 1971 to the funding of the Inter-American Development Bank. Although no action may be expected on transfer, pricing or foreign tax credits, there might be some movement on foreign tax deferrals, which could be conceivably supported by the executive branch.

In conclusion, the perspective from the Hill is certainly not that multinational profit has become a dirty word but just that they are not quite as sacred as they once were held to be. Attorneys would do well to counsel clients to ponder the closing words of Adolf Berle, when he wrote in 1954, at the conclusion of his book, *The 20th Century Capitalist Revolution,*

> . . . . Corporate mamagements, like others, knowingly or unknowingly, are constrained to work within a frame of surrounding conceptions which in time impose themselves. The price of failure to understand and observe them is decay of the corporation itself. Such conceptions emerge in time as law. It may be said of the corporation as old Bracton said of the Crown: "There is no king where the will and not the law prevails."