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On the Definition of Transnational Corporations in a UN Code of Conduct

by Gerd Schetting, Bonn*

The UN Commission on Transnational Corporations which was appointed by ECOSOC will have its next meeting in May. An Intergovernmental Working Group will have held ten sessions by then and present a draft Code of Conduct dealing with transnational corporations. (For a review of the state of preparations for this Code see the article by Hartmut Scheele in *INTERECONOMICS* No. 6/1979). The Commission itself and the Working Group have dealt more than once with the question to which enterprises the future Code is to apply but they have so far been unable to reach agreement. The difficulties are examined in the following article.

The multinational or transnational corporations (TNC) have not been defined in generally valid terms either in the scientific literature or in the political discussion. The following criteria are however widely accepted as characteristic of TNC:

- ☐ Transnationality (activities in various countries),
- ☐ Global business strategy,
- ☐ Central decision-making,
- ☐ Economic power (market influence, size).

Other criteria are mentioned in addition – according to the observer's political viewpoint – as characteristic and relevant:

- ☐ Legal status of the decision-maker ("the owner"): private – public – mixed;
- ☐ Legal form of control (domination) between the entities within the TNC: shareholdings – other forms of control;
- ☐ Country of origin (principal domicile): developing country – western industrialized country – socialist industrialized country.

The political debate on TNC in the framework of the North-South dialogue has so far been concerned with

the actors on the world economic stage who meet the four principal criteria, i. e. with the "big" ones, but it must be added that it has not proved possible to define clearly the meaning of "big".

The reason for the limitation to the big enterprises is their influence on national economies and on the world economy. Their international character makes it in several ways difficult for the states to control them. Their global business strategy – pursued in practice by a central authority – may diverge from the interests of the states in their area of operations; in parts of their area such divergences are bound to occur. The situation is complicated by the fact that the interests of the home and host states may also diverge. Both will look for ways of preventing or at least mitigating TNC activities running counter to their own interests. The state power of the country concerned – or its weakness – is a pertinent factor in regard to such efforts.

While the growing influence of the TNC was at first only a political question within the western industrialized countries, the weak position of most developing countries in relation to the big combines soon became a central topic in the North-South dialogue. The demands for regulations to cover the conduct of the TNC were therefore from the outset directed against the economically powerful TNC.

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The governmental efforts to bring about regional and international arrangements and the discussions in the various bodies together with the extensive literature have however made three points clear:

- ☐ To which circle such arrangements ("definition of transnational enterprises") are addressed depends on their purpose;
- ☐ The arrangements serve the purpose of reinforcing the positive effects of the conduct of TNC and preventing negative effects;
- ☐ The modes of conduct are thus what matters and the definition of TNC for the purpose of arrangements taking the form of codes of conduct must depend on the question which modes of conduct can be regarded as having comparable economic and social effects.

Legal Status of the Decision-maker

In regard to the mutual interests of the parties concerned, it is immaterial for the consideration of the conduct of TNC towards their host countries whether the decision-maker is private, public or a mixed authority.

Even if it can be assumed that political criteria play a part in business decisions of *state enterprises* and may – in socialist countries to a greater and in western market-economy countries to a smaller extent – be crucial for a decision, this fact does not fundamentally alter the mutual interests. Political intentions of the home country may differ widely from those of the host country. The host countries of socialist state enterprises find themselves directly confronted not only by the economic power of the enterprise itself but by the political power of the state concerned whereas in wholly or partly state-owned western enterprises, because of their private-enterprise set-up, the public element recedes into the background. State enterprises whether socialist or western have however this in common that it is their primary aim in international economic cooperation to achieve long-term economic advantages. In this respect they are on a par with purely *private companies*. Nevertheless the socialist states have made the point throughout the consultations on a UN Code of Conduct that their state trading companies could not be regarded as TNC or put on the same footing.

The distinction between domination of TNC entities by means of shareholdings and other forms of control is of no relevance to a generally valid definition of TNC.

A foreign enterprise can, in principle, be subjected to influence through licence, management, supply, purchase, service, coproduction, financing and other *non-equity* contracts as well as by the traditional form of *equity capital participation*. What matters is in either case the intensity of the relation.

The problem is related to the distinction between public and private enterprises insofar as non-equity contracts are the rule with socialist state companies whereas in the western countries participation through direct investment is still the most common form of taking an interest in other enterprises; cooperation arrangements on a non-equity basis are however increasing.

Developing countries sometimes suggest that the term TNC should be applied only to corporations with their principal domicile in an *industrialized* country. This has recently been accepted by the secretariat of the United Nations Industrial Development Organization (UNIDO) in connection with the preparations for the Third General Conference of the organization.

TNC which are domiciled in *developing* countries do not in principle behave differently from those which have their principal domicile in industrialized states, no matter whether the enterprises which they dominate are situated in other developing countries or in industrialized countries. Moreover, many of them are controlled from the industrialized countries.

The repudiation of TNC status for concerns domiciled in *socialist countries* of the eastern bloc by these same countries is in accord with their view of state-owned companies.

For the existing codes (the Tripartite Declaration of Principles of the International Labour Organization (ILO) on multinational corporations and social policy and the OECD Code of Conduct) both of which aim at encouraging the positive contribution of TNC and reducing or avoiding difficulties to which their operations may give rise (Art. 2 ILO Declaration, Art. 2 OECD Code) the above three criteria for the definition of TNC are therefore of no significance (see Art. 6 ILO Declaration, Art. 8 OECD Code). The provisions of both codes are intended for large as well as small and medium-sized enterprises.

Criteria of Size

The UN Code conforms with the two existing codes in its general objectives. A formula to this effect will be inserted in the preamble. Its definition will thus also

refer to comparable modes of conduct by enterprises. Any definition – albeit in the “non-definition” form chosen by the ILO and OECD – must therefore cover public and private enterprises with their principal domicile in western or socialist industrialized countries and in developing countries irrespective of the form in which they bring their influence to bear.

There are no differences on this point between the western countries but the question whether criteria of size are of significance for the applicability of the code to various enterprises has not yet been unequivocally clarified within this group of countries. France and Japan have expressed themselves in favour of its limitation to big corporations. The French delegation has submitted a paper on this point to the UN Working Group which introduces criteria of size under the keywords of “central decision-making authority” and “network of controlled enterprises”. What attitude the developing countries take on this point is not clear. In presenting their argument they often referred to the powerful TNC but there have been isolated demands for the inclusion in the Code also of small and medium-sized enterprises.

Inclusion of Small and Medium-sized Enterprises

A point against the inclusion of small and medium-sized enterprises is that their smaller influence on the economy of the host country markedly lessens the possibility of conflicts of interest between the individual enterprise and the host country. The host country – also if it is a developing country – is always in a stronger position vis-à-vis small and medium-sized enterprises than vis-à-vis multinational groups and for this reason does not need regulations concerning their conduct as much as for the big TNC.

From the viewpoint of development policy it can be argued that small and medium-sized enterprises are especially well-suited to assist the economic and social advancement of developing countries because they

- ☐ use as a rule labour-intensive production processes with intensive training effects,
- ☐ apply less complicated marketing methods,
- ☐ often operate in intensive contact with and responsibility to indigenous partners, and
- ☐ play a special role in the transfer of appropriate technologies because technical and organizational problems arising in the transfer process (e. g. training

of native personnel, adaptation to conditions in the host country) can be solved directly on the operational plant level.

The small and medium-sized enterprises have themselves an interest in starting production quickly and making good use of their plant capacity which coincides with the interest of many developing countries in speedily increasing the capabilities of their own small and medium-sized industries.

The promotion of economic cooperation arrangements for small and medium-sized enterprises is currently given a high rating in the ambit of national and international development strategies (see for instance the UNIDO secretariat's proposals for the Third General Conference). Considerations of structural and development policy have given rise to reflections on the question how the Federal Republic of Germany can do even more than hitherto to encourage private commitments by small and medium-sized enterprises in developing countries by assistance through flanking measures. The hitherto available promotional instruments relate only in part to these enterprises specifically. It is a fact that the investment legislation and practice of many developing countries has created obstacles which, although intended to protect their interests from the big TNC, can – thanks to their experience of operating in other countries, their economic power and sometimes also their political weight – be surmounted by these much more easily than by smaller enterprises.

Lack of Differentiation

The frequently observed absence of a differentiative approach may discourage more intensive engagement by small and medium-sized enterprises and thus frustrate or at least hamper operations which would supplement the activities of big combines and thus be of advantage and welcome to the developing countries. Seeing that even now small and medium-sized firms willing to cooperate are hampered by measures directed at the big TNC, there is reason to fear that a code of conduct which was originally also demanded as an instrument against the big TNC as possessors of economic and political power would turn into a further, more comprehensive obstacle if the new regulations were applied likewise to the smaller enterprises.

The Code could greatly add to the difficulties in the way of the Federal Government's efforts to mobilize the available potential of small and medium-sized

enterprises for cooperation projects in developing countries. This is especially true of provisions involving additional costs which hit smaller firms with more limited manpower and financial capacities than the big TNC especially hard.

Inadequate Power Indicators

The actual power of corporations and the effect of their activities are not adequately indicated by such formal criteria of demarcation between small and medium-sized enterprises and the big TNC as sales, workforce, number of foreign establishments, etc. In certain circumstances even smaller firms may be able to exercise almost as much economic power as big TNC. Small and medium-sized enterprises may have considerable influence on the economic and social development in an economically weak country. The activities of a medium-sized enterprise, e. g. in one of the least developed countries, can carry far more weight for this country than those of a TNC in a newly industrialized country where many other TNC are also at work. Medium-sized firms with a specialized product dominating its market may generate as much economic power as big combines. A small establishment of a big TNC has as a rule less effect on the host country than a major foreign establishment of another enterprise which is of small size in its own country. Corporate power and influence are relative terms; their significance varies from country to country, from partner to partner. Among the hundred biggest companies of most industrialized states of Europe there are some which are mere dwarfs in comparison with the hundred biggest firms in the USA.

Application of the Code to small and medium-sized enterprises is also suggested by the way in which the work of the UN working group has developed: The western countries insisted from the outset on the inclusion into the Code of regulations addressed to the host countries. Provisions of this kind were formulated by the Working Group chairman as a basis for further

deliberations and are contained in Art. 45-56. They provide a certain standard of protection for the enterprises; the details are still contested however. Limitation of the Code to big TNC could lead to a situation in which the big corporations enjoy this protection (whatever its legal status and value) but the small firms are barred. Most of the other envisaged regulations pertaining to enterprises, like those relating to respect for the laws, human rights, adherence to certain modes of conduct in economic, financial and social decisions could in justice be applied to big as well as small enterprises although some of them, as for instance those relating to the effect of TNC operations on the balance of payments, will often be of no relevance to the smaller firms because of the latter's relative insignificance in certain fields. These regulations must be seen in the light of the conflict situation between big TNC and host countries but their applicability to the smaller firms does no harm since the developing countries are already in a sufficiently strong position vis-à-vis them to induce them – and in part also large TNC – to conform to the ideas of their host countries without the sanction of a code and to conduct themselves in a practical situation accordingly.

Some of the regulations on the provision of information (duty to report; balance-sheet regulations) in Art. 43 ff. would however put a particularly heavy burden on small and medium-sized enterprises.

Limitation of the UN Code of Conduct to the big TNC would result in a disparity between the OECD Code which applies also to small and medium-sized enterprises and the UN Code although the conduct of small and medium-sized firms in the OECD area is more transparent than in the world at large, although all the OECD countries are in a stronger position vis-à-vis the enterprises than the majority of developing countries and although some OECD countries – namely those in the EC – already possess other legal

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instruments enabling them to scrutinize transnational corporate activities. As for the ILO Declaration which also applies to small and medium-sized as well as large enterprises, it can be argued that its provisions, relating to employment, training, working and living conditions and labour relations, are of direct concern to the working man to whom it is fundamentally immaterial whether his contractual employer is a big TNC or a small or medium-sized firm.

There is a tactical consideration which is admittedly somewhat conjectural but can be adduced as an argument for including the small and medium-sized enterprises in the UN Code: There is less scope for differences of interest between developing countries and small and medium-sized firms and the negotiating positions are less uneven, so that many arguments of developing countries for strict and comprehensive regulation of TNC operations carry less weight as applied to small and medium-sized enterprises. Besides, developing countries have a major interest in mobilizing smaller and medium-sized firms in industrialized countries for cooperation ventures. If one wants to avoid an excessively strict regulation and control of the operations of transnational enterprises by the UN Code, involvement of the small and medium-sized enterprises in future negotiations can mollify the developing countries in some areas where their arguments spring mainly from modes of conduct associated with the big TNC.

Finally it is to be borne in mind that all western countries except France and Japan have already expressed support for the inclusion of the small and medium-sized enterprises in the UN Code and that France has shown signs of falling into line with the majority while Japan has so far failed to explain its attitude.

Striking a Balance between Pros and Cons

Striking a balance between the pros and cons of a wider definition for the TNC, it could be argued that the exclusion of small and medium-sized enterprises would conform with the common – generalizing – ideas of development policy. This would however leave those smaller enterprises out of account whose conduct in relation to a certain country, certain economic sectors, certain economic, financial or social areas or particular concrete cases bears comparison with that of the big TNC.

For this reason it is advisable on the one hand to choose a definition which can cover all comparable

modes of conduct and on the other to ensure that the small and medium-sized enterprises are not subjected to the same guidelines as the big TNC in regard to their conduct in areas in which this would impose disproportionate burdens on them. Both these aims can be achieved by choice for the mentioned reasons of a wide definition including the small and medium-sized enterprises, which means without criteria of size – perhaps corresponding to those in the OECD Code or in the ILO Declaration – combined with explicit exemption of small and medium-sized enterprises from the application of particular substantive provisions. The reporting and balance-sheet regulations may be considered in this context. The UN group of experts on international balance-sheet and reporting standards has already suggested an exemption for such enterprises. Other areas should be examined in this respect when the proposals for the drafting of the future code take more definite shape. It will however be necessary to find a practicable dividing line between small and medium-sized enterprises and big TNC. This will be easiest in regard to regulations in the formal area of balance-sheets and reporting where use can be made of the national legislation of many countries.

“Non-Definition”

As for the text of the definition itself, the one in Art. 6 of the ILO Declaration deserves to be given preference over that in Art. 8 of the OECD Code:

“Multinational enterprises include enterprises, whether they are of public, mixed or private ownership, which own or control production, distribution, services or other facilities outside the country in which they are based. The degree of autonomy of entities within multinational enterprises in relation to each other varies widely from one such enterprise to another, depending on the nature of the links between such entities and their fields of activity and having regard to the great diversity in the form of ownership, in the size, in the nature and location of the operations of the enterprises concerned.”

Apart from the substantive advantage that this “non-definition” unlike the OECD Code relates to actual and not merely possible control by a TNC it is to be preferred because it has already been accepted by the western countries, the developing countries and the socialist countries and as a constituent part of the “Tripartite” Declaration of Principles has been approved not only by the governments but by the employers’ and workers’ organizations.