

Chapter 4

Global Foundations for Establishing a Need for the Regulation of MNEs

4.1 Introduction

Currently in the Republic of South Africa (RSA) there is no governmental body at any level of government that is charged with complete/centralized responsibility for policy-making and regulation of foreign direct investments (FDI) in the form of multinational enterprises (MNEs). Other advanced industrialized countries have long been convinced of the need to regulate this type of investment through such government agencies as the Foreign Investment Review Agency (FIRA) in Canada and the Committee on Foreign Investment in the United States (CFIUS).

In this age of regional trading blocks forming across the globe, countries with the wealth of resources as exists in South Africa need to address trade and investment issues that go beyond simply attracting increasingly greater amounts of foreign investment. That is, although big business has much to contribute towards global economic advancement, unregulated big business is subject to engage in a number of social, legal and economic abuses least of which is the distortion of markets through market domination and the erection of barriers to competition. As case in point, a substantial proportion of the organizations that are in a position to operate monopolistically or as oligopolists also tend to operate internationally as multinational enterprises. The size and scope of foreign direct investment activity in South Africa is significant enough

to warrant concern and closer examination of government policy and administration applicable to these businesses.

A discussion of foreign direct investment and multinational enterprise policy from a public administration perspective, necessitates at the very least a basic understanding of the empirical as well as the theoretical debates on this type of investment. Thus case studies as well as theory are looked upon in this chapter for guidance in addressing the possible legal, political, administrative, social and economic (among other) perplexities posed by this type of investment in South Africa.

The overarching goal of the current chapter is to explore the following research question – i.e., is there a need for multinational enterprise policy for South Africa? Although the next chapter (chapter 5) addresses this question to some extent, it does so from a markedly different perspective than that proposed in this chapter. In chapter 5 the objective is to resolve this question by surveying and evaluating those policies that are currently in place within the existing decentralized arrangement and assessing the level of adequacy of said policies.

In contrast to the approach of chapter 5, the current chapter takes a much broader and comparative approach to resolving the above-mentioned research question. The current chapter will look outside of South Africa for answers to this question. The approach is to analyze events from a number of countries or regions in order to gain a contextual setting against which South African foreign direct investment policy and regulation (or the approbation thereof) can be evaluated. The chapter then narrows its focus to address this fundamental question within the local context through case study examination in order to highlight the appropriateness and need for policy regulating multinational enterprises in South Africa.

4.2 International Perspective on the Justification for MNE regulation

In the process of determining the adequacy of existing foreign direct investment and multinational enterprise policies, and in order to assess the organizational soundness of government structures that exist to implement these policies, it is necessary to first define the terms policy and regulation. A comprehensive definition of policy is given in chapter 5 (Supra Sect. 5.2) and will thus not be duplicated here.

Exploring the universal bases upon which foreign direct investment and multinational enterprise policies stand, begs the question of why this type of investment should be regulated. Regulation is defined in the New Merriam-Webster dictionary as the act, or state, of being regulated; and alternatively as a rule dealing with details of procedure and having the force of law (The New Merriam-Webster dictionary). Regulation derives much of its meaning from its root word regulate, and regulate in turn is defined as the act of fixing or adjusting the time, amount, degree, or rate of (The New Merriam-Webster Dictionary). In discussing the regulation of multinational enterprises, it is instructive to associate the meaning of the term regulation with the aforementioned definitions as opposed to yet another definition that equates regulation to control. The term control suggests rather radical or extreme connotations, and is more aptly used in the context of the power to restrain or direct, which go beyond what is relevant to the discussion that follows.

Amongst the international community of nations a number of motivations have been posited for the essentiality of regulating foreign direct investment at the national, regional and international levels. Most of these rationales regress

upon the vast magnitude of the resources controlled by these enterprises and the resultant economic, social and political power that this wealth infers.

These regulatory policy motivations and actions are best explored from an historical perspective in order to understand the evolution of foreign direct investment policy to its *current* ideological state and the environmental factors (social, political or economic) that may have contributed to or influenced these policy positions.

One approach to studying this dynamic of the interplay between cause and effect is the systems approach (Parsons 1995:23-5). The systems approach to problem solving provides an organized way of separating institutions and organizations from their environment(s) thus bringing all pertinent relationships into sharper focus. For the case in question, multinational enterprises possess or stand to gain some power (social, political and economic) over their environment – the host country; whilst at the same time, the host country/environment exercises some power (or control) over multinational enterprises through regulation in order to limit the perceived social, political and economic power they may obtain. This set of relationships defines the fundamental and overarching framework within which the foreign direct investment and multinational enterprise policy process takes place and evolves over time (1974 United Nations Report in Modelski 1979:319-20; Cf. Parsons 1995:23-5).

4.2.1 Stages of evolution of multinational enterprises

Within the context of the systems approach, the need to regulate multinational enterprises is related to the significance given to this type of investment by government administrators and policy makers. In this regard, accepting that multinational enterprises are an important derivative of the world economy, it is instructive to note that at different times throughout history, multinational

enterprises have occupied a greater or lesser place in the field of international trade regulations. At times, concern vis-à-vis controlling the possible abuses of multinational enterprises was prevalent among policy makers and at other times the issue proved to be insipid. These variations in interest over the activities of multinational enterprises can be explained by taking account of Makler's (1982) stages of development of the world economy, in addition to Taylor and Thrifts (1982) description of the development of international capitalism, and Muchlinski's (1995) evolutionary phases of modern multinational enterprises.

Makler (1982:5-12) offers a stageist approach to analyzing the vicissitudes of these dynamics and argues that the world economy (and by default, multinational enterprises) developed through subtle yet clearly distinguishable transitional phases (Cf. Taylor and Thrift 1982:277-284; Cf. Muchlinski 1995:19-33). These phases being:

- (a) The shift from feudalism to capitalism;
- (b) The stage of competitive capitalism;
- (c) The stage of imperialism; and
- (d) The stage of transnational capitalism.

The importance of these theoretical phases lies in their specification of the relational values that underlie them. Thus, the relational properties of integration and conflict among firms, markets and states can be discerned in each phase along with the policy responses thereof. Following Makler's (1982) reasoning, it can further be ascertained that foreign direct investments by multinational enterprises are a contemporary phenomenon for which policy stances have understandably been erratic. This political erraticism emanates in part from the lack of empirical work on the effects of inward foreign direct investment and multinational enterprises. The stages of development through which multinational enterprises have evolved are briefly discussed hereunder.

4.2.1(a) The stage of transition from feudalism to capitalism

The first of Makler's (1982) phases is marked by a transition from feudal economic systems to capitalism and thus covers the period leading up to and including the Industrial Revolution circa the sixteenth century to the early nineteenth century. This period of world economic development was characterized by the accelerated propagation of international trade that was underpinned by the evolvement of distinctive cultural, legal and socio-structural arrangements that proved conducive for the implementation of capitalist economies and societies. Thus, development during this phase was spurred on by; firstly, the freeing of labor from feudal restrictions; secondly, the accumulation of merchant and financial capital; and lastly the growth of international markets.

The industrial revolution also brought about a new mode of trade between industrializing/developing countries (center) and underdeveloped countries (periphery). The nature of this mode of trade was such that industrializing countries had the industrial capacity to concentrate on the production of fully manufactured and luxury goods, for which trade in raw material inputs from underdeveloped countries was essential. Thus began the development of what has since come to be known as the unequal exchange mode of trade between center and periphery countries. The accumulation of surplus capital and the formation of monopolies also resulted from the industrial revolution, which in turn represented the necessary conditions for the development of globally oriented multinational enterprises that could engage in both export trade as well as in foreign direct investment (Taylor and Thrift 1982:279-281).

4.2.1(b) The stage of competitive capitalism

The second of Makler's (1982) stages, competitive capitalism, was prevalent throughout the nineteenth century. Although this stage is characterized by a general acceptance of free-market systems and political sovereignty by the majority of the world's nation-states, there was also a simultaneous and robust ideological shift towards an interdependent world economy dominated by the then colonial superpower, Britain. As the first of the world's nation-states to become truly industrialized by the middle of the nineteenth century, Great Britain was able to manipulate the world economy in favor of British capital supported by British military power and geo-political colonial policies (Makler 1982:5-6).

4.2.1(c) The stage of imperialism

Makler's (1982) third phase, imperialism, extends from the turbulent period of the world economic crisis of 1873-96 to the Second World War. The defining characteristic of this phase was the conquest and colonization of non-industrialized nations by the established industrialized powers of the time. During this phase, however, the rate of growth of foreign direct investment by multinational enterprises declined steadily as a result of global political and economic instability. Thus in this period, the Bolshevik Revolution which brought communism to the Soviet Union cut off trade and investment to a sizable participant of the then global economy. Almost simultaneously (circa late 1920s to early 1930s), the collapse of global capital markets led to the great depression during this period, which also contributed to the slow down in international investment. Lastly, the fear of the outbreak of a Second World War was yet another factor that soured the global investment climate by

precipitating nationalistic economic policies characterized especially by the erection of high tariff barriers to trade (Muchlinski 1995:22-3).

4.2.1(d) Transnational capitalism

The last of Makler's (1982) phases, transnational capitalism, resulted as an aftermath of the Second World War. Whilst the Second World War precipitated the collapse of the world economy, it also ushered in a period of rebuilding and renewed international competition led by the United States. This phase covers the post Second World War period and runs to the present and is characterized by the expansion of both capital accumulation and foreign direct investments by multinational enterprises. This new era of the international economy is also marked by a greater degree of international economic interdependence than was witnessed in previous phases. Significantly, Makler's (1978) transnational capitalism phase has run concurrently with and been supported by the re-establishment of an organized international monetary system, the development of advanced technologies that facilitated significant economies of scale in production, and vast improvements and innovations in transportation and communications. As a result, the dominance of the multinational enterprise in international production was established during this phase. Consequently, American firms dominated the period from the end of the Second World War into the 1960s. It was only by the decade of the 1970s that American multinational enterprises encountered significant competition from European and Japanese firms. Newly industrializing countries of the periphery have also begun to spawn globally competitive multinational enterprises in this modern era (Muchlinski 1995:25-6).

4.2.2 Post-war foreign direct investment policy

As the nature, structure and size of international firms changed over time, they eventually came to dominate economic life, yet at the same time their predominating presence caused reaction from the environment within which they operated and led to attempts to restrain and control their potential for anti-competitive and other abuses. Muchlinski's (1995:chapter 1) analysis takes us forward from where Makler's analysis ends. Muchlinski (1995) identifies the post Second World War era as the period in which the issue of multinational enterprises came to the forefront of contemporary political debate. The basis for this positioning of multinational enterprises into the geo-political spotlight can be attributed to a growing awareness in academic and popular circles of the potential for the abuse of power especially by multinational enterprises operating in developing host countries as had been demonstrated in a handful of highly sensationalized cases. One of the most important cases in this regard involves the attempted overthrow of the presidential administration of Salvador Allende in Chile in the 1971 by the Central Intelligence Agency (CIA) in cooperation with telecommunications giant International Telephone and Telegraph (IT&T) (Muchlinski 1975:6-7; Cf. United States Senate Subcommittee on Multinational Corporations 1973 cited in Modelski ed. 1979: chapter 14).

Although Makler's analysis looks largely at the economic environment within which multinational enterprises evolved, Muchlinski's work focuses more explicitly on the policy dimension of host states towards multinational enterprises in the post World War II period. Policies towards multinational enterprises have, of design and necessity, differed across regions and countries. The discussion to follow deals with a small but significant sample of policy approaches applied in key regions and countries in the post Second World War era. The sample of regions and countries includes Europe, Japan, the United States and Africa.

4.2.2 (a) Europe

Whilst the Second World War left much of Europe's physical and economic infrastructure demolished, it also led to the rise of United States domination in world trade and economic affairs. A natural manifestation of this development was the rapid proliferation of United States multinational enterprises throughout the world (Muchlinski 1995:3-4). By the 1960s, however, this trend began to meet ideological resistance from Europeans in particular who began to express misgivings about the overwhelming presence of United States firms in the European market, particularly in crucial high tech industries. Ironically, it was felt that although United States capital and business had played a major role in rebuilding Europe, these same United States interests also stood to impede European economic success if left unchecked. Thus, the policy orientation toward multinational enterprises in Europe by the early 1960s favored regulation especially at the supranational level (Muchlinski 1995:3-4).

4.2.2 (b) Japan

Japanese economic policy also favored regulation over multinational enterprises in the immediate post war era. Unlike the situation in Europe, Japan received far less foreign assistance in rebuilding its war torn infrastructure and economy. Instead, Japan made extensive use of protective trade barriers and highly restrictive policies on inward foreign direct investment. Although the Japanese firmly restricted the entry of multinational enterprises within their borders, they still managed to benefit from access to foreign capital and technology by accepting foreign loans and licensing contracts. As one of the few countries in the world with consistent foreign trade surpluses, Japan drew attention and pressure from her major trading partners and the Organization for Economic Cooperation and Development (OECD) to liberalize

it's foreign investment policies. This external pressure combined with pressures from within Japan from a business community that feared restrictive trade reprisals and wanted to guarantee themselves continued export markets and access to foreign technology. These pressures lead to a gradual easing of foreign investment policies from the late 1960s onward despite initial resistance to reform from the state bureaucracy and special interest groups (Muchlinski 1995:3-4).

4.2.2 (c) The United States of America

In the United States, the 1970s ushered in a period of intense public concern and debate over both inward and outward foreign direct investment. On the one hand, domestic United States firms lobbied for protection from cheap state sponsored imports; and on the other hand, United States labor unions lobbied for legislation that would curb the flow of outward direct investment as a way of keeping jobs in the United States. Union efforts in this regard culminated with the Burke-Hartke Bill of 1972. Although the Burke-Hartke Bill did not succeed in being enacted into law, it's foundational principles and policies continued to influence import control laws. Since the congressional debate over the Burke-Hartke Bill, United States economic policy has not attempted to limit outward foreign direct investment but has put in place controls to review inward direct investment into strategic and national security sectors (Muchlinski 1995:3-4).

4.2.2 (d) Africa

On the African continent, the post-war era coincided with the reversal of the colonial movement. Thus, from around 1945 to 1975 the major European powers (i.e. Britain, France, the Netherlands, Belgium, Spain and Portugal) granted independence to their colonies in Africa and elsewhere. Despite the fact that the majority of African countries gained independence during this

period, this independence was essentially of a political nature only. The European powers continued to dominate the continent economically and socially. Economic domination took place firstly through trade which was characterized by the uneven exchange of raw minerals out of the Africa for manufactured goods from Europe, and secondly through the extraction of excess rents and profits via private multinational European firms (Muchlinski 1995:3-4; Cf. Seidman and Seidman 1977:7-8). As was discussed earlier in the chapter, unindustrialized countries lacked the industrial and intellectual capacity to undertake full production processes for finished goods and instead acquired much needed foreign exchange by trading their agricultural and mineral goods. Although South Africa is now considered an industrialized country, the government recognizes that there is still a lack of sufficient beneficiation taking place in mining and minerals production.

Generally, African policy towards foreign direct investment in the early post war period was articulated through African representation in the United Nations under the aegis of the Group of 77. The Group of 77 (named after the 77 initial member states that constituted it) was formed within the United Nations to give a voice to the un-industrialized and developing countries in the United Nations. The Group held an overwhelming majority in the United Nations and represented an important source of pressure and reforms in the areas of international, regional and unilateral foreign direct investment policies in the underdeveloped and developing countries (Muchlinski 1995:5-6; Cf. Modelski 1979:265-8). The Group of 77 expressed deep reservations about the possible negative effects of foreign direct investment in the newly independent and less developed countries (LDCs) of the world. The Group of 77 thusly managed to exercise its influence within the United Nations by getting a resolution passed to have the Secretary General of the United Nations appoint a Group of Eminent Persons to study and report on the effects of green-field foreign direct investments of multinational enterprises on development in less developed

countries. Policies that emerged from the work of the Group of Eminent Persons aimed to control the ability of multinational enterprises to (Muchlinski 1995:5-6):

- (i) Evade national regulation and taxation;
- (ii) Use technological and capital endowments to monopolize markets;
and
- (iii) Engage in non-economic abuses of the host state such as through political subversion, the introduction of alien cultural values and lifestyles, and the generation of intergovernmental confrontations between home and host states.

The Group of Eminent Persons envisaged that these foundational and ideological prescriptions would define the principles upon which host countries of foreign direct investment could formulate their policies (Muchlinski 1995:5-6). It was further envisioned that the abovementioned United Nations prescriptions would be adopted at the levels of individual states, regionally and supra-nationally (Muchlinski 1995:5-6). United Nations protocols on foreign direct investment at that point in time were indirectly countered by the Organization for Economic Cooperation and Development (OECD). By 1976, the OECD was made up of twenty-four member states, the majority of whom were industrialized countries (such as the United States, Canada, Britain, France, Japan, and West Germany). Although the OECD issued its “Declaration of International Investment and Multinational Enterprises” its approach to the issue of foreign direct investment seemingly favored the positions of industrialized/developed countries over those of underdeveloped countries (Modelski 1979:265-6).

4.3 Contemporary Thinking on the Regulation of Multinational Enterprises

The above-mentioned postwar policy orientations are not particularly representative of the current thinking on the regulation of the foreign direct investment of multinational enterprises. Since the 1970s there has been a gradual shift towards openness globally and especially in the former socialist states of the Eastern Bloc. There has also been an increase in the number of countries that have introduced laws that aim to attract inward foreign direct investment. The trend seems to be moving towards moderating tax and other incentives to multinational enterprises with provisional requirements regarding improved technology transfer, job creation and industrial development (Muchlinski 1995:9-11; Cf. Dunning 1993:571-2). These largely global trends and generalizations are decomposed to give a more detailed and regionally specific analysis of foreign direct investment policy in the passages that follow.

4.3.1 Six factors that influence foreign direct investment policy

By integrating Makler's (1982) work (which looks at the evolvement of firms into multinational enterprises) with Muchlinski's (1995) analysis of the historical positioning of policies regulating multinational enterprises it can be argued that foreign direct investment policies of host government's are highly influenced by (or perhaps even determined by) the following six factors, namely (Cf. Dunning 1993:chapter 19,and pages 579-83; Cf. Muchlinski 1995:90-102):

- (a) The growth and proliferation of multinational enterprises;
- (b) Economic effects of foreign direct investment associated with competitive markets;

- (c) Economic effects of foreign direct investment associated with developmental objectives of host nations (especially in developing countries);
- (d) Social and cultural intrusion and domination;
- (e) National sovereignty; and
- (f) Legal concerns (with particular reference to corporate responsibility, dispute resolution and international law).

Each of these will be discussed in turn in the following sections, with the exception of the economic effects of inward foreign direct investment as this has been covered earlier in the dissertation (Supra chapter 2) and will therefore not be repeated here.

4.3.1(a) Growth and proliferation of multinational enterprises

Although academics and practitioners may not be in agreement on many of the key points concerning the impacts of multinational enterprise investment, empirical as well as anecdotal evidence clearly bears out the fact that as a result of their phenomenal growth over the past half century, they have become significant role players in the economic and political affairs of both host and home countries (1974 United Nations Report cited in Modelski 1979:309).

Generally, in the policy process and in the political environment, unanticipated change and the pace of that change causes immediacy of response and reformulation of priorities. Thus, large-scale and rapid institutional, structural or environmental change that may have some bearing on the public interest will usually lead to calls from the electorate for policy responses on the part of the elected. In this regard, by the decade of the 1960s, world attention, academic literature and public policy were drawn to multinational enterprise at a time directly corresponding with their most active rate of proliferation (Muchlinski

1995:3-7); The United Nations Department of Economic and Social Affairs (1973 United Nations Report cited in Modelski 1979:23-4), expressed major reservations about the fact that –

“... The value added by each of the top ten multinational corporations in 1971 was in excess of \$3 billion – or greater than the gross national product of over 80 countries. The value added of all multinational corporations, estimated roughly at \$500 billion in 1971, was about one-fifth of world gross national product, not including the centrally planned economies. [Thus], International production, defined as production subject to foreign control or decision and measured by the sales of foreign affiliates of multinational corporations, has surpassed trade as the main vehicle of international economic exchange. It is estimated that international production reached approximately \$330 billion in 1971. This was somewhat larger than total exports of all market economies (\$310 billion).”

Although readily verifiable, statistical comparisons of this kind (i.e. between the profit margins of multinationals and the gross national product of countries) may or may not have signaled any significant relationship in real as opposed to perceived terms (1973 United Nations Report cited in Modelski 1979:23-4; Dunning 1993:6-10). Instead, this information tends to serve more explicitly to shed some light on the motivations, composition of and/or changes in the policy environment during the decades of the 1960s and 1970s.

Further, although the growth and proliferation of the multinational enterprise has been identified as an important factor in the determination of multinational enterprise regulatory policy, this growth and proliferation was in turn determined by a number of other factors including the following (Dunning 1993:105-9; Cf. Spybey 1992:135; Cf. Muchlinski 1995:22):

1. The industrial revolution and its technological and legal innovations;
2. Foreign raw material and mineral wealth and availability; and
3. Overcoming tariff barriers.

4.3.1(a)(i) Significance of the Industrial Revolution

Historians and economists are unable to set a definitive timeframe within which the multinational form of business commenced. Scholars of this field prefer to date the beginnings of this form of business enterprise with the period(s) in history when their activity and influence was most significant. Thus, although historical references can be affirmed as far back as the colonizing activities and enterprises of the Phoenicians and the Romans, and at later stages in history to the colonizing period of the Europeans in South America and Africa (Dunning 1993:96; Cf. Muchlinski 1995: chapter 2), the relevant period is the Industrial Revolution - which is described as the birth of the *modern* multinationals (Spybey 1992:135; Muchlinski 1995:19-20).

Mass production and important mechanical inventions and innovations that occurred during this period expedited the expansion of production capacity and increased profits and reinvestment capital, which in turn facilitated increased international trade and opportunities for international production by multinational enterprises. Of the many innovations of this era, mass communication and mass transportation (combined with improved business and management

strategies) were amongst the key elements in the proliferation of foreign direct investment (Spybey 1992:135).

The industrial revolution is also slated as the period in which a change in the legal structuring of large business enterprises facilitated their national and international expansion (Spybey 1992:135). Due to the large amount of financial capital required to launch large-scale production facilities, shared ownership through the joint-stock company arrangement had existed since at least the Middle Ages. Spybey (1992) notes that with the introduction of the limited liability legal concept during the second half of the nineteenth century, shareholding became less risky and more attractive as investors were held liable for debts of the company only to extent of their original investment or shareholding. Thus the debt burden in cases of liquidation or insolvency was shared proportionally amongst investors. In other words, an investor could not lose more than his equity share invested in a limited liability company. The popularity of this type of legal business entity was sufficient, at that time, to precipitate the development of capital markets in all the industrialized countries. A secondary consequence of the development of capital markets was the growth, development and proliferation of multinational enterprises that were able to easily access capital markets for the procurement of investment capital (Spybey 1992:135). Thus, it can be noted that the introduction of the limited liability form of business was a significant factor that contributed to the proliferation of multinational enterprises in the period of the industrial revolution.

4.3.1(a)(ii) Multinational enterprises in search of raw materials

Another important factor that contributed to the proliferation of multinational enterprises was the lack of natural resources and minerals in the home countries of the multinational enterprises. Muchlinski's (1995:22) analysis of the half century or so prior to the First World War decomposes world distribution of

direct foreign investment by industry as follow: 55 percent in primary products (i.e. raw materials and agriculture), 20 percent in railways, 15 percent in manufacturing and 10 percent in trade and distribution, with the remainder in public utilities and financial services. The emphasis on primary products during this period coincides with the gearing of the industrial revolution and is indicative of the reliance, at that time, of the industrializing world on the less industrialized third world countries for the provision of raw material and mineral inputs.

4.3.1(a)(iii) Overcoming tariff barriers

In essence firms that have sufficient capital and asset endowments have the option of exporting to foreign markets, licensing their products to local producers in foreign markets, or establishing their own production facilities abroad (Caves 1996:27). An important factor determining which of these options is followed is the global incidence of import trade tariffs. The existence of high tariffs and import quotas has been forwarded as a motivating factor for the proliferation of international production. The rationale here is that where foreign domestic markets are restrictive towards imports, the international enterprise will prefer to avoid high import charges (in the form of tariffs, quotas and other import limiting measures) by setting up production facilities in those markets.

In this regard, Muchlinski (1995:23) has identified the inter-war period 1918 - 1939 as a period of growth and proliferation of multinational enterprises that was significantly above the pre-war levels (i.e. prior to 1914). This Muchlinski (1995) associates or attributes to the relatively high tariff barriers endemic during the period surrounding the First World War. These high tariff levels in turn were representative of the highly nationalistic, import substituting economic

policies engaged in by states prior to and during the war years as a means of shielding themselves against the world depression (Muchlinski 1995:23).

4.3.1 (b) Social effects associated with inward foreign direct investment

A key concern of the United Nations with regards to the issue of foreign direct investment in the post war era is the *social dimension*. The Merriam-Webster Dictionary (1992:684) defines the word social as – naturally living and growing in groups or communities. For the purposes specific to this thesis, the term ‘social dimension’ is defined as the shared traditions, customs, belief systems, and norms that serve to define a group of people. Given the latter definition, social dimension can be seen as being made up of a number of elemental parts, these parts themselves being alternatively and collectively defined as *culture* (Cf. Daniels and Radebaugh 2001:47). Thus the terms social dimension and culture are used interchangeably.

The pragmatism of this definitional exercise serves to enhance the general understanding of the policy framework aimed at addressing issues in the social dimension (i.e. the social effects associated with inward foreign direct investment). In terms of foreign direct investment policies coming from the United Nations, as indicated above (Supra - sect. 4.2.2), the Group of Eminent Persons in the United Nations aimed to prevent, through regulation, the ability of multinational enterprises to engage in non-economic abuses of the host state such as through political subversion, the introduction of alien cultural values and lifestyles, and the generation of intergovernmental confrontations between home and host states (Muchlinski 1995:6).

Focusing on the cultural aspect of non-economic abuses of the host state by multinational enterprises, Daniels and Radebaugh (2001:50) suggest that the appropriate scope for analysis is the nation-state. This is because “...*the*

similarities among people is both a cause and an effect of national boundaries...[and also] the laws governing business operations apply primarily along national lines.” Thus, within the nation-state, culture can be analyzed in terms of (Muchlinski 1995:6):

1. its method of sustaining itself via transmission and adoption from one generation to the next; and
2. the manner in which it evolves.

In terms of transmission, culture is normally successfully transferred by way of observation and verbal communication and flows in the direction of parent to child, or teacher to pupil, or social leader to follower(s), and also even from one peer to another (Muchlinski 1995:6). In terms of cultural evolution, this can either be voluntary or forced/imposed (forced cultural change is also commonly referred to as cultural imperialism). Voluntary change occurs when the culture is not interfered with in any way by other cultures, but instead natural environmental conditions change and the culture adapts itself to such changes. An example of voluntary change is when a significant drop in agricultural productivity, due to natural environmental changes such as drought and soil erosion, causes migration from rural and farming areas to urban areas. This is in contrast to forced cultural change where the direct cause of the change in culture is the introduction of foreign cultural elements (Muchlinski 1995:6). Daniels and Radebaugh (2001:50) note that multinational enterprises tend to be conduits of imposed cultural change and thusly governments have attempted to control the entry and business practices of multinational enterprises in order to protect some semblance of their cultural identity and heritage.

The two principal, and diametrically opposing, arguments concerning the contribution of multinational enterprises to cultural imperialism are modernization theory on the one hand and dependency theory on the other.

Whereas modernization theory tend to be overly optimistic about the ease and appropriateness of transforming cultures of underdeveloped countries into Western style cultures, dependency theory is extremely pessimistic of such transformations and proposes that the very structure of the capitalist world-economy creates unequal development internationally and in-equitable distribution of public resources domestically (Robock and Simmonds 1989:310; Spybey 1992:1). Spybey (1992:134-5) argues that a more accurate reflection of cultural change vis-à-vis international investment lies somewhere in the ideological center of the continuum between these two polar extremes. In this regard Spybey (1992) characterizes the organizational structure and behavior of MNEs as being conducive to, but not guaranteeing, social control and manipulation by enabling certain social, political and economic activities while restraining others. Spbey's (1992) claim is partly supported and documented by Taylor and Thrift (1982:296) who find that "...*the recent intensification in the center's use of peripheral resources, markets and labor has been accompanied by an intensification of cultural domination.*"

Corporate advertising on a global scale, is yet another and, perhaps the most important mechanism through which multinational enterprises influence cultural change (Taylor and Thrift 1982:276-7; Dunning 1993:536). By necessity, mass production and commodity supply on a global scale require the development of mass markets that will demand these global products. In turn, the establishment of the demand for the multinational enterprises products is normally accomplished through advertising that aims at creating a global homogenization of cultural wants, needs, tastes and behaviors (Ewan 1976:12 cited in Taylor and Thrift 1982:291). As previously noted, governments that fear compromising their unique cultural identity due to the business activities of multinational enterprises will consider regulatory control measures as a stop-gap solution (Dunning 1993:534-5).

4.3.1 (c) National sovereignty

The more extreme but less frequently occurring justification for multinational enterprise regulation is that of the perceived threat of contravention of national sovereignty by multinational enterprises through political, social, cultural and economic obstruction or intervention (Dunning 1993:19; Sunkel in Modelski ed. 1979:13). National sovereignty issues, as a basis for multinational enterprise regulation, have found expression in the legislation of almost all countries that maintain some level of policy on foreign direct investment. However, geographic demarcation and distinction can be drawn between those countries and global regions that give greater consideration to the national sovereignty issue and those that give it a more subordinate position in their foreign direct investment policy. In respect of these generalized policy stances (rooted in the sovereignty debate) and based on informed research of foreign direct investment policy, these geographical divisions can be made as follows (Spybey 1992: part IV):

Middle Eastern, Latin American, Sub-Saharan Africa, Eastern Europe, Asia, East Asia, The United States, United Kingdom and Western Europe. The discussion here will be limited to the three most relevant areas in terms of the sovereignty issue.

4.3.1(c)(i) Central and Latin America

Dependency theorists broadly contend that although the former European colonies were granted *political* independence, their inherited economic arrangements essentially remained dependent on servicing the enterprises and markets of their colonizers (Spybey 1992:20; Muchlinski 1995: 98-9). Further, even after gaining *complete* independence the continuing domination of these newly independent states was subsequently exercised through the exploitative

investments of the earliest European (and American) multinational enterprises within their borders. These investments were (and for several generations continued to be) in primary production and mining. Thus, foreign direct investment activity amounted to an exchange of low-priced raw materials from developing countries for high-priced manufactured goods from the industrialized countries (Spybey 1992:159). This 'unequal exchange' was in essence the primary objection to multinational enterprise investment extended by the dependency school and their focus for policy reform.

Perhaps as a result of their actual experiences with foreign investors, and/or based on a strong nationalistic and cultural identity (Dunning 1993:532-3), Central and Latin American countries gave new momentum to dependency theory during the period of the 1930s to the 1970s. For South American economists of that era 'dependencia' came to represent not only a connotative description of a set of international economic conditions but also more importantly, 'dependencia' as an ideology perpetuated a highly influential political movement that brought about significant change in foreign investment policy in this geographic region. Thus, 'dependencia' was the driving force behind the restrictive policy approach adopted by the Latin Americans (Muchlinski 1995:98-9; Cf. Sunkel 1972 in Modelski (ed.) 1979:chapter 13; Cf. Spybey 1992:23-7).

The culminating points of this political movement took place in Chile under the presidency of Salvador Allende, with the nationalization of American oil companies in Chile and the subsequent subversive efforts by International telephone and telegraph (ITT) to overthrow his administration (United States Senate 1973 cited in Modelski ed. 1979: chapter 14). 'Dependencia' was concerned not only with the economic situation, but was also concerned secondarily with social and cultural domination.

4.3.1(c)(ii) Middle East and Islamic States

National sovereignty concerns have been much more pronounced in this region of the world than in most others. Further, the key difference between the degree of nationalism expressed in this part of the world as opposed to others, is that almost every condition of life – social, political and economic is carried out according to strict adherence to the rules of the region's dominant religious doctrine which is Islam. Thus, for example, 'Islamic Law' affects the business community by prohibiting the charging of interest in any and all interactions (Spybey 1992:213). Beyond this, there have been periods (especially in the 1980s) in which a clear contempt for foreign influence (especially Western) was demonstrated.

In fact, history demonstrates that the culture, politics and economies of this region until relatively recently remained free of Western influence (Spybey 1992:213). Western colonialism did not extend into the Arab States due in large part to the impervious rule of successive Islamic empires. As a consequence, European maritime activities required the circumvention of these territories in order to reach India and the Far East.

The Second World War, however, involved the Arab states tangentially as the French and British allied forces came to the assistance of the Arab states in their battle against the German supported Turks. The conclusion of WWII ironically brought the Middle East under the control of the allied forces who adopted a divide and conquer strategy to their encroachment into the region. France obtained a League of Nations' mandate over Lebanon and Syria, with significant oil concessions in Iraq, whilst the British mandate apportioned to themselves Iraq, Palestine and Transjordan. Later, with the discovery of major oil fields in the Saudi Arabian peninsula, the USA also gained major oil concessions there.

Thus, Western capitalists have maintained a formidable investment presence in this region since discovering the vast oil reserves contained therein (Spybey 1992:213). This discovery coincided with the end of the First World War and the fall of the Ottoman Empire (Spybey 1992:210). Further, despite the general rejection of foreign culture and influence in the Middle East and the domination of society by Islamic dogma, these sets of conditions has not resulted in autarkic economic relations with the rest of the World. Whilst maintaining economic relations with Western business interests, the political and social nationalist phenomenon was directed most strongly toward the Western powers. A key event leading to this build-up of resentment toward the West can be attributed to the creation of a Jewish state within Palestine.

This Jewish state was the product of British foreign policy under the Balfour Declaration of 1917 and has enjoyed substantial financial and military support of the Western allies especially the United States of America. Two major wars and the numerous lesser military conflicts between Israel and the mobilized and united Arab states served as a prelude to the complex and uneasy relationship that currently exists between foreign investors and governments in the Middle East.

Further, the rise to power of Ayatollah Khomeini in Iran in 1979 marked a significant move toward Islamic fundamentalism and anti-western sentiment in the region. Other influential leaders in this movement (circa 1980's) include Moamar Khadafi of Libya, and Sadam Hussain of Iraq. Thus, as Dunning (1993:533) generally points out concerning the Middle East "...*notably [in] Iran and Iraq, the contemporary resurgence of Islamic fundamentalism is dominating all trading relationships with the outside world. Their unwillingness to accept inward direct investment from countries whose economic policies and cultures are perceived to undermine these beliefs is hardly less great than the communist world less than a decade ago*".

4.3.1(c)(iii) The Former Soviet Union and Eastern Europe

The current foreign direct investment policy approach in this region of the world can be characterized as a complete revision and reversal of past policies followed by these formally socialist governments (Muchlinski 1995:23). This dynamic transformation in foreign direct investment policy approach necessarily is taking place in an environment of uncertainty as this change in policy represents a microcosm of the larger transition from socialist economies to capitalist market economies. This greater transition in ideology came about in the late 1980s and early to mid 1990s after socialism endured approximately one hundred years in the former Soviet Union and fifty years in Eastern and Central Europe. Understandably the details of foreign direct investment policy have not been clearly worked out relative to other areas of economic policy reforms. One of the key issues currently being addressed in this regard is the issue of privatization and private property rights.

Although foreign investment and privatization are the agenda issues of the day in this region, history of the socialist movement in the Soviet Union and Eastern Europe indicates that the national sovereignty issue was the primary driving force behind much of government policy to date - both domestic and international. Foreign direct investment policy, as an extension of international relations was thus characterized by a closed system of trade and investment limited to the CMEA (Council for Mutual Economic Assistance) countries (Bleaney 1988:52).

A cursory examination of the socialist economic mechanism reveals that foreign direct investment was essentially non-existent. That is, since the state owned and/or controlled all means of production (both agricultural and industrial), the possibility of foreign direct investment was not a reality at this point in history. However, one aspect of the national sovereignty issue showed itself by way of

the massive military buildup during the cold war. Since at least the 1950s, the Soviet leadership was determined to compete with the West (especially the USA) on economic, technological and military grounds (further, they were determined to prove the superiority of their socialist system of government). Early successes in all three of these areas in the 50s and 60s were met with steady decline in the 70s and 80s (the military priority being the exception) (Bleaney 1988:Chapter 2). Political upheavals in the region combined with the systematic failures of technology and economy led to the fall of the Berlin Wall in 1989 and the disintegration of the Soviet Union in 1991.

Currently, this region is in an embryonic stage of economic policy development as it moves away from the central planning model towards integration into the international economy. It should be noted, however, that a number of states in the region now have in place advanced measures concerning foreign direct investment. For example, the protection of foreign investments is guaranteed in Estonia with relevant laws and international agreements. Also on the books are bilateral agreements on the promotion and protection of investments, which have, been concluded with Switzerland, Germany and the United States of America as well as taxation avoidance and double taxation agreements with a number of other states. However, for the region as a whole, the major stumbling block (as noted above) is the inconsistency contained in the property rights issue.

4.3.1 (d) Multinational enterprises, corporate responsibility and international law

The very nature of the multinational enterprise, that is a business enterprise legally incorporated in one country and conducting its business affairs in a number of different countries, opens up the possibility of avoidance of accountability in the legal domain. In this regard, a number of well documented

cases – for example, Union Carbide in Bhopal India, and Cape Plc. in South Africa – reveal that local as well as international law has, to date, not offered adequate and/or timely solutions to problems arising in cases dealing with extraterritorial jurisdiction. This is evidenced by the fact that the fundamental principle of international law is to confer upon each state exclusive sovereignty over the territory it controls (Muchlinski 1995:124). Strict adherence to this principle carries with it the corollary duty of non-intervention on the part of other states. Thus, this requirement of non-intervention essentially negates the ability of states to pursue legal claims against their home-country firms located in foreign jurisdictions. In fact, as Muchlinski states "*...any assertion of extraterritorial jurisdiction by a state would amount to a violation of international law. Such a view might be unduly restrictive of a state's legitimate interest in the effective enforcement of its laws against [multinational enterprises] MNEs.*"

A highly instructive, and perhaps deterministic, case for the South African legal and regulatory framework on inward foreign direct investment is the case of Lubbe vs. Cape Plc. Cape Plc is an asbestos mining, processing and distributing company whose articles of incorporation are founded in England in 1893 under the name – Cape Asbestos Company Limited (Westlaw 2003; Van Niekerk 2001; Coombs 2002). Cape Plc, had been engaged in asbestos mining in South Africa from 1893 to 1979, mainly in what is now the Northern Cape Province and Limpopo Province. It also began operating an asbestos processing factory in Benoni near Johannesburg in 1940. From 1948 its South African business activities were conducted through wholly owned subsidiaries with head offices in Johannesburg. In 1979 the company sold all its mining and mining related interests in South Africa, with the exception of its Benoni factory, to a local company. In 1989 it sold the Benoni factory and has since then ceased to have any physical presence or assets in South Africa, thus effectively putting itself out of jurisdictional reach of the South African legal system.

In 1997 the first of 11 writs was served on Cape Plc, the defendant, in England by South African plaintiffs. The basis for this lawsuit can be summarized as follows:

- 7,500 South African plaintiffs, resident in South Africa, claimed damages for personal injuries (and in some cases death) allegedly suffered as the result of exposure to asbestos and its related products that were mined, processed and distributed in South Africa by Cape Plc during its tenure in the country.
- the claim is made against the defendant as a parent company which, allegedly knowing that exposure to asbestos was gravely injurious to health, failed to take proper steps to ensure that proper working practices were followed and proper safety precautions observed. In this way, it is contended that, the defendant breached a duty of care which it owed to those working for its subsidiaries or living in the area of their operations, with the result that the plaintiffs thereby suffered personal injury and loss.
- The major stumbling block to resolving this case was the issue of whether the proceedings brought by the plaintiffs against the defendant should be tried in England or in South Africa. It took several court cases and two Appeals Court hearings in England to resolve this issue before the case could be heard in the House of Lords of the English court system.

With regards to the issue of the appropriate forum in which to hear the case, arguments centered around common law principles set in a similar case, *Spiliada Maritime Corporation v. Cansulex Ltd.* [1987] A.C. 460, heard before the House of Lords of the English legal system. On the basis of the precedence set in *Spiliada*, if it can be successfully argued that a foreign plaintiff will not obtain justice against an English defendant in the plaintiff's home country, the English court may not grant a stay (a refusal) to have the case heard in

England. By the conclusion of the hearings in the second Court of Appeals, *Lubbe v. Cape Plc.* passed the *Spiliada* test, thus favoring having the case heard in England.

The plaintiffs further argued that a second test for assigning the case to the British courts is that of Article 6 of the European Convention on Human Rights. As Article 6 is consistent with the *Spiliada* test in principle, it was successfully argued that granting a stay of the proceedings in favor of South Africa as the legal forum would amount to a violation of the Article since the lack of funding and legal representation that the plaintiffs encountered in South Africa would deny them a fair trial on terms of litigious equality with the defendant.

Comparing *Lubbe v. Cape Plc.* with an earlier case against Cape Plc., *Gisondi v. Cape Plc.*, demonstrates the lack of adequate protection for South African complainants in certain cases of extraterritorial jurisdiction. Vincenzina Gisondi and three other Italian plaintiffs successfully sued Cape Plc. for damages in England. There are numerous similarities, with the *Lubbe* case, in terms of both the nature of the writs and arguments presented with one critical exception – i.e. attorneys for Gisondi successfully argued for consideration under Article 2 of the Brussels Convention to which both England and Italy are signatory states. Under Article 2 of the Brussels Convention the English courts were compelled to not decline jurisdiction in favor of the Italian legal system and accordingly the defendant had no opportunity to apply for a stay on the grounds of *forum non conveniens* (inappropriate forum). Unfortunately for South African claimants, international agreements that make up the Brussels Convention only apply to states that are party to the Convention, thus South African claimants bear a greater burden than some of their counterparts in pursuing legal remedy in foreign courts.

4.4 Conclusion

South Africa has on the whole always maintained an open stance towards inward foreign direct investment. The disruptions in these inward flows, experienced in the 1970s and 1980s, were externally generated (through divestment, dis-investment and embargos) as opposed to being the result of a change to a more closed regulatory regime on the part of government. It has been demonstrated in this chapter that most other countries and regions of the world have felt the need not only to regulate inward foreign direct investment, but have also felt the need to regularly review these policies as internal and external environmental circumstances changed.

As policy based on theory cannot always take account of all counterfactual possibilities, there are often loopholes in laws and policies that are to be exploited. It is therefore the norm that case studies have been the driving force for change. In particular, the case involving the attempted overthrow of the Chilean government by telecommunications giant ITT and the CIA brought with it renewed awareness of possible abuses of a foreign multinational enterprise within a host country and suggested new policy options for governments to pursue. Another important case, especially for South African foreign direct investment policy, is that of *Lubbe v. Cape Plc.* in which a British company, Cape Plc., owned and operated asbestos mining and processing concerns in South Africa for almost 100 years. By 1989 the company no longer had a physical presence in the country and was therefore beyond the reach of South African law and South African claimants seeking compensation for alleged asbestos poisoning due to the negligent conduct of the company. Although the case was eventually settled in 2001 in England, the difficulties experienced in getting to that stage provide valuable lessons for a renewed assessment of South African government policy. In this regard, the Brussels Convention, in Article 2, provides a model that should be considered for South Africa.