

Ref: BUR70

Paris, 19 September 1996

23 SEP. 1996

Dear Sir/Madam:

DRAFT BIAC SUBMISSION TO OECD AMBASSADORS
"Pursuing Domestic Policy Objectives in a Global Economy"

In preparation for BIAC's 8 November consultation with the OECD Liaison Committee with International Non-Governmental Organisations (OECD Ambassadors), I am pleased to send you a preliminary draft submission entitled, "Pursuing Domestic Policy Objectives in a Global Economy".

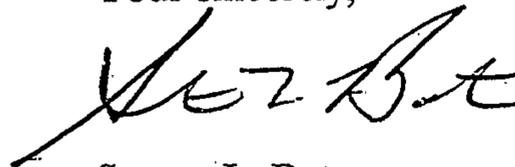
This paper was prepared by the BIAC Secretariat following the Executive Board's decision that this year's consultation should focus on domestic policy barriers to trade and investment. As you will notice, we have included sections on taxation, competition, technology, information and communication, environment, social affairs, corporate governance, product/service standards, and a general comment on the potential impact of "national politics".

The attached draft is clearly a preliminary effort, requiring considerable input from BIAC Member Organisations and Committees. We therefore kindly request that you consider this paper and send any corrections, modifications and/or additions to the BIAC Secretariat. Where possible, when suggesting modifications, we would appreciate it if you could provide specific text.

You will also notice that we have inserted boxes after each section which would provide an opportunity to give case examples of domestic policy problems experienced by multinational companies. We believe practical examples would be particularly useful in illustrating the issues covered in the paper. For this reason, we ask that you send us any specific cases corresponding to the various policy areas which could be included (without identifying the company involved).

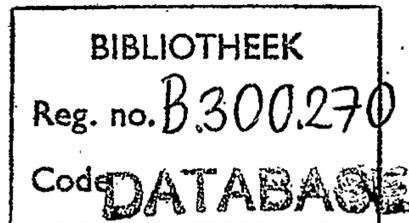
Please send your comments by **close of business (Paris time), Monday, 7 October 1996**. All comments received by that time will be taken into account in preparing a revised draft which will be re-circulated to Member Organisations for final approval.

Your sincerely,

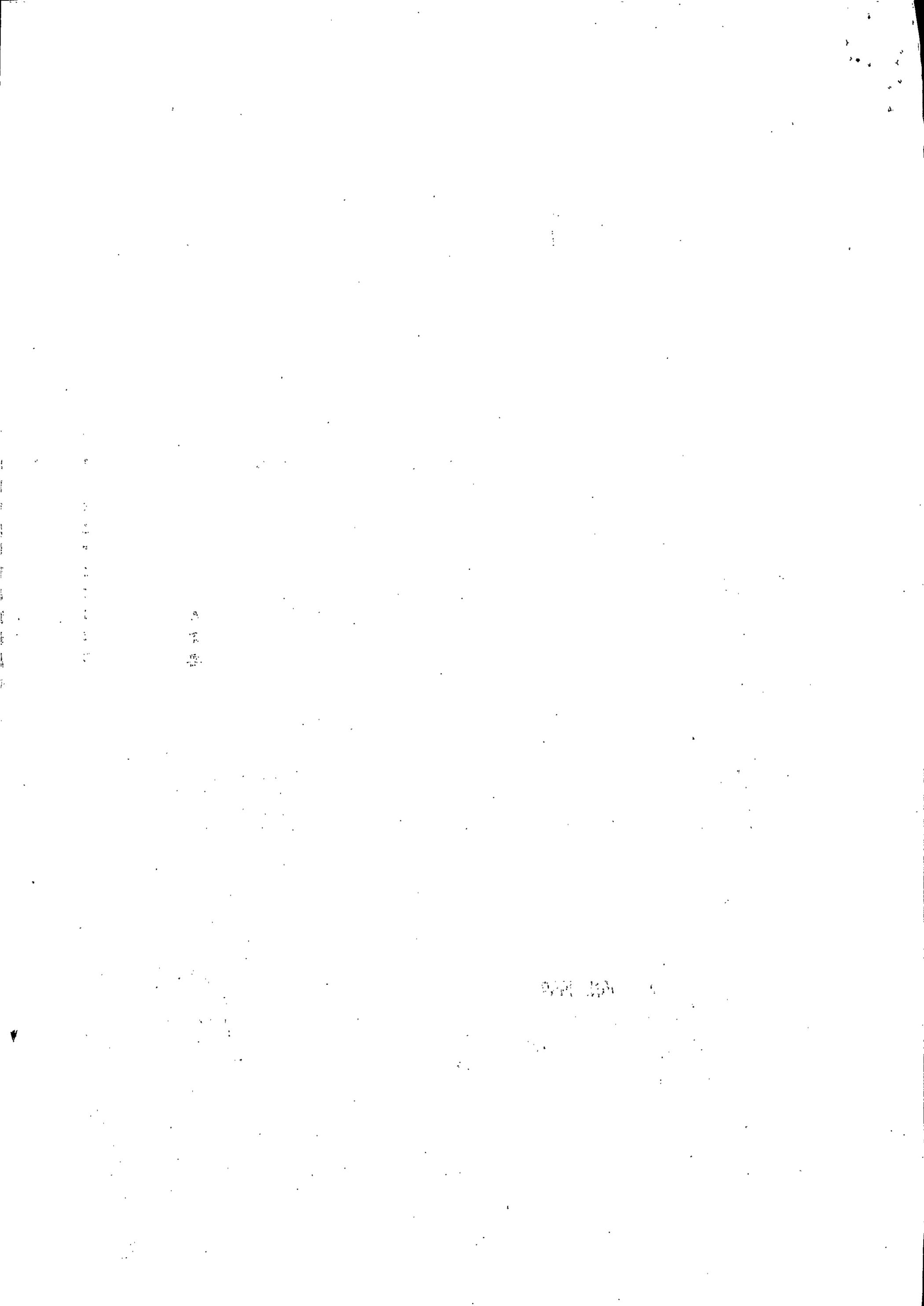


Steven L. Bate
Executive Director

22 JAN. 1999



To: Director Generals of BIAC Member Organisations
Members of the BIAC Executive Board
Members of the following BIAC Committees: ELSA, EPC, CLP, Environment,
ICCP, MNEs, Taxation, Technology, Trade



BIAC CONSULTATION WITH THE OECD LIAISON COMMITTEE
WITH INTERNATIONAL NON-GOVERNMENTAL ORGANISATIONS

8 November 1996

Pursuing Domestic Policy Objectives in a Global Economy

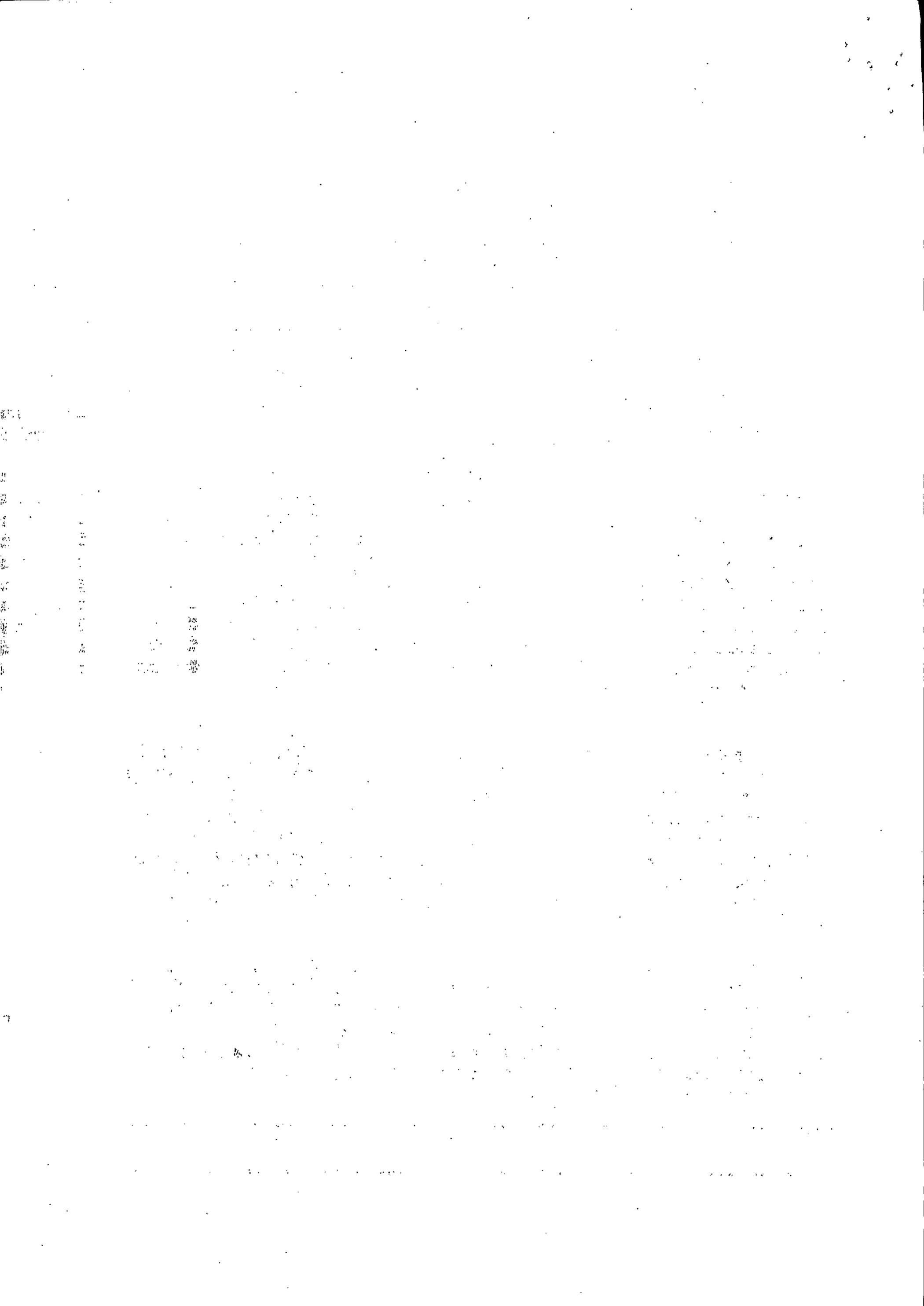
--Preliminary Draft Discussion Note--

Introduction:

Following the considerable progress made in reducing or removing traditional obstacles to trade and investment, certain domestic policies are now increasingly cited as "new" barriers to market access. In fact, many of the issues referred to are not new in the strict sense, but have simply taken on "new" importance under changing paradigms of global competition and policy effectiveness. As OECD Governments have frequently stated, the globalisation phenomenon is a positive force for our economies. The international business community represented by BIAC strongly agrees that the globalisation of product development, production and distribution processes offers both OECD and Non-Member countries a powerful source of growth and employment. We are therefore concerned that many domestic measures are impeding the potential benefits to our economies by distorting international markets and restricting, usually unintentionally, cross-border business activities.

The OECD has addressed the effects of domestic measures on economic performance, most notably in its 1987 landmark study on Structural Adjustment and Economic Performance, and new efforts are under way to analyse particular aspects of this issue. Of particular interest is the current, "horizontal" study on regulatory reform. Another important example is the Industry Committee's ongoing analysis of Framework Conditions for Industrial Competitiveness. Indeed, all OECD Committees have focused on related problems in their particular domains, e.g., in Labour Policies (as part of the extensive Jobs Study), Fiscal Affairs, Competition Policy, Banking and Financial Market Supervision, etc. Generally, the analysis of domestic policy reforms concentrates on the national effects, and not necessarily on the broader implications for international economic activities [notwithstanding the implicit assumption that more efficient national economies would benefit the wider world economy].

This paper attempts to bridge this gap by highlighting certain examples of problems encountered by multinational companies in some markets as a result of domestic policy measures. The issues do not necessarily involve violations of national treatment. Indeed, the effects may be felt by both domestic and foreign companies alike. But the impact on foreign companies may be more pronounced for a variety of reasons. In some cases, these issues amount to little more than complicating factors which simply add to the cost of conducting business in a given country. In others, the problems have been identified as significant impediments to market access, and have thus become a source of bilateral friction between the governments concerned. Regardless of the extent of the impact, we believe the frequency of such cases is likely to rise as a normal outcome of the globalisation process. It is therefore crucial for Governments to be able to recognise and deal with the international effects of their domestic actions.



The list provided below is by no means exclusive, but rather illustrates certain domestic measures with impacts beyond national borders. The conclusion makes certain recommendations to the OECD and its Members for further analysis of these issues.

Taxation:

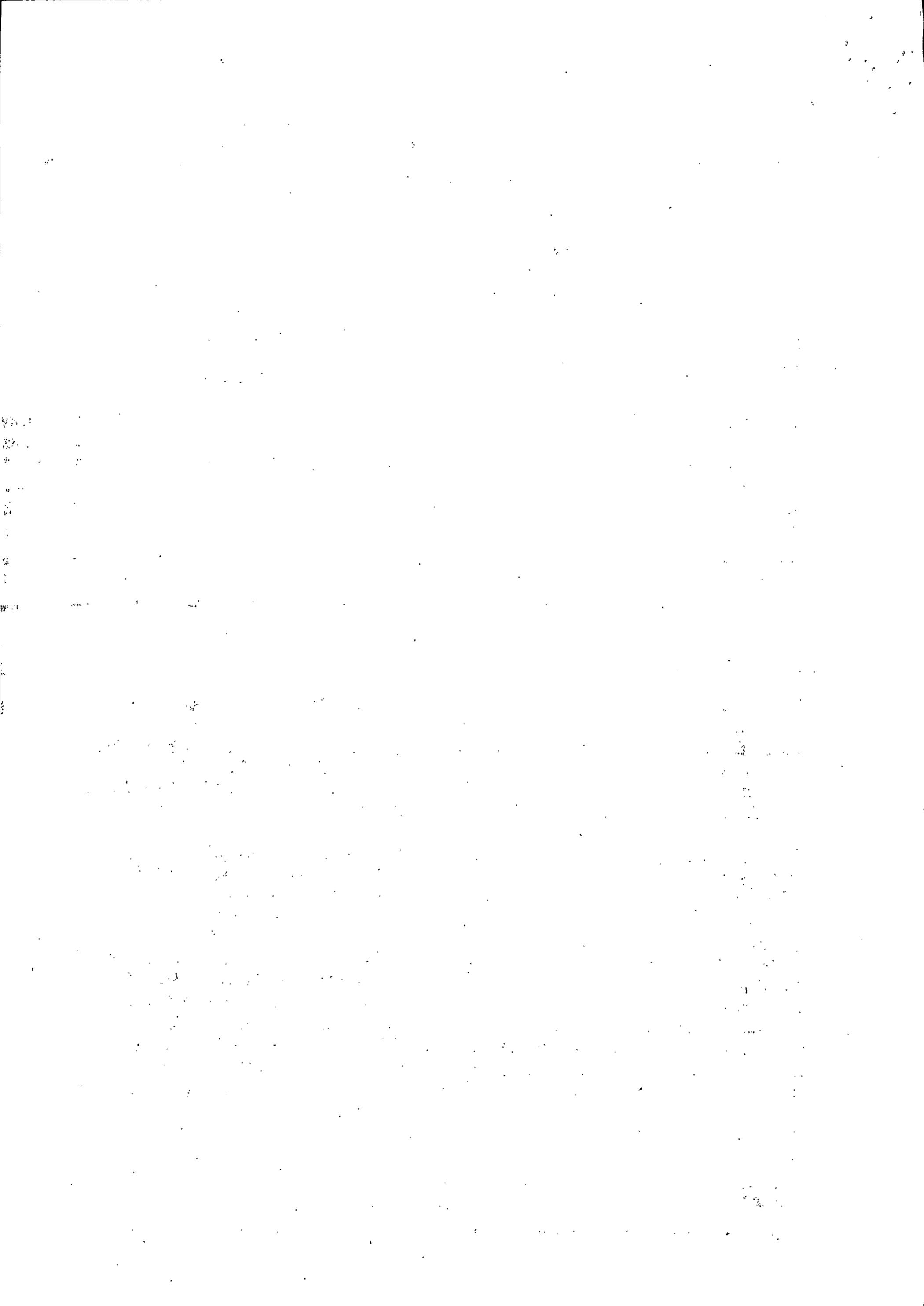
One of the clearest examples of domestic policies which can serve as "new" barriers to trade and investment involves taxation. In the current economic environment, nearly all OECD Member governments are continuing the drive to bring their public deficits into balance. BIAC wholeheartedly supports these efforts. However, while a significant part of fiscal retrenchment involves reducing public spending, there is also understandably a desire to ensure that governments receive their fair share of tax revenues. Since raising taxes on constituents is politically difficult, many tax authorities are seeking to close loopholes which permit tax evasion or avoidance. One of the primary targets of such efforts tend to be foreign companies, which, it is common believed, use sophisticated tax planning techniques to reduce their tax liabilities in a given country. This seems to result in a continual search for new, more effective rules and techniques for administering international tax policies, which in turn provide the basis for one of the most important activities of the OECD.

The OECD Committee on Fiscal Affairs has been indispensable as a vehicle to maintain consistency in Member countries' international tax policies according to multilaterally recognised standards and BIAC works hard to ensure that the Committee's delegates are aware of the views of the business community on the many issues under discussion. Still, we see a continuous risk in some governments' efforts to develop new rules or different interpretations of agreed standards, such as the arm's length principle in transfer pricing, to address the potential for tax evasion. There are also many new attempts to develop tax compliance methods and harsh penalty provisions to further restrict the ability or will of companies to evade local taxes. The new penalty regulations under Section 6662 (a) of the United States Internal Revenue Code provide an excellent example of where the burden placed on foreign taxpayers is clearly excessive.

BIAC has always maintained that there is far too much emphasis placed on tax evasion, since the vast majority of companies are good corporate citizens who duly comply with national laws in the countries where they operate. Changing rules and procedures add considerable expense to the operating costs of such companies' operations and often result in conflicting requirements/assessments among governments leading to double (or multiple) taxation. While BIAC continues to believe that taxation is just one of a number of factors of importance to an MNE in allocating resources across geographical borders, it is nonetheless a significant factor since it can affect, sometimes drastically, an MNE's rate of return in a given jurisdiction. Therefore, taxation can be a potent tool for controlling, and hence distorting, international trade and investment flows.

The vast network of bilateral tax treaties, based on the OECD's Model, extant among many governments can and does help to mitigate the potential for abuse of national tax policies. However, the very negative reaction by many OECD Members to the possible inclusion of taxation in the MAI is a cause for concern. Do Member governments wish to maintain the ability to control investment by resorting to tax measures which fall outside the purview of the Agreement? BIAC believes that national taxation will increasingly be a controversial issue in our interdependent world economy.

Case Examples: ???



Competition Policies:

Last November, BIAC presented a discussion note to OECD Ambassadors on the interaction between trade and competition policies in which we provided various examples of how differing interpretations and/or enforcement of national (or regional) competition policies can cause friction between international trading partners. We also identified some of the principal challenges for policy-makers and suggested some proposals for further work in this area.

From that analysis, it should be clear that the international business community considers that national competition policies will play an increasingly important, and perhaps even more contentious, role in the years to come. Without further convergence in the application and enforcement of Member countries' policies in this area, differences of interpretation and implementation on such issues as horizontal and vertical agreements, abuse of dominant positions, and public involvement in the economy may create considerable friction among major economies, and seriously impede the cross-border activities of multinational enterprises.

Through monitoring and, updating as necessary, the 1986 Council Recommendations, and its ongoing efforts to promote convergence in Members policies, the OECD Committee on Competition Law and Policy is playing a vital role in resolving the present and potential problems in this area. However, the issues are clearly complex and, as a result, progress is relatively slow. Therefore, and as we stated last year, Governments should attach greater priority to dealing with these issues.

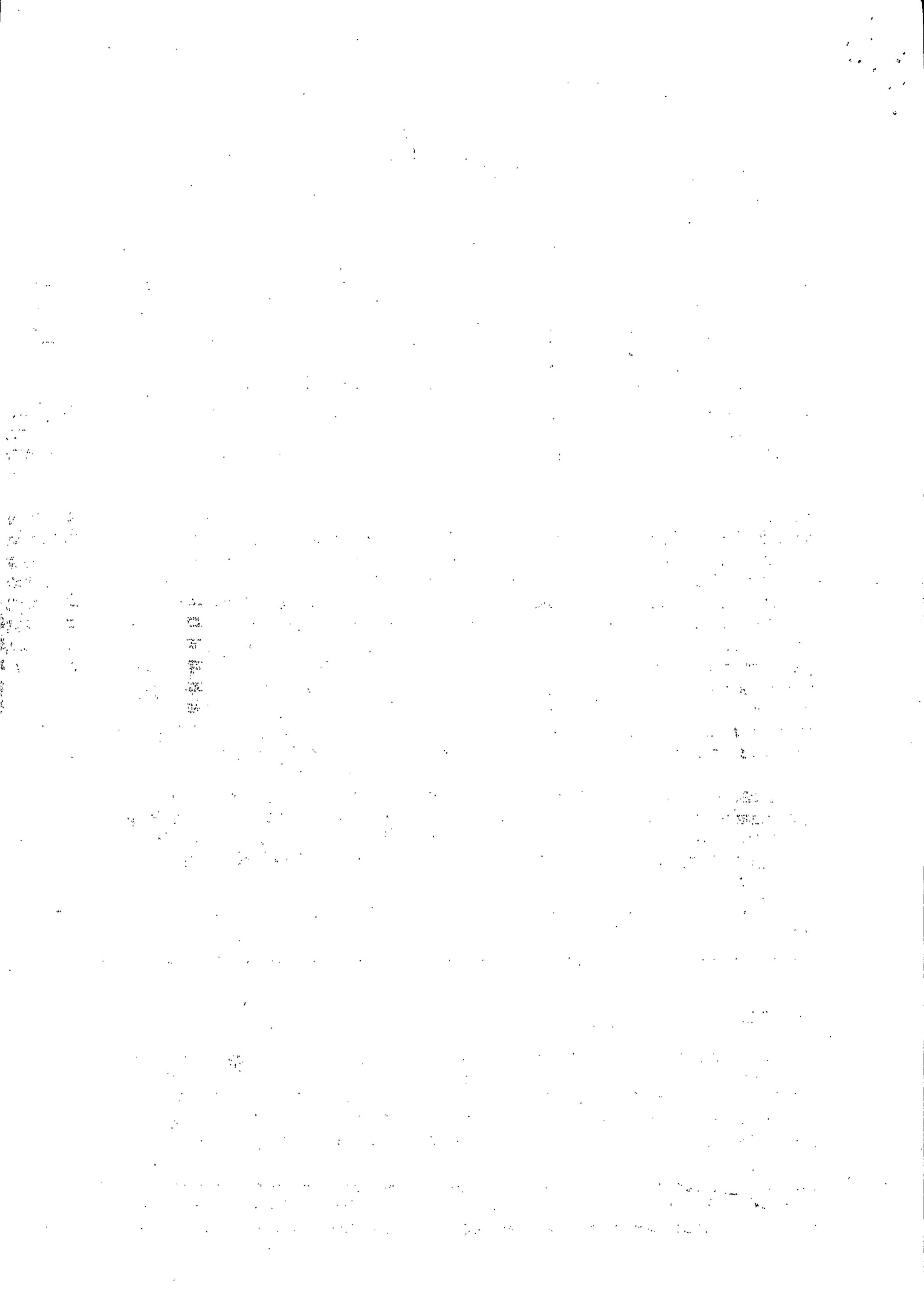
Case Examples: ???

Technology Policy:

National policies on technology and innovation, including rules governing developments in telecommunications, often have an extensive impact on globalisation as such new technologies are among the principal driving forces behind the ability of companies to integrate production and distribution processes around the world. As a result, such policies are increasingly important factors in cross-border business activities, and may serve as a source of considerable trade and investment friction in the years to come.

In technology policy, national public sponsorship of research and development, through direct subsidies or sharing of defence-related innovations, and/or special anti-trust exemptions for R&D co-operation can affect the international competitive balance among companies operating in the sector(s) involved. Domestic companies may also be given preferences in local government procurement or enjoy comparative advantages in national standards for certain technologies. In some countries the ambiguous or incomplete provisions of regimes governing intellectual property rights or their high cost of implementation may also act as a restraint on innovation or foreign participation in technology development. To pick a major example, the incompatibility of patent protection regimes among the broad OECD regions, such as the costly and bureaucratic procedures required in the acquisition of a patent in Europe, and heavy reliance on costly litigation in defending patent rights in North America, often presents formidable barriers to co-operation between firms from different OECD regions, and therefore is a barrier to trade in R&D activities. (See BIAC *Discussion Paper on Barriers to International technology Co-operation Involving Enterprises*, October 1996, for more examples.)

Case Examples: ???



Information and Communications Policies

The concern that regulatory environment tends to affect foreign based companies more adversely than it impacts on the domestic ones, and that therefore it is a trade barrier, is very pertinent to the communications field. The added cost to consumers -- both corporate and household -- of over-regulation/protection of the telecommunications sector has been well documented and, fortunately, is prompting efforts towards deregulation in a number of countries.

There are also a number very crucial issues that inhibit the development of a globally accessible information infrastructure, the absence of which means that the markets for information and communications technology (ICT) products and services, as well as other markets which use the former heavily (which is an increasingly larger share economic activity) remain segmented, providing safe havens where inefficient producers can reap monopoly profits and constrain the growth of new products and services that elsewhere thrive on the rapidly diminishing costs of ICT products and services. The segmentation of markets cuts across national boundaries and can often be exacerbated by policies on other issue areas such as "national security" or "culture" arbitrarily developed without regard to economic and business concerns, often by agencies operating outside the main economic policy making community.

In the area of security of information systems, the use of *public* networks for data transmission is held back by problems such as restrictions on the availability (which depends on free import and export) or use of adequate encryption. The use of proper encryption tends to be limited by outright prohibition or administratively complex, time consuming and sometimes arbitrary application of rules for the authorisation of the use of encryption products. In practice, such obstacles affect companies of foreign origin far more seriously than they constrain the national ones. The result often is that, economic activity that depends on the use of proper security systems cannot be transplanted to areas with incompatible regulation or, worse yet, foreign enterprises in those areas are systematically discriminated against in the application of rules. This can be a serious limitation on the willingness to invest by foreign companies, or expand existing operations. That this is so, is often unknown by the principal economic policy makers of the potential recipient country, as the issue of security is left to the "specialists".

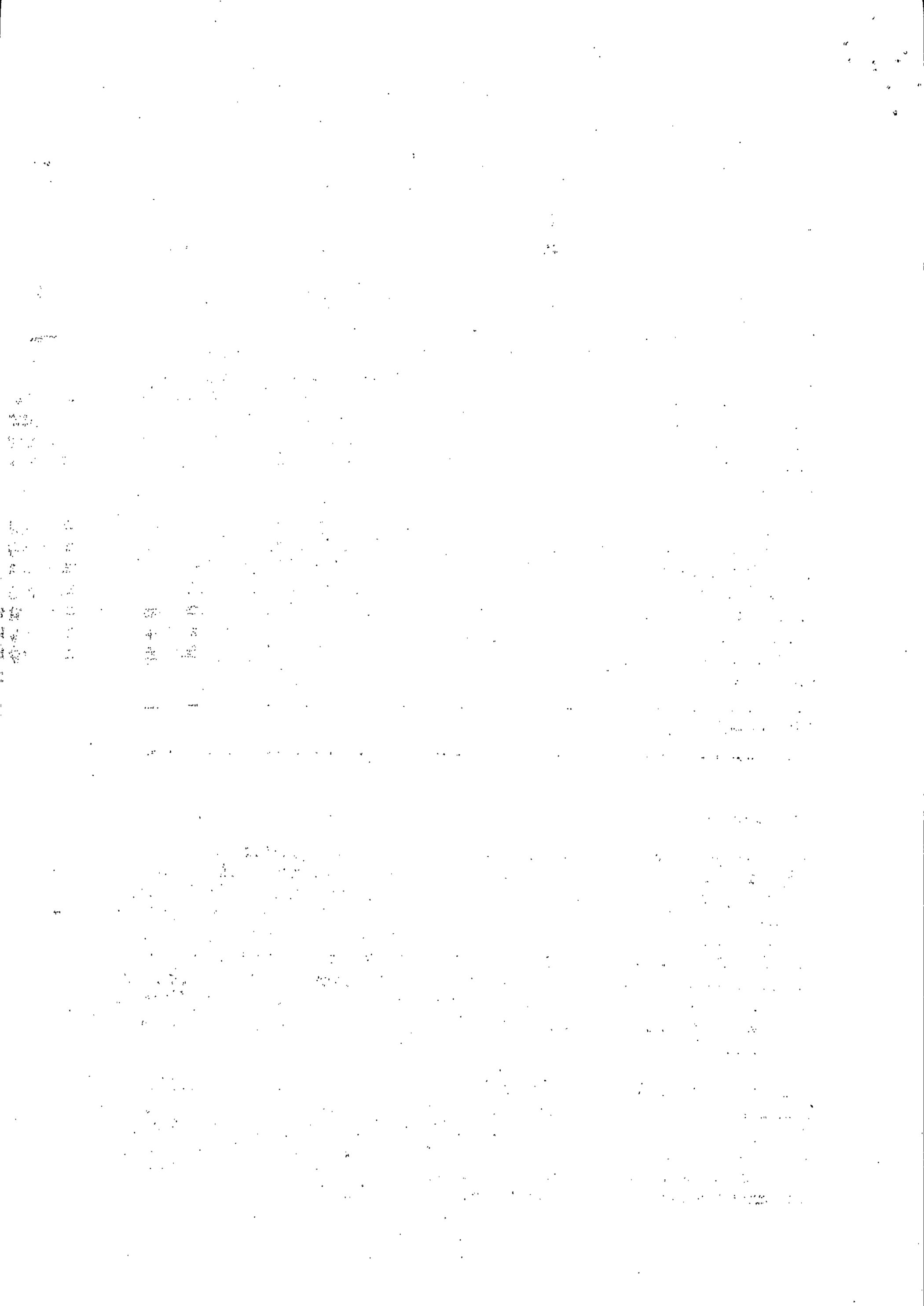
In this context, BIAC wholeheartedly supports the work that is in progress at the OECD Committee for Information, Computer and Communication Policies (ICCP) and its subsidiary bodies aimed at facilitating the development of a global information infrastructure, and the widening of the application of market principles in the areas of telecommunication and information services.

Case Examples: ???

Environment:

The effects of national environmental regulations on international business transactions is the focus of considerable research and debate. Most existing environmental law at the national level does not create trade barriers. But, as trade and environmental regimes expand, the possibility for environmental regulations to create unwarranted trade barriers which limit the ability of business to function efficiently and to use resources sustainably will increase.

Each country has the right to adopt laws, measures and standards to protect the natural environment within its territory. An important trade issue arises when these proliferate in an unharmonised fashion, or are applied to foreign products and processes, potentially limiting or



preventing market access by companies based abroad. The use of eco-labels, a market instrument aimed at encouraging the development and consumption of more environmentally sound products, is a key example.

The criteria for determining which products are awarded an eco-label are set by national authorities, and there is significant disparity eco-label standards and criteria-selection processes among countries. Foreign companies can easily be disadvantaged by the process. For this reason BIAC feels that there is considerable scope for continued work by the OECD on the comparison of national eco-label schemes with a view to enhancing international co-ordination.

Another salient example is the regulation of process and production methods (PPMs), which governs the manner in which products are manufactured or processed and natural resources are harvested or extracted. To date, GATT law has not permitted domestic PPM standards to be applied to products originating in another country. However, there has been some debate about the possible expansion of the unilateral rights to extend PPM regulations to foreign products. The competitiveness issues at stake are extremely high, since in some cases the application of domestic PPM standards to foreign products could help to preserve the competitiveness of businesses producing in countries with higher standards. However, these advantages must be carefully weighed against the international economic and environmental considerations.

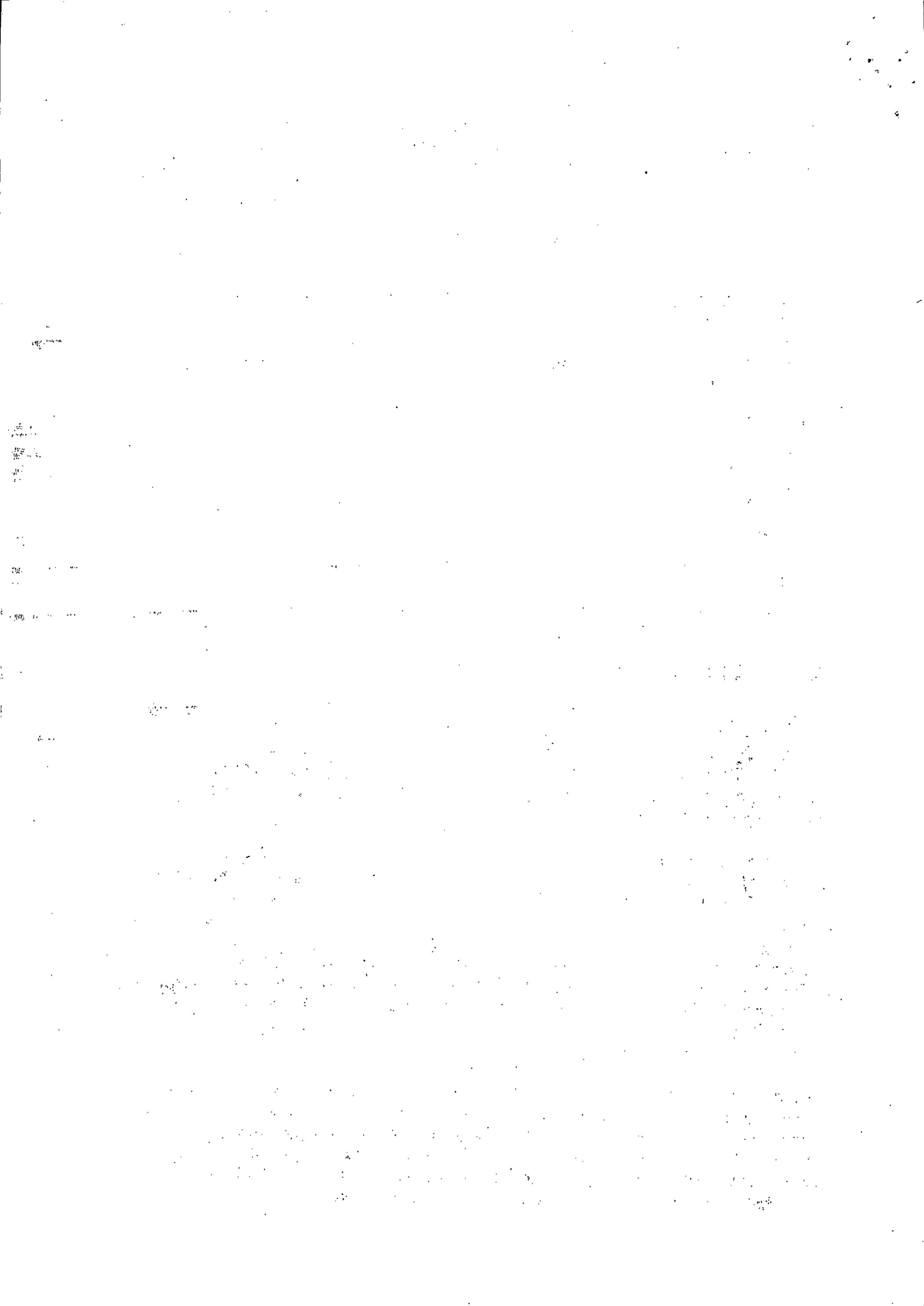
Overall, BIAC believes that the multilateral approach is the most promising route to addressing potential conflicts between national environmental legislation and the smooth functioning of the international economy. The OECD has conducted extremely useful work in harmonising standards related to the testing and evaluation of high production volume chemicals; it has begun a crucial study to develop an agreed international basis for distinguishing waste and non-waste, which, if completed in a satisfactory manner, could reduce trade barriers constituted by different national and regional definitions of the term « waste ». BIAC fully supports the continuation of these efforts.

Case Examples: ???

Social Policies:

It should come as no great surprise to the leadership in advanced market economies that subjugating the production and provision of a good or service to competition is the most reliable way of achieving sustainable productivity increases in the sector concerned. In the area of social services (health care, old age pensions, assistance for job search and reintegration in the labour market, care for the disadvantaged etc.) increasing productivity is the only policy objective that is likely to prevent continuing problems in social protection systems. It is obvious that fully competitive provision of social services may take time to achieve, or, may, in some sectors, not be appropriate. However, a clear determination to move in that direction, more than any other policy, would go far to relieve the pessimism which pervades the current outlook for reform in this area.

International trade and investment in social services is at present severely constrained by regulatory barriers. The experience of OECD economies in the last half-a-century also tells us that opening a sector to competition is meaningful if it means opening it to competition by competitors from the highest productivity area in the OECD in that sector. What is therefore needed is reform of social welfare and health care provision systems that will allow the OECD economies to move towards free trade related products and services.



An obvious starting point for widening the application of market principles in the social area is health care and its allied sectors (hospital management, pharmaceuticals, medical equipment production, health insurance, management of medical information etc.), in some of which an element of international trade already exists. However, even in these sectors, productivity is held low and its growth is constrained by several factors, which are present in other social services as well. Not only the content but also the prices of health care products and services are heavily regulated, by national authorities (or, in some cases, the EC) quite independently from one another. It is not clear why societies with comparable social and ethical standards and means should need to develop widely different standards. It is even less understandable why, when standards are by and large similar; their observance should be tested and verified by separate agencies and processes. The staff time and money spent on separate registration of health care products in different OECD countries, or the market opportunities lost as a result are identified as a veritable barrier to trade by the private business. In some cases competition by foreign enterprises in the provision of a service is outright banned; an example being public medical insurance systems that do not reimburse medical expenditure carried out abroad, or the purchase of medical service from private providers.

BIAC wishes to develop these points further through its participation in the OECD Conference on the New Welfare Agenda (*Beyond 2000*, 12-13 November 1996) and is willing to contribute actively to the work programme that is likely to emerge from the Conference on this subject.

Additional/different points?

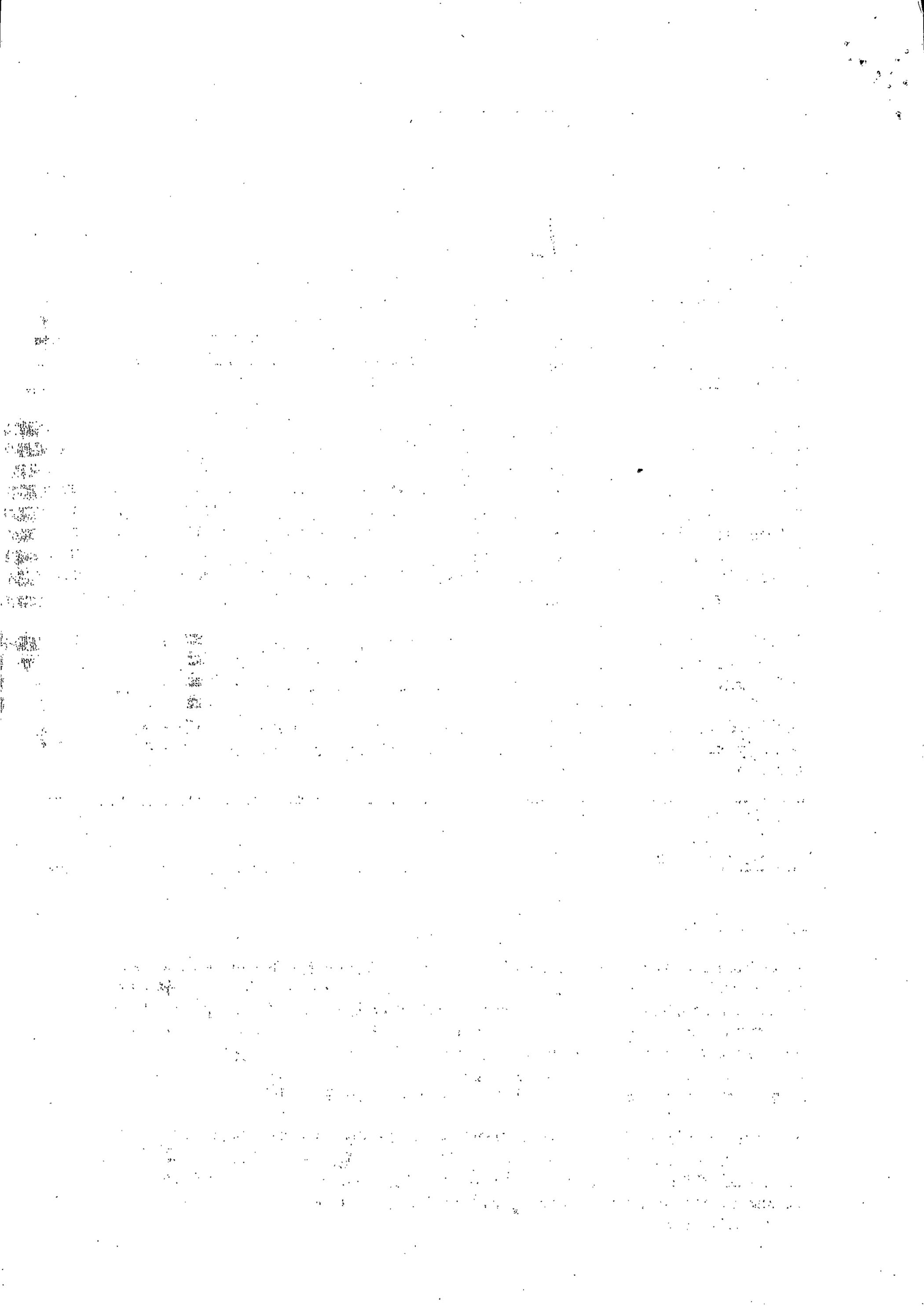
Case Examples: ???

Corporate Governance:

The OECD is presently studying issues related to corporate governance in different Member countries. In the current work on Framework Conditions for Industry, corporate governance policies and practices are raised as principal elements in a country's business environment. While the Industry Committee's analysis tends to look at the issue in terms of the effects on national competitiveness, BIAC would like to highlight some of the implications of such policies or practices on foreign companies.

Rules and regulations on corporate ownership, board composition, information disclosure, mergers and acquisitions, banking and credit policies, debt/equity ratios, and bankruptcy are correctly identified in the Framework Study as significant determinants of a domestic company's governance structure and performance. For foreign companies, adapting different corporate structures, practices and cultures to such local rules can be very problematic. It is even more difficult when there are differences between local rules and how they are implemented (or respected) in practice. While corporate governance policies may not prevent a foreign company from investing in a given market, they will certainly dictate the type of organisational structure and financing used and thus have an important impact on the company's operations.

In some cases, such rules explicitly favour local companies or investors over foreigners (e.g., domestic nationality requirements on corporate boards). In other cases, discrimination can be more obscure, working quietly through local interpretations of how business should be conducted. While cultural attitudes and expectations may be difficult to legislate, there is clearly a potential for manipulation of formal rules and their enforcement to restrict foreign companies' ability to invest and to conduct their operations as they choose.



Case Examples:

Product/Service Standards:

The barriers to trade and investment posed by differing national product and/or service standards are generally well known. Significant progress to reduce such barriers has also been made in the development of the European single market, and in negotiations/discussions within the context of the GATT and WTO. Most recently, participants in the OECD Symposium on Regulatory Reform and Market Access discussed this issue and one of the principal mechanisms for mitigating the problem: mutual recognition agreements (MRAs). The business community believes that MRAs should be a critical feature of the world trading system in the future, and applauds the efforts to negotiate such agreements between the United States and European Union, and in other bilateral and regional settings.

For companies operating and/or selling products around the world, different national standards in such fields as automobiles and their component parts, information technology, electronics, telecommunications, medical devices, pharmaceuticals, etc. add considerable costs to the design, manufacture and distribution of goods. Domestic companies are frequently better able to meet local standards and thus may have a significant competitive advantage in their home markets on the basis of such regulations rather than on the strength of their product. These issues are similarly prevalent in the service and/or professional sectors. Local standards for certification or licensing frequently act as a barrier to foreigners' provision of, for example, financial, legal, accounting or medical services.

It is clear that individual governments have a strong interest in ensuring certain levels of product safety and/or quality of services delivered to their citizens, and believe that enforcement of such standards are a matter of national sovereignty. However, it is also clear that OECD Governments share a common level of concern for consumer welfare and of sophistication in developing appropriate standards. It should therefore be possible to find a mutually acceptable basis on which to judge products or services emanating from Member countries.

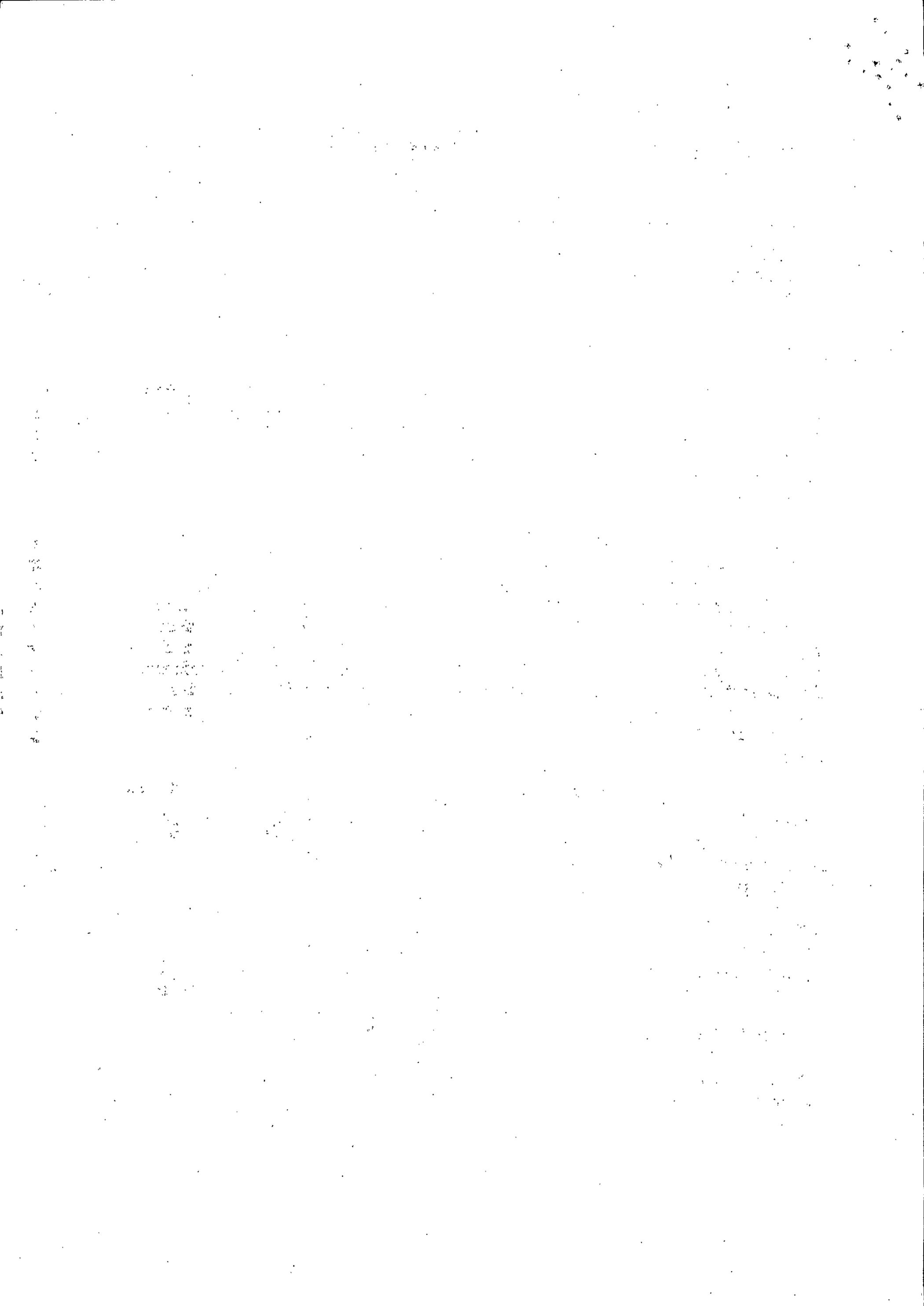
Case Examples:

1. Manufacturing sector:
2. Service/professional sector:

National Politics:

This section does not deal with a specific policy domain, but rather domestic political pressures which can affect a country's attitude towards foreign products and/or investment and hence its treatment of foreign companies. Multinational enterprises have always been subject to the vicissitudes of public opinion in host countries, and fortunately most countries have adopted very positive attitudes towards foreign investors and their products over the last decade. Indeed, the vast majority of governments have been actively promoting policy frameworks designed to attract foreign business activities and the jobs generated by them.

However, there are still frequent examples where foreign companies become the target of negative public relations campaigns, sometimes initiated by politicians seeking to curry favour with specific voters or interest groups. In the best cases, such campaigns remain at the level of rhetoric; but at worst, policies are suggested which would adversely affect their foreign companies' operations.



It is clearly difficult to avoid these situations, much less to prevent them in democratic societies. However, governments must remain responsible hosts and avoid reactionary responses to domestic pressures, especially if they involve the introduction of policies with extraterritorial effects. As an illustration of the latter, BIAC would highlight the very negative effects of the Helms-Burton Act on foreign business confidence. The OECD provides an excellent forum to discuss the international implications of such policies.

Examples:

1. Purely domestic:
2. Other Extraterritorial:

Conclusions:

This paper has attempted to identify certain domestic policies which have an impact on foreign companies' operations, and which will become increasingly important as traditional barriers to trade and investment are removed. Since the pursuit of domestic policy objectives is correctly considered a matter of national sovereignty, what can be done at the multilateral level to limit the negative impact on international business activities? BIAC believes the OECD can play a critical role in this regard.

The first objective should be for the Organisation to continue to promote **transparency** in Members' domestic policies. Many OECD Committees conduct roundtable reviews of national developments in their respective policy domains and, in some cases, publish the results of this "monitoring". International dissemination of specific national laws and regulations is extremely useful to multinational enterprises for planning purposes, especially when done on a comparative basis. Moreover, objective updating of the surveys, as well as how rules are applied in practice, should not only keep companies informed of changes, but also government officials (particularly parliamentarians) who do not normally attend OECD meetings. Indeed, targeting the latter audience may serve to moderate proposals for controversial new policies by raising the level of understanding of the implications of such measures for the international economy.

A related objective should be for the OECD to recommend to its Members that all **cost/benefit analyses** of new laws and regulations should consider whether the measures will have any particularly negative effects on foreign companies' operations. Such assessments should consider whether the new rules will result in conflicting requirements for companies operating in multiple jurisdictions.

Third, the OECD could promote the practice of **pre-notification** of pending domestic legislation which could have impacts on foreign companies' operations. Early access to such information by a Member's key trading partners, and an opportunity to discuss it within a multilateral context, will serve to quell potential controversy and post-enactment friction. A positive example of the value of pre-notification (and consultation) is the U.S. policy of publishing draft tax regulations for public (international) comment.

Finally, the OECD itself can set a very positive example by including a more **regular assessment of international implications in its analysis of targeted domestic structural reforms.**

