Transnational Corporations: Beneficiaries and Driving Forces of Globalization

Corporate Capture or Capturing the Corporate?

The Debate about Human Rights, Investor Protection and Corporate Taxation in Retrospect

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Introduction

The roughly 80,000 transnational corporations (TNCs) operating throughout the world are *the* global players *par excellence*, responsible for approximately 80 per cent of global trade flows. Their economic and financial strategies have economic, social, environmental, and political effects at the local and national levels. The relationship between multinational enterprises and national and local actors has been characterised by a significant asymmetry to date. TNCs' interests have been secured along a broad front – for instance, in the guise of applicable investment protection rules. The situation stands in stark contrast to the protection of human rights and labour standards affected by the activities of TNCs. This is particularly the case in countries with weak state structures or poor governance. To meet these responsibilities, multinational enterprises have to identify and disclose the consequences and risks of their activities and business relations along the entire value-added chain and to ensure that there are mechanisms for negatively affected persons to lodge complaints, secure free interest representation of employees, and accept the right of trade unions to organise workforces. However, in contrast to the issue of investment protection, when it comes to human rights TNCs generally call for self-regulation and as few contractual obligations as possible. Yet, as practice shows, voluntariness only works to a very limited degree; moreover, the contribution to the common weal usually proves to be modest. This is the case for both industrialised countries and developing and emerging economies. The financial crisis of 2008 underscored the fact that national regulatory tools and instruments are unable to guide and steer global financial flows. A lack of transparency and woefully inadequate regulation not only enable a legal reduction of the tax burden, but also tax avoidance/evasion on a massive scale.

As a consequence, not only is economic growth constrained and economic inequality exacerbated, but governments also forfeit the possibility to shape political and social development. The results are dramatic, as surveys and elections in industrialised countries show. People are disenchanted by the cosy ties between policy-making and business spheres and the preferential treatment afforded multinational enterprises. Some are calling it a »refeudalisation« of politics, in which sealed-off economic elites and lobbyists are able to exert direct influence on government policy. The excesses of capitalism are now threatening the very foundations of democracy itself.

Political and regulatory solutions are urgently needed that are aimed at protecting employees and human rights, achieving more just taxation and combating tax evasion/avoidance along with balanced protection for investment. There have been promising initiatives at regional and international levels over the last few years. The Friedrich-Ebert-Stiftung held an international conference in Berlin in April 2017 to discuss the range and impact of these initiatives, explore perspectives of the North and the South in terms of commonalities and differences, and analyse ways and means to implement and deepen the reform agenda in spite of adverse global trends and tendencies.

I. The Struggle to Assert Human Rights in Global Supply Chains

Extreme working hours, inadequate pay, gender-based violence, and restrictions on trade union rights as well as violence against trade unionists describe the daily working conditions along the global supply chains. Adopted in 2011, the UN Guiding Principles of Business and Human Rights (UNGP) outline responsibilities of both states and corporations, particularly underlining the importance of an effective access to remedy for adverse human rights impacts. Thus far, 17 countries have implemented a National Action Plan on Business and Human Rights (NAP). Parallel to the UNGP process, a group of states – with South Africa and Ecuador taking the lead – is pushing for a binding UN treaty on business and human rights. After being approved by the UN Human Rights Council in 2015, this proposal is currently under negotiation in a multilateral working group.

How can the different initiatives be assessed? What are best practices and lessons learnt from the different NAPs that have already been implemented? Which process does the Global South favour, and who stands to gain?

TNCs are the main actors of globalisation. They have substantial power in economic and political terms. Human rights standards often fall by the wayside in the struggle for favourable location factors, mining rights, and cheap commodities. Those who are affected by human rights violations resulting from entrepreneurial activities, often lack the opportunities to take action against corporate groups. The government structures are either too weak or the governments are unwilling to guarantee compliance with human rights. Furthermore, in the TNCs' home countries, respecting human rights outside of the country is considered to be a voluntary matter. In recent years, however, there has been movement in the debate about TNCs' responsibility for human rights and labour standards. The objectives are clear: those affected should be granted access to complaint and compensation mechanisms; countries should be put into a position or required to monitor companies' due diligence regarding human rights, and punish violations not only locally, but across borders. However, there are different views about the most suitable way to reach these objectives. There are two instruments in particular that are currently being debated – the UNGP and binding agreements.

A group of countries, especially in Europe, have developed NAPs. They start with the UNGP, which define non-binding standards and the main elements of due diligence for corporate responsibility with regard to human rights. Initially, the participating countries must implement the guiding principles at the national level to obligate corporate groups to comply with human rights along their supply chain and with their business activities. These principles are implemented at the national level and are non-binding under international law. However trade union members and activists from the Global South, in particular, regard this approach as insufficient. They demand binding rules for corporate groups under international law, so that corporate groups also comply with human rights on a global scale. Ecuador and South Africa started an initiative in 2015 in the UN Human Rights Council to do so. An international task force was implemented with the objective of developing binding rules for TNCs. If the initiative is implemented, individuals will be able to take action against companies from corporate groups for human rights violations, and countries would also be able to sue other countries.

Why Do We Need a Binding Agreement?

In terms of developing a binding agreement, proponents list the following points:

• Extraterritorial obligations of countries must be recognised. Trade agreements, subsidies, foreign trade promotions, etc. have effects beyond a country's own borders; countries must take responsibility for this. Many proponents of a binding agreement wholeheartedly believe that the guiding principles are a suitable instrument for national companies. However, other regulations are necessary for TNCs to consider the issues of extraterritoriality mentioned above.

• Setting up a level of jurisdiction to convict criminal offenses committed by TNCs. The first point of contact for victims should always be given in their own country. If this is not possible, a higher-level appeal – similar to the International Criminal Court – should be possible.

• Parent companies should also be obligated to assume liability for their suppliers and subcontractors. In its statement on multinational companies, the Organisation for Economic Co-Operation and Development (OECD) called for its member states to set up what are called national contact offices, to which victims of human rights violations caused by companies can turn. Currently, the hindrances for the victims are too high and the local offices are too weak to adequately handle the cases that are submitted.

• Financing providers, including international financing institutions, should assume more responsibility. Development financing institutions must be made more accountable. This also gives civil society an important role as a watchdog.

• The rights of affected persons to compensation and the prevention of more errors must be guaranteed. Compensation payments for victims are difficult to accomplish. Access to information is often extremely difficult for affected communities – beginning with the information that there is even a complaint mechanism at all.

Between Nation States and International Levels

The status quo for workers and trade unions has deteriorated in recent years. This is a consequence of globalisation. The power of TNCs is growing, and at the same time, the working conditions along the global production chains are worsening. Most of the workers along these production chains are not organised into trade unions, and opportunities to do so are often limited. The tools of trade unions – freedom to unionise, collective bargaining, and the right to strike – are attacked and criminalised in countless countries. The recent economic and financial crisis has made matters even worse and has led to a further concentration of power and riches. At the same time, however, countries find themselves in a fierce competition for investments. The result is more deregulation of production conditions, which is meant to increase the attractiveness of the location for foreign investors. This not only affects the workers, but the communities where the production facilities are located also suffer.

Especially in the Global South, it has been shown that the power of TNCs – particularly that of financial groups – is greater today than the power of nation states. Of course, countries are still responsible for compliance with human rights. However, in times where capital is globalised, the countries of the South have been pushed into the background. How are they supposed to exercise control over TNCs whose economic power corresponds to the GDP of 50 small economies? Thus, the international community must create universal instruments on its own, such as the binding agreement, which is for example the standard argument of the Trade Union Confederation of the Americas (TUCA-CSA).

The typical response is that countries would not at all become weaker on a broad front. On the contrary, a worldwide trend towards authoritarianism is noticeable. It is not only about defending increasingly weaker nation states against the behaviour of TNCs; but it must also be considered that countries themselves often have a strong influence on the corporate groups or that the corporate groups are state-owned.

Both interpretations are not only legitimate, but they are essential for an analysis that is as comprehensive as possible. There is no doubt that we are dealing with both situations today on a worldwide scale. A one-sided debate does not lead to the objective. TNCs themselves, as well as the countries in which they are active, must be held to increased responsibility.

The position with regard to the question of which strengths and capabilities nation states actually have today, also influences the selection of suitable instruments. If you assume that a country's statehood has been pushed into the background in relation to TNCs, you will inevitably regard the NAP as not disruptive enough. Moreover, starting at the national level not only requires a sufficiently strong country, but also requires a sufficiently willing country. Binding regulations can be effective to the same extent with respect to TNCs and governments that do not comply with their obligation to protect.

National legislation is very important. When instruments are discussed at the international level (when they must be discussed), it is because countries are not complying with their duty to regulate, or are not implementing existing obligations. International instruments are the second-best approaches. They are perhaps necessary because lobbying is too strong; the fear of losing investments through comprehensive regulations is also an important factor. In this scenario, it is quickly pointed out that pressure to act at the national level in no way disappears because of international agreements. The struggle for strong state institutions does not become obsolete due to international regulations. Moreover, there have already been three debates at the UN level since the 1970s about a binding agreement for TNCs. They failed. Moreover, the black-and-white representation of the North (as not being interested in more comprehensive regulations as the home of the majority of TNCs) and the South (as the homestead of exploitation of raw materials and cheap labour on the victim side) does not always hold true when considered more closely. Therefore, the resistance against binding regulations does not just come from industrialised nations. A recent example is the attempt by the German Federal Government to add a paragraph on Sustainable Production Chains to the G20 statement; in this case, resistance was coming from China, India, and Brazil. Another example is the new Asian Infrastructure Bank: a current discussion is whether a complaint mechanism will be introduced at all. The OECD guidelines and the UNGP at least contain complaint mechanisms.

Reform or Revolution?

But the debate goes even deeper: a fundamental disagreement arises about whether a fundamental system change is necessary or whether reforms to the existing system could also lead to more fairness. The Global South tends to take the first viewpoint – which is unsurprising, because the existing system was established to the greatest possible extent without including them and primarily serves the interests of the North. In this interpretation, reforms to the existing system have a cosmetic nature by definition. They do not lead to the desired objective and they even help to strengthen the existing unfair system, which serves the interests of the North. The proponents of specific steps to reform the existing framework should not be unanimously accused of being uninterested in actual improvements. A series of small reform steps may only lead to the objective in a slow manner, but real reform steps are still being achieved. However, a radical system change appears very unlikely in light of the current global balances of power; nevertheless, the South's desire to participate equally in developing global standards is more than justified.

A compromise between radical system changes or (small) specific reform steps is difficult, which will become even clearer in the following chapters on investments and taxes. However, with regard to the issue of responsibility for human rights, the positions seem quite compatible – at least in some respects; many proponents of a binding agreement see the two processes as complementary, but the binding agreement more important. They think the sequence should be different: it would make much more sense to create NAPs if an international agreement already provides the framework. For many who doubt the feasibility of a binding agreement, it is not so much that they reject the matter, but it seems important to them that individual countries are not excused from responsibility for local production conditions. Moreover, they reject the focus on TNCs, and instead are proponents of including all companies, as is in the UNGP. These positions could be harmonised. There is no doubt, however, that the voluntary nature of the UNGP is an absolute no-go for many non-governmental organisations (NGOs), human rights activists, trade union members, etc. From their point of view, rather than the UNGP, political regulations are required that determine the responsibilities, obligations, and rights of corporate groups, which are then supported by mechanisms at the international level. They have one argument clearly on their side: the prevailing asymmetry. Currently there are only non-binding regulations for corporate groups at the international level in the area of human rights, and it is left to their discretion to regard human rights on a global scale. The situation is completely different with investment protection, as the following chapter shows. But if TNCs insist on their contractually documented rights in the area of investments, what argument can they use to evade contractually documented duties?

Is the Glass Half Full or Half Empty?

The dissent that has been described is closely connected to another fundamental issue (there is also a parallel here to the issues of investment protection and fair taxation): how extensive is the current progress when it comes to TNCs assuming responsibility? Do the things that have already been achieved offer a reason for hope that relevant reforms are realistic in the near future? Or is the progress that has been achieved thus far discouraging and minimal, suggesting that only the pressure of a binding international regulation offers the prospect of finally achieving more fairness?

Optimists point out that even in the mid-1990s, there was no consensus whatsoever about debating social standards in world trade. An important initial step was reformulating the core labour standards in 1990 at the level of the International Labour Organization. In 2000, the reformulation of the OECD guidelines on multinational corporate groups followed, and the Global Compact was also adopted. The UNGP followed in 2011. Now there is a trend of worldwide recognition that comprehensive regulations are necessary, and that the entire supply chain and all business relationships must be taken into account. The question about the correct strategy to make TNCs more responsible is closely tied to the evaluation of what has already been achieved. Should the work primarily continue with the existing instruments and improve them (the NAPs, the OECD Guidelines for Multinational Corporations, etc.)? Or is this a wrong path that tends to divert attention from the efforts for a large breakthrough? This leads us back to the original question.

The TUCA-CSA – a proponent of the binding agreement at the UN level – takes a clear stance in this matter. None of the actions that have been taken to date have really led to control of corporate group power in practice. That is why the TUCA-CSA does not participate in formulating NAPs. The TUCA-CSA fears that the NAPs divert attention from the intended objective of a binding agreement. A procedure based solely on voluntary agreements is absolutely insufficient in their view. Moreover, the TUCA-CSA criticises that there is no uniform methodology in the NAPs; instead, each country follows its own strategy. Other criticisms are that the participation of civil society is not ensured, and those who are affected – that is, the victims of TNCs' activities – are not involved.

Moreover, the previous, specific experiences are not promising from the TUCA-CSA's perspective. Colombia is used as an example; it is the first country in Latin America to submit a NAP. The plan, however, does not refer to the current situation after the end of the armed conflict between the government and the FARC guerrillas. This armed conflict was always related to the dispute about territory and the exploitation of raw materials. The activities of TNCs in the country are closely tied to these issues.

This builds on another, more comprehensive item of criticism of the procedure used as a basis for the NAPs: the authorities developing the NAPs (ministries, etc.) as a general rule are not from the human rights sector. Moreover, the process is often affected by the lobbying work of TNCs. Many ministries are closer to the business community than to civil society groups. Furthermore, it is quite problematic when companies in the course of negotiations about compensation payments are involved in a final decision and virtually determine themselves what financial compensation and damages they can afford.

It is relatively undisputed among experts that the NAPs that have been submitted to date fall short of expectations. Thus far, 17 NAPs have been accepted (mostly in industrial nations), and none of them is significant. In Germany, for example, the threat has been issued that in the case of noncompliance, a national law will be enacted – by 2020, half of corporations with more than 500 employees are supposed to have submitted a due diligence plan for human rights. The optimistic viewpoint, however, assumes that the mere threat of a law will bring action into the debate. Moreover, suppliers in other countries would also be influenced by the debate. The result could be a trickle-down effect. Using the same logic, the debate about the binding agreement could also affect the motivation of TNCs to implement the NAP regulations. Optimistically, it can be hoped that the current discussion will influence thinking about the responsibility of TNCs.

Moreover, it is argued that equal conditions of competition would be made for the participating countries by the widespread implementation of NAPs (or for the TNCs that are based in those countries). However, it is obvious that this argument would be complied with considerably earlier, if there were a binding agreement. The debate is not whether it is important to establish equal minimum requirements for everyone. Corporate groups are in competition with one another and they fear competitive disadvantages if they are subject to more ambitious standards than their competitors. They not only guide globalisation, they are also guided by globalisation. They also have an interest in a uniform starting point.

This starting point also explains the EU's stance in a main issue of the binding agreement. From the EU's perspective, it is important to include all companies in the same underlying conditions and not only TNCs (this was a condition of the EU for taking part in the debate again in the UN Human Rights Council after it left the first meeting). The UNGP follow this logic.

The case of the UNGP is the first time in the UN's history that the member countries have agreed on common standards for companies and countries to protect human rights in global supply chains. In light of the above, it is important not to play the various processes against each other; both processes are important, and they should be considered complementary tools.

Incidentally, an important argument for universal application is a reference to practices that are known from other fields: if the same duties do not apply to all corporate groups, it may lead to jurisdiction hopping, which is already known from investment disputes and tax practices. A company's various business locations are used to secure the best possible interpretation. And there is another direct connection to trade issues. It is necessary to ensure that governments can enact statutory regulations to protect human rights without subsequently being sued by TNCs for doing so with the argument that these regulations affect their investments.

II. Investment Protection and the Regime of International Investment Agreements (IIAs): Investor Rights *versus* Democratic Control?

Investment protection clauses in trade agreements – commonly known as investor-state dispute settlement (ISDS) – have recently triggered a heated debate about the extent to which this protection system could undermine governments' right to regulate. As foreign investors, TNCs have increasingly been making use of ISDS in the last decade, challenging government reforms in various fields, such as health and environmental standards or consumer protection. The United Nations Conference on Trade and Development (UNCTAD) has counted around 760 cases worldwide so far, with 2015 and 2016 seeing a record-high of new cases initiated (74 and 62 respectively). During negotiations for the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU, public outrage led the European Commission to review its investment provisions and to eventually propose the so-called Investment Court System (ICS) in 2015, which is to replace the ISDS with a multilateral court system. Likewise, UNCTAD has been working for a few years on proposals to reform the international investment regime and in 2015 launched its »Investment Policy Framework for Sustainable Development«. Do these two proposals by the EU and UNCTAD lead the way for a new, fairer, and more transparent system for dispute settlement in the international investment field?

Investment Protection System

Private arbitration tribunals meet behind closed doors and make decisions that can cost governments billions. Merely the threat of their involvement causes many governments to abandon proposed reforms, such as reforms to protect the environment or to increase labour standards. Private arbitration tribunals that deal with investment disputes between corporate groups and countries have considerable power – power too great for the tastes of many people. Originally, investment protection was only supposed to give companies an instrument – in the case of expropriations – to enable them to assert claims for compensation for investments that had been made. If corporate groups see their profits threatened, they can sue governments based on bilateral trade agreements. These lawsuits are dealt with by private arbitration consisting of three lawyers from international law offices. One represents the company, one represents the country, and another functions as a judge. The judgments are not public, and there is no possibility of recourse or appeal. This parallel justice system has recently provoked several protests in industrialised nations. In developing and emerging nations, the dissatisfaction has been brewing longer, primarily because in these nations, courts of arbitration have sentenced a series of governments to make billions in compensation payments, which may bring national budgets of poorer countries to the brink of collapse.

The debate about ISDS may seem relatively new, but the system on which it is based on is old. The ISDS system was established at the end of the 1950s. There are currently approximately 3,300 treaties worldwide to regulate investment issues between two or more countries. Today, more than 700 ISDS cases have been initiated, and the number is rising. General concerns about the current

ISDS system focus in particular on the proceedings' lack of transparency, the arbitrators' lack of independence, and, above all, the asymmetry: only one affected party has access to the complaint mechanisms – the foreign investor. This is why critics feel that the principle of non-discrimination that was the focus of the main negotiations for investor protection has not been fulfilled: the entire proceedings do not apply to domestic investors. In this respect, one can complain about discrimination inherent in the system. In addition, other affected groups cannot use ISDS proceedings. The possibility of third-party opinions in the form of *amicus curiae* is normally granted, but these opinions have no legal effect and do not have to be taken into account when judgment is pronounced.

The fear of negative consequences for policymaking is widespread today. Of course, investments must be made in agreement with national legislation. If a national law provides for environmental protection, the inclusion of trade unions, etc., and the investment violates that, then it would not be protected under the agreement. However, this only applies to regulations that were valid when the agreement was concluded – not to reforms from newly elected governments, etc. This restricts the possibilities of budgetary policy, for example. Global South representatives make it clear that this is especially problematic in the commodities sector, because it is very dynamic. They demand the possibility of also being able to react flexibly to these dynamics.

Four core elements are very important in the current system of investor protection or ISDS:

• Most favoured nations treatment – comparison between various foreign investors

• National treatment – foreign investors may not be treated worse than domestic investors.

• Fair and equitable treatment – often filed as elements of an offense involving the protection of trust to verify whether the country has failed to fulfil the investor's legitimate expectations.

• Expropriations – they can only be made under certain conditions and must be reimbursed.

By this interpretation, there is no cause for proceedings if a government's regulations merely affect the profit or the investments of a corporate group. It is necessary that one of the stated four conditions was violated. In practice, however, the principle of fair and equitable treatment causes countless proceedings. Moreover, what is called treaty shopping is a big problem: TNCs file lawsuits by way of a subsidiary that was not damaged, but which resides in a country that has concluded a suitable agreement for investor protection with the country that is being sued.

Civil societies also regard corruption as problematic when corrupt officials have signed detrimental agreements and governments' hands are tied, which is a widespread argument in the Global South. This is perceived as problematic because agreements are retroactive for so long.

The European Commission's Reform

The EU is the largest importer and exporter of investments worldwide; hence it has a core interest in investment protection. Moreover, the European Commission is convinced that the possibility of recourse to investment protection rules and dispute resolution proceedings increase the readiness to invest. This is not the key factor, but is an important one. It also alleges that many countries have no regulations to protect foreign investments in their national legislation.

One cannot trust that national courts will sufficiently protect the interests of foreign investors, but will tend to decide to the disfavour of investors. In principle, this raises the question of whether national legal systems sufficiently take international law into account.

Yet the European Commission does not consider the existing system to be perfect, either. Due to the massive public criticism of the existing system, the European Commission recently proposed some significant reforms. The key component of these reforms is the establishment of an International Investment Court System (ICS). Moreover, a clarification of the fair and equitable treating standard was made. The concept of indirect expropriation was also specified. The procedural changes to the dispute resolution proceedings are highly important. The objective is to get the proceedings out of the back room, to make the decisions more understandable by having more transparency, and to help provide greater acceptance of the proceedings in the public's eye. Ultimately, the desire is to establish a multilateral investment court. This investment court should be filled with a predetermined group of people, who will no longer be selected by the parties to the dispute, as is currently the case. Moreover, these people are supposed to exclude conflicts of interest (currently someone can appear as a referee in one set of proceedings and appear as an advisor to a party in another set of proceedings). The profile of arbitrators is also supposed to change; today, most come from the area of commercial arbitration. This is problematic for two reasons. They lack expertise in international public law for investment protection proceedings. Moreover, they primarily come from the United States (US) and the EU. According to the EU's concept, the composition of a multilateral court should be structured in a more balanced fashion. The possibility of appeals is also provided for. The proceedings are supposed to be public.

The first treaty designated for the new system is CETA, the trade agreement between the EU and Canada (the treaty is currently before the parliaments of the member states for ratification). Moreover, the system is designated for all current and future treaties that the EU negotiates. Thus, the European Commission is attempting to turn the ICS system into the new international benchmark for investment court systems.

Main Demands

The European Commission's proposal has provoked countless critics. For many, it does not go far enough; most of the weaknesses that are inherent in the system remain untouched, and the corrections are only cosmetic. The main issue under discussion was already addressed above in the chapter on business and human rights: do these reforms not stabilise a system whose core is based on asymmetrical balances of power and that unilaterally favours one actor? From the perspective of most critics, the current system's main problem is the very uneven weighting of the rights and duties of the various parties. Nothing has changed about that.

Another issue is that the European Commission's proposal also spreads the ISDS system to countries that have a well-functioning legal system, where recourse to domestic courts would be preferred – as in the case of the EU and the US. Moreover, there is still only access for foreign investors; other interest groups remain left out. Currently, there are no legal means under trade and investment treaties to combat corporate groups or investors, and the demand to change this is growing. This is where every new regulation should start. Room must be given to take rights and duties into account that are related to investing – such as commitments made by investors, international norms and standards, and voluntary standards such as the OECD guidelines. Furthermore, other mechanisms should be included, such as investor liability for human rights violations, etc., as discussed earlier. The possibility of mediation should exist between the various interest groups, not only between governments and investors.

Investments as a Golden Calf

This is far removed from reality. About 95 per cent of investment treaties evaluated so far by UNCTAD – currently nearly 2,600 – contain ISDS clauses. Even if they were interested in doing so, 32 per cent of these treaties do not allow investors to solve disputes at the national level. Only 3 per cent of these agreements provide for voluntary contributions from the business community under corporate social responsibility (CSR) or regulations on combating corruption.

In 2012, UNCTAD submitted the International Policy Framework for Sustainable Development (IPFSD). This framework presents a broad spectrum of possible policy recommendations and NAPs from which governments can choose their national and international policies, including the area of investments. In practice, governments decide on a wide range of strategies in the area of investment protection: for example, Brazil focuses on country-country solution mechanisms. South Africa has terminated several investment treaties and refers to its investment act that provides for equal conditions for foreign and domestic investors, and Ecuador has recently decided to unilaterally terminate all treaties that contain ISDS clauses.

However, representatives from the Global South and civil society fundamentally call for another look at the importance of investments. The widespread belief prevails amongst governments and political decision makers that one must only offer favourable conditions to investors to draw attractive investments, which consequently contribute to creating jobs and strengthening the local economy. Reality is often far different. For example, African countries have signed more than 800 bilateral investment treaties to date. This includes 400 double taxation treaties; the UN Convention on Transparency in Treaty- based Investor-State Arbitration, however, has currently only been signed by ten countries. However, only 4.4 per cent of foreign direct investment (FDI) made worldwide are made in Africa. Various examinations, such as from UNCTAD, were unable to prove a correlation between bilateral investment treaties and the amount of FDI. Moreover, a majority of FDI goes directly to the commodity sector, which is only loosely tied to the local economy. In 2015 alone, African countries were involved in 111 ISDS disputes.

Specific Reform Approaches

The trend in Africa is currently moving in the direction of subregional frameworks (such as in the East African Community, the Southern African Development Community). The EU has a proposal to create a pan-African investment court. This proposal also lists equal conditions of competition as a main factor. Thus far, the power relations have been perceived as very unequal. Every new regulation must start at this point. An important initiative was realised on the African continent in 2010 with the establishment of the African Legal Support Facility, which primarily focuses on the commodity sector. The objective is to provide data and knowledge to governments and to enable them to negotiate agreement terms that are favourable to them or to support them in arbitration proceedings. These proceedings are very expensive, and many countries from the Global South try to avoid them solely due to cost considerations. As a result, laws to protect consumers or employees have not even been enacted to avoid the risk of proceedings. This new institution now provides an incentive for governments to enter into arbitration proceedings.

The call is becoming louder on a worldwide basis to grant countries the opportunity to initiate countersuits if the investor has violated the interests of the common good. The EU should take on this debate and remain involved in the international reform debate, a crucial requirement of civil society.

III. Key Elements of a Reform of International Corporate Taxation and Initiatives for the Fight Against Illicit Financial Flows

The extent of legal tax avoidance and tax evasion by TNCs is immense and deprives national tax systems of significant financial resources. A reform of international corporate taxation is urgently needed, as today's regulations are outdated. Different measures are currently being discussed. One important initiative is the Base Erosion and Profit Shifting (BEPS) Project, which is being pursued by the OECD and the G20. It aims to prevent harmful tax competition and the aggressive tax avoidance of TNCs. However, in the Global South, the BEPS Project is only seen as a first step, which is important but far from sufficient. Another proposal was presented by the Independent Commission for the Reform of International Corporate Taxation (ICRICT). Without doubt, the implementation of this proposal requires intensive international cooperation and high willingness amongst global actors. The current political situation in some industrialised countries may indeed make it difficult to implement the urgently needed reform steps.

Little is known about illicit financial flows (IFFs), either in terms of the volume of global financial movements or their negative consequences for states – those mainly in the Global South. For instance, in the case of Africa there is only a rough conservative estimate of 50 billion US dollars the continent is said to lose due to IFFs annually. Beyond the damage to economic development, IFFs have a tremendous impact on good governance by fostering corruption, organised crime, *and mismanagement of tax revenues. As a result, many developing nations remain trapped in a spiral of poverty with high rates of unemployment, institutional instability, and dependent on aid from industrialised nations. The Global North stands to gain the most out of the existing order, because TNCs and other actors involved in IFFs are predominantly based in North America and Europe. Hence, it is paramount that developed states – together with emerging actors including China, Brazil, and India – push for reforms to curb IFFs. So far, IFFs leaving developing countries still end up in banks of developed countries like Luxembourg, the UK, and in tax havens like the British Virgin Islands, Singapore, or Switzerland.*

Often Legal, Seldom Legitimate

The global financial crisis of 2008 and scandals – such as the Luxembourg Leaks or the Panama Papers – have made it clear that the international tax system desperately needs to be reformed. The rules that currently apply were mostly formulated about 100 years ago. They reflect the requirements of an economic and production system that has long been obsolete. National regulation instruments are insufficient in an age of globalisation. Loopholes occur through poorly coordinated tax law systems and by tax competition among countries; TNCs and rich individuals use these loopholes to reduce their tax burden to a minimum. Large corporate consultants help corporate groups systematically and aggressively avoid tax payments. The transition from legal to illegal means is often fluid, and a differentiation between the legal use of a tax loophole and illegal tax evasion is often difficult in practice. Notwithstanding the above, many legal practices are not necessarily legitimate – such as when profits are shifted to countries where there are few or no employees. TNCs divide their profits between their subsidiaries in a way that is most favourable for them in terms of taxes. Low-tax countries, known as tax havens, not only offer rebates, but also the opportunity to set up offshore companies and, by doing so, draw financial flows. This undermines the principle of fair taxation. The consequences are distortions of competition and huge tax losses.

The Tax Justice Network estimates that approximately one-fifth of worldwide assets are transferred to tax havens. The importance of tax havens is growing constantly. Not even increased public interest has changed anything about the importance of tax havens; in fact, investments in tax havens have quadrupled in the last 15 years. The growth is almost linear and was somewhat weakened only during the financial crisis. These investments are currently growing approximately twice as fast as the world economy. If either the origin or the shifting of such financial flows is illegal, they are referred to as illicit financial flows (IFFs). They can be based on tax evasion and fraud in international trade or also on corruption and organised crime. Developing and emerging nations lose an estimated one trillion US dollars annually through the outflow of IFFs.

The debate about tax avoidance/evasion and tax havens has become vastly more important at the international level since the 2008 financial crisis; it is vital to increase the tax base to compensate for the resulting budget deficits. The legal practices of tax avoidance and the illegal transfer of large sums of money are highly favoured due to the lack of regulation at the national and international levels, as mentioned above. While this affects all countries, the consequences are more serious for developing countries. Losses in the area of business taxation amount to approximately 6 to 13 per cent of GDP for countries of the Global South. This value is at approximately 2 to 3 per cent for industrialised nations. UNCTAD estimates that public budgets lose approximately 100 billion US dollars through shifts to tax havens. The UN Economic Commission for Latin America (ECLAC) assumes that tax evasion for capital, income, and value-added tax in Latin America amounts to approximately 6.3 per cent of GDP. The High Level Panel on Illicit Financial Flows from Africa – under the leadership of former South African president Thabo Mbeki – came to the conclusion that Africa itself loses 50 billion US dollars annually from IFFs. Accordingly, these funds are lacking for important development activities and for supporting disadvantaged groups. For example, the 2030 Agenda for Sustainable Development, which was adopted in 2015 at the UN Sustainable Development Summit of the heads of state and government, relies on the mobilisation of local resources to finance development. Tax avoidance practices by corporate groups lead to growing pressure on governments to open up other tax sources. Regressive tax systems are the result, because value-added taxes and consumption taxes are often increased to compensate.

Downward Competition with Tax Incentives

Aggressive tax avoidance/evasion and the use of tax havens are not the only noteworthy factors. It is also important to note that countries often engage in tax structuring that is attractive to companies in the competition for investments, and by doing so reduce tax receipts generated by the activities of TNCs. Special economic zones are set up, temporary tax breaks/waivers are granted for specific industry sectors, or export zones are created in which the customary tax norms do not apply. In return, taxes on consumption are often increased to compensate for the losses. The public, workers, and families bear the tax burden. Meanwhile, people speak of a race to the bottom when it comes to corporate taxation. The downward competition for corporate taxes is demonstrated at two levels: by the tax ratio and by tax incentives. The relationship between revenue from taxes and incentives in the field of investment policies is at the discretion of governments. The understanding of when tax incentive policies make sense and when they do not is often not particularly well developed. In a survey from the World Bank, 93 per cent of the surveyed investors in South East Asia indicated that tax incentives had no influence on their decision to invest. There are also often contradictory actions within the same government. One ministry gives an incentive and another gives a completely opposite incentive. It is common that a framework for analysis is lacking. In this situation, the African Data Consensus is focusing on data and analysis as an answer to the challenge. High revenues could be generated or profit reductions reduced by withdrawing senseless tax incentives. This could make a significant difference in particular sectors. Without subregional and regional arrangements, it will not be possible to break this trend of downward competition. The business taxation reforms that are now being debated in the US and in the UK could cause a domino effect, thus making the competition with regard to tax rates even worse.

The OECD's BEPS Project: The Orientation Is Correct, But the Measures Fall Short

The debate about the practices of tax avoidance and shifting is not new, and both have carried on for decades. However, the scope and awareness of the weak points in the current system have grown vastly in the recent past. In 2013, the G20 commissioned the OECD to develop proposals to reform international group taxation. The BEPS Project, which was adopted in 2015, is aimed at taking internationally coordinated action against harmful tax competition and aggressive tax structuring of companies that are active internationally. The BEPS Project is supposed to strengthen international tax standards, set rules for international tax competition, and coordinate tax law systems more effectively with each other. The BEPS Project provides recommendations that can be specifically implemented. As a rule, taxation should occur where the entrepreneurial activities and the value creation based on those activities take place.

Trade flows are critical for avoiding and evading tax payments. Today, 60 per cent of worldwide trade takes place within corporate groups. Transfer pricing – determining business prices for reciprocal transactions – is very important in the debate. The various parts of a company invoice each other for their activities. Using transfer pricing, companies can distribute profits within the corporate group in a way that is most advantageous for them. However, it does not take into account the duties and the risks of the local company units. In particular, patents, trademark rights, license fees, or loan interests are shifted to affiliates that are purposely located in tax havens.

Provisions in the area of transfer pricing are supposed to prevent such abuses in the future and ensure that individual parts of the company claim their share in profits and can be appropriately taxed. For the BEPS Project, what is called the arm's-length principle is important for determining prices for goods or services within a corporate group: the prices between various parts of a corporate group should correspond to prices between two companies that are completely independent of each other. The OECD refers to this as the separate entity approach. The BEPS Project focuses on improving the underlying standards and rules for applying the arm's-length principle. However, trustworthy information is necessary to do so. A main requirement is the obligation to document the practices regarding transfer pricing of TNCs. Otherwise, tax administrations cannot verify the information and determine the tax rates. A key component of the BEPS Project is what is called country-by-country reporting. This should create transparency about the regional distribution of production factors, profits, and tax payments. The objective is to discover tax avoidance strategies. As part of the BEPS Project, a toolkit was developed that is geared towards helping developing countries overcome their lack of trustworthy data. Further policy options are currently being discussed.

The Global South feels insufficiently recognized by the BEPS Project

The BEPS Project represents an important step in solving the global problem; even critics point this out repeatedly. The project acknowledges that the current global financial architecture has many weaknesses and is urgently in need of reforms. However, many groups and regions were not sufficiently involved with developing the BEPS Project. Consequently, their priorities were not taken into account. Moreover, the results of the BEPS Project are rather weak. There are still many loopholes that allow TNCs to transfer profits to tax havens. From the perspective of many countries of the Global South, the G20 and OECD did not give important issues sufficient consideration in the BEPS Project. From the civil society perspective, it is especially problematic that country-by-country reporting has not been made public after all, contrary to the original plans (the US and Germany had spoken out against it). Tax officials – especially in the poorer countries – also often don't have sufficient comparison prices available to them. Thus, the knowledge gap continues to exist. And since non-public exchange continues, the result is a gap in trust. The representation gap has already been discussed.

A point of criticism is that the taxation of national resources is not taken into account in the BEPS Project. The same applies to indirect transfers of assets in the informal sector. The debate on the relationship between the informal sector and IFFs is only just beginning. Moreover, the falsification of invoices for commercial transactions is also not covered by the BEPS Project (see also the chapter on the G20), nor was the commodity sector taken into account. Only the service and technology sectors are important, according to the logic of the North. In addition, the effect of double taxation treaties was not discussed; in practice, however, they are often effective as non-taxation agreements. The toolkit for tax incentives was only developed for low-income countries. This is disappointing from the Latin American perspective, because these incentives are one of the greatest factors in the downward competition for the region.

The BEPS Project is cost intensive to implement and therefore is in competition with other development goals. Of course, its reforms can also help broaden the tax base and generate funds. To do so, however, it must first be implemented; this requires the creation of a completely new internal infrastructure, which takes personnel and financial resources. Both are limited. This can quickly turn into a competition: should the limited resources be used to implement the BEPS Project or to generate income?

The political will to implement the BEPS Project may be weak in the light of the fact that specific requirements and priorities were not taken into account. In Africa, there are currently debates about how to structure their own reform processes. The African Tax Administration Forum, for example, has developed a series of model tax agreements.

The G20: Focus on Individuals instead of Corporate Groups in IFF Matters

The G20 also has IFFs on its agenda. However, their work up to this point on the issue has been strongly concentrated on individuals, such as assets being shifted due to corruption and individual tax avoidance/evasion. Capital flight from companies is disregarded. Recently, a standard for automatically exchanging information relevant to tax issues was agreed upon, which over 100 countries will implement. This is certainly progress, but the focus is on individuals. The greatest portion of IFFs results from what is called trade misinvoicing, which is over- or under-invoicing related to trade. According to estimates, trade misinvoicing constitutes approximately 70 per cent of IFFs (according to numbers from Global Financial Integrity). Thus far, the G20 has been largely inactive in this field.

This is where the difference lies with regard to the BEPS Project: in the typically constellation reflected within BEPS, prices might be set in such a way that they are as advantageous as possible for the company; nevertheless, they are talking about the same price on both sides of the transaction. However, with trade misinvoicing, it is a matter of two varying invoices. In any case, trade misinvoicing is dealt with as a side issue in the BEPS Project with regard to the issue of transparency; and there are no specific measures that have been taken against this form of illegal activity by TNCs. Such activities go far beyond the tax avoidance debate. Up to this point, lawmakers, researchers, and civil society have not dedicated enough attention to this problem. There is especially a lack of well-trained, authorised experts who are able to trace the transactions in international trade, so that companies no longer can present two different statements for the same transaction. Moreover, to do so, transactions must be structured transparently.

Furthermore, this issue is not even covered by the »G20 Compact with Africa«, designed to promote private investment and investments in infrastructure as part of the partnership between the G20 and Africa. There is only a commitment to exchange information. Some G20 member countries have no interest in thoroughly dealing with the issue.

The G20 has taken the issue of beneficial ownership – that is, beneficial owners of companies – into consideration (concealed owners or beneficiaries provide favourable conditions for tax evasion and money laundering). The Financial Action Task Force (FATF) is dealing with the issue, but the standard that they are debating is very weak. For example, no centralised registers or public databases on the issue of beneficial owners of companies are planned. The current FATF regulations could even lead to regression at the level of national legislation.

Another issue that has been neglected up to this point by the G20 and other organisations has to do with the institutions that make IFFs possible: banks, attorneys, consulting firms, etc. There are, however, discussions about the misconduct of banks at the G20 level; yet they focus on market manipulations, currency transactions, etc. Thus far, the role of banks in tax avoidance and IFFs has hardly been debated. This is also a field of activity for the C20.

Even the current critical debate in the G20 about corruption is not yet associated with issues of tax avoidance/evasion in conjunction with trade issues. From the perspective of the Global South, it is important to not only consider the issue of corrupt government employees when discussing the issue of corruption, but also the private sector. Corruption also occurs based on supply and demand.

The ICRICT Proposal: Radical Action Is Required

The Independent Commission for the Reform of International Corporate Taxation (ICRICT) submitted a comprehensive proposal to restructure international corporate taxation in 2015. Their goal is to control tax competition and increase transparency. These reforms are supposed to be implemented with an inclusive approach. From the perspective of ICRICT, radical action is required. Contrary to the BEPS Project, the ICRICT proposal is aimed at a system change. The core of the reform proposal is treating TNCs as one company. The principle of »separate entity« that makes it possible to transfer taxable income from operating activities would no longer be applicable in this case. In the view of the ICRICT, the BEPS Project was incorrectly designed from the beginning, because the basic tax avoidance mechanism is based on transfer pricing. As already described, transfer pricing is referred to as billing price structuring and as determining business prices for reciprocal transactions. These transfer prices within a corporate group are viewed by the BEPS Project as if the parts of the company involved were independent. The ICRCIT argues that this assumption is false. Relevant decisions that affect individual subsidiaries are made in the top management of the corporate group, so no independence exists. The global public interest would come to the foreground with the ICRICT approach and would take priority over the advantages of individual countries or corporate groups.

The total group taxation desired by the ICRICT is accomplished in three steps. First, the total profits of the corporate group are determined. To do so, all activities of subsidiaries must be indicated, broken down by country – that is, the country-by-country reporting mentioned previously. Then, the corporate group's profit is allocated to individual countries with the help of a formula. This process is referred to as »formulary apportionment« and is a progressive way for the ICRICT to allocate profits of multinational corporate groups on the basis of three key factors: sales, labour factor, and assets. The current system, for example, disregards scandalously labour-intensive activities. Manufacturers and retailers generate little profit. The largest amount of profit is made in the area of intellectual property and senior management. According to the ICRICT, this is why formulary apportionment should be based on equal distribution between profit, employees, and assets. Then, the profit allocated to a country on the basis of the application of this formula is taxed at the national tax rate. Moreover, the ICRICT supports the demand to give more power to the expert committee under the auspices of the UN. Another main demand is aimed at improving the transparency of tax payments made by TNCs.

Who Is Driving the Reforms?

In the debate on reforming corporate taxation, the question of which level has first priority also immediately arises. As in the other debated issues, the answer is the national level, as well as the regional and international levels. Individual countries must combat tax avoidance and corruption and strengthen their national legislation; yet without international cooperation, significant progress will be impossible. As discussed above, the debate about reforming corporate taxation has recently gained a lot of momentum. Although there has been a sequence of initiatives, the global architecture for a comprehensive reform is insufficient.

It is important not to primarily consider issues of creative tax avoidance/evasion or IFFs as a technical problem that must be solved by experts. For example, the BEPS Project is under the auspices of the OECD, because it is a standard-setting process. However, the debate about standards does not reach the core of the problems; first and foremost, it is a political problem based on unequal balances of power. Therefore, the political will is primarily decisive when controlling aggressive tax avoidance/evasion and IFFs. Consequently, reforms must also be initiated at the political level. There is broad consensus among representatives of the Global South and civil society that, ideally, the UN must drive the debate about fair corporate taxation. Defining and reforming global tax norms should be managed by a universal, democratic, and well-financed international organisation under the auspices of the UN. However, there is doubt about whether the UN is able to spearhead the debate in its currently weak state. The G20 on the other hand turns a blind eye on the desires of most developing and emerging nations; they are not sufficiently heard in the G20. For example, the Addis Ababa Development Agenda, which is important for many representatives of the Global South, does not play a significant role in the G20. Many representatives – particularly from the progressive camp in Africa and Latin America – are striving for a structural transformation under the development agenda. Sufficient financing is necessary to do so. Africa's focus is on IFFs, because the funds required to implement the development agenda have been lacking up to this point, and containing IFFs could generate important funds. The priorities of Europe and the US are different; they emphasise the private sector's role in development financing. A lack of interest in these issues can also be observed from the OECD, whose members pursue their own interests during internal discussions. This became clear, for example, in the debate about country-on-country reporting. The initial intention was to publish this data, which would have helped many countries of the Global South, but some OECD members had no interest in doing so.

For many representatives of civil society, progress can only be achieved through alliances between dedicated countries or with civil society. Cooperation in this area would offer developing and emerging nations great opportunities. The Addis Ababa Action Agenda could be taken as a starting point. The debate about a possible South-South cooperation shows parallels to the debate about the debt crisis of the 1970s and 1980s. At that time, the lenders pursued a divide-and-conquer strategy. Banks and governments feared that the indebted countries could join together, which could have threatened the existing system to its foundations. But there was neither an institution nor a suitable mechanism on which the Dublin states could have built their cooperation. The result was the Brady Plan and neoliberal support to make the local economies dependent on international investments.

The appropriate course of action is being debated in addition to the main actors to implement a system change. Is an international agreement necessary? Or are a few willing countries sufficient for the beginning? However, efforts for stronger coordination at the regional level have not been successful up to this point. Therefore, it is critical to intensify the regional and global debates. If various regions of the Global South work together, the probability is greater that an alternative agenda will be determined that cannot be immediately blocked by the EU or the US. If progress only comes through consensus, initiatives are almost always blocked (see the long-standing debate about the financial transaction tax).

In addition, naming and shaming countries that have thus far not played an active role in the struggle against IFFs and tax havens or that themselves function as a tax haven could be a promising approach at the international level. If nothing else, public awareness of the issues can be increased in these countries. Increasing diplomatic pressure at the international level could lead to countries doing their own homework and not simply criticising other countries – for example, when they point at Caribbean countries that function as tax havens. In this area, alliances between civil society and dedicated countries could lead to success.

What to Do Now

The main challenges on the issue of international corporate taxation consist of making the issue accessible to society. This is the only way that the necessary public pressure will occur, which is required to initiate reforms at the national and international levels. The importance of the issue to the public and to economic and social development must be more clearly emphasised, and its reputation as a boring and technical issue must be combated.

There are other, more technical challenges that are also vastly important. Tax administrations in the countries of the Global South often have only very low capabilities. Thus, it is paramount to increase the personnel capacity in the public tax administrations of the Global South, which often lose out in the struggle with the private sector for the best minds. For example, according to estimates of the High Level Panel, approximately 650,000 tax specialists are lacking in Africa to reach a level that is comparable to the OECD. In the short term, it is important in the light of limited abilities – especially in emerging and developing countries – to clarify expectations and set priorities to decide where the initial starting point should be. First, it must be clarified in light of the limited resources what is more important: analysing and possibly revising a country's own tax incentives, or fulfilling the guidelines of transfer pricing. An alternative would be a simpler system that would be easier to administrate, as ICRICT proposes.The legislation level is also extremely important. Tax administrations and the political level are often not in harmony. Good tax administrations are easily thwarted if there are no reforms at the political level.

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