

THE ANDEAN MULTINATIONAL ENTERPRISE REGIME: EMERGENCE, DECAY, AND REFORM

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ABSTRACT

This article addresses the question regarding the ability of the Andean Multinational Enterprises for fostering intraregional inward investment within the pale of the Andean Community of Nations. The deficiencies in the philosophy behind the regime, inspired by the Regional Industrialisation Programme Model (RIPM), the insufficiency of the benefits, and the rigor of the requirements have conducted to an impairment of the regional scheme. This paper explores these problems studying the main characteristics of the transnational Andean corporations, assessing the role of the RIPM in the decay of the regime, and proposing a reform that moulds a new policy of business facilitation for regional investors.

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Key words: Andean Community, multinational corporations, multinational enterprises, transnational corporations, regional industrialisation, development, foreign investment, supranational law.

RESUMEN

El presente artículo desarrolla el cuestionamiento sobre la habilidad de las empresas multinacionales andinas para promover la inversión intrarregional al seno de la Comunidad Andina de Naciones. Las deficiencias en la filosofía del régimen, la cual está inspirada en el Programa Modelo sobre Industrialización Regional (RIPM por sus siglas en inglés), la insuficiencia en los beneficios y los rigurosos requisitos de constitución han llevado al desaparecimiento virtual del esquema corporativo regional. Este ensayo explora estos problemas estudiando las principales características de las sociedades transnacionales andinas, evaluando el rol del RIPM en el decaimiento del régimen y proponiendo una reforma en la que se plasme una política de facilitación de negocios para inversionistas regionales.

Palabras clave: Comunidad Andina, empresas multinacionales andinas, empresas multinacionales, multinacionales, EMA, industrialización regional, desarrollo, inversión extranjera, derecho supranacional.

SUMMARY

- I. Introduction
- II. The regional industrialization programme model
- III. RMEs in the andean community
 - A. Genesis of the AMEs
 - B. Main characteristics of the AMEs

IV. Thoughts and reflections on the AME regime

A. Difficulties with the requirements

B. Special treatment provisions

V. Conclusions

VI. References

I. INTRODUCTION

The role of multinational enterprises from developing countries has been an emergent issue in the last twenty years. Scholars have argued that these corporations suffer deficiencies such as inadequate transfer technology¹, non-sophistication of their management, insufficient training of technical and professional personnel, uncertain business sustainability, and confused decision-making processes. However, further studies have approached the topic from a more optimistic point of view, recognising that firms can accumulate technological skills and networking capabilities due to their familiarity with the “third world” market and the management of resources that conform their home country’s “comparative edge” or “comparative advantage”².

Thus, national entrepreneurial champions from developing countries have realized that they can offer their industries to other developing and developed nations. The conquest of international markets has been the next step in the business of these corporations, having as a primary scenario their own economical regions. This process of entry and establishment has been supported by different regional organizations that have created special schemes to

1 See NARULA, R., 1997.

2 See KUMAR, K. and MCLEOD, M. (1981), LALL, S. (1983), KHAN, K. (1986), and CHUDNOVSKY, D. and LÓPEZ, A. (1999).

encourage sub-regional entrepreneurs to initiate an economical venture through the creation of supranational corporate forms. The main theoretical background for the creation of these Regional Multinational Enterprises (RMEs) has been the Regional Industrialisation Programme Model (RIPM) which aims at the reduction of development differences between member countries through joint mechanisms of industrial promotion and intraregional investment.

In 1971, the Andean Community (ANCOM) introduced a version of RMEs known as Andean Multinational Enterprises (AMEs) which, like the rest of ANCOM's common policy, was notably influenced by the RIPM. The excessive deference to this philosophy, plus other structural deficiencies in the regional promotion of the AMEs, has converted the AMEs regime in dead letter, leaving investors without any sound mechanism to facilitate their business within the region.

The objective of this essay is to analyse the theoretical background and concrete deficiencies of the AMEs regime. Part II introduces the RIPM; part III explains the genesis and main characteristics of the Andean regime; part IV critically assesses AMEs; and the last part concludes that the existing model, in its current terms, is unattractive and needs an urgent reform in order to fulfil the real expectations and necessities of intraregional investors. A business facilitation scheme is proposed.

II. THE REGIONAL INDUSTRIALIZATION PROGRAMME MODEL

The RIPM is an approach to regional economic integration whereby existing differences in levels of development among member countries are reduced through programmes of joint industrial development. The model seeks the expansion, specialisation, sophistication, and promotion of regional industrial activity and the improvement of regional productivity through coordination and complementation between enterprises, and an adequate internationalisation of regional industry.

This model encompasses different policies for the general development of the industrial process of a region in areas ranging from agricultural policy to macroeconomic common guidelines. However, for the specific reach of this essay, it is relevant to study the role of the RIPM in the design of investment policies, and in particular, to focus on the entry and establishment provisions for foreign direct investment (FDI) within the member countries. This constitutes the theoretical background of the creation and promotion of regimes such as RMEs, as study below.

UNCTAD has identified the RIPM as one of the five major models that define the approaches to entry and establishment of FDI³. This regional model grants full rights of admission and establishment based on national treatment for all “investors from member countries of a regional economic organisation only for the purposes of furthering such a programme”⁴. Hence, in the context of investment, the RIPM model promotes the entry of intraregional investors that might enhance, through their entrepreneurial power, the common regional plan of improvement of the general industrial scope and capacity. The model has a special focus on fostering inward investment and on the creation of special conditions for the exploitation of resources and markets from the sub-region.

3 The other four models are: first, the “investment control” model, which is characterised as a fully control over entry and establishment by the host state. Second, the “selective liberalisation” model that offers a positive list limiting the areas where the host state grants rights of entry and establishment. In third place, the “combined national treatment/most-favoured-nation treatment” model, which grants full rights of admission and establishment while carving out some exceptions through the form of negative list. Finally, it is the “mutual national treatment” that, as the RIPM, is applied only to regional schemes of integration and is characterised by the concession of full rights of entry and establishment based on national treatment for all the nationals of a member country (UNCTAD (1999a) pp. 3-4).

4 *Ibid.*

As said in the introduction, one tool to materialise the theory thereof has been the RME, which is a supranational form of business organisation, broadly defined as “an entity that generally is owned or controlled by two or more persons that posses the nationality of countries in the region”⁵. RMEs are therefore conceived as instruments that encourage intraregional economic development and strengthen the internationalisation of local corporations, enhancing their performance abroad in the regional market.

RMEs are originally conceived as corporate vehicles with a special role in the development and growth of regional communities. Because of the proximity between the culture of the corporation and the culture of the host state, these companies are supposed to have a clearer social responsibility with local communities and economies in comparison to those non-indigenous transnational corporations⁶. In early stages of regionalism, they could be the only illustration of real free movement of capital, and their existence can be an example of compromise among member states for the elimination of economic boundaries within a region.

RMEs can be found today in regional agreements such as ANCOM, the Caribbean Community Organisation (CARICOM), the Association of South East Asian Nations (ASEAN), the Common Market for Eastern and Southern Africa (COMESA), the Economic Community of West African States (ECOWAS), the Argentina-Brazil Bilateral Enterprises Agreement (leading to MERCOSUR), and recently in the European Union⁷.

5 UNCTAD (1999b) p. 31.

6 ADAMS, J. (1994), referring to the Andeans, argues that “They had seen too many investors come with their capital and promises of progress, extract natural resources using cheap labour, take all their profits back home and, having exploited the land, leave the people without jobs when the foreign companies went back home” p. 426.

7 However, the *Societas Europaeae* (SE), which is the name of the RME model in the European Union, does not respond to a RIPM. The SE regime is a medium to

III. RMEs IN THE ANDREAN COMMUNITY

A. GENESIS OF THE AMES

ANCOM adopted the RIPM as one of its foundations and as the basis of its economic and integrationist project, which started with the signature of the so-called “Cartagena Agreement” in 1969. Article 3.d. of this treaty⁸ sets forth that

“Joint programming will be instituted, sub-regional industrialisation will be intensified, industrial programs will be implemented, and other means of industrial integration will be applied”

in order to comply with the main objective of ANCOM: the promotion of the

“balanced and harmonious development of the Member Countries under equitable conditions, through integration and economic and social cooperation” (article 1)⁹.

The guidelines for this industrial programme are present all over the agreement and with special detail in articles 60–71 under the “Industrial Development Programs” Chapter. All the provisions of this Chapter were designed to promote intraregional investment and mutual coordination and collaboration of member states in the development of an industrialisation process. Although there are no norms regarding AMEs in the specific Chapter, it is implied that the

facilitate the operation of the European companies in a transnational level and the consolidation of a common corporate law system, rather than to promote the industrialisation of the already industrialised markets. See HAUSWIESNER, F. (2003) and CHETCUTI CAUCHI, M (2001).

8 According to the official new codification enacted in 1997.

9 An electronic version of the codified Cartagena Agreement is available at http://www.comunidadandina.org/ingles/treaties/trea/ande_trie1.htm

latter is one of those mechanisms created for the consecution of the industrialisation objective.

Certainly, since the foundation of ANCOM, AMEs were conceived as an engine for regional investment. The Bogotá Statement, issued in 1967, and which constitutes the very first white paper of the regional organisation, stated that

“The adoption of entrepreneurial projects with the participation of Latin-American entrepreneurs and capital would facilitate the integration process, a reasonable economic specialisation, and an equitable distribution of the regional investment”¹⁰.

In addition, the same document expressed the agreement of member countries in the study of a special treatment to an Andean scheme of RMEs, conceding them a range of benefits including elimination of double taxation, duty waivers for importation of technology and equipment, and international trade facilitation¹¹.

Article 38 of the original codification of the Cartagena Agreement was the provision that eventually ordered the creation of an AME regime¹². Once the then Andean Pact was constituted, the Commission¹³ enacted in 1971 the Decision 46 which was replaced by Decision 244 and then by the current 292 in 1991. Decisions have a supranational character and they are incorporated automatically “from-the-top” in the national legislation of the signatories. Further internal regulations have harmonised this model

10 Grupo Andino, *Historia documental del Acuerdo de Cartagena*, Imprenta Desa, Lima, Perú, pp. 216-217 cited by UNCTAD (1982), p. 21. (translation by the author).

11 *Ibid.*

12 The original codification of the Cartagena Agreement mentioned the AMEs in two other articles. These provisions were: Arts. 38 and 86 (establishment of AMEs for special industrial and infrastructural purposes). The new codification in its article 56 orders the enactment of an uniform regime for AMEs, which already exists in the Decision 292, while article 104 refers to the promotion of AMEs for specific industries. Article 107 contains provisions for the financial facilitation of the AMEs.

13 During the reform process of 1997, the name of the group changed from Andean Pact to Andean Community and the Commission changed for “General Secretariat” (executive body of ANCOM).

with domestic corporate and tax law, and other disciplines related to the Andean RME regime.

It is important to clarify that the investment policy in the sub-region is not merely a straight application of the RIPM. Decision 291, which defines the common policy in FDI¹⁴, sets forth the principles applied for the admission and establishment of foreign investors within the ANCOM territory. The rules contained therein and the investment internal provisions of the member states resemble a mixture of the models sketched by UNCTAD¹⁵. In general, there is unrestricted entry for FDI, national treatment for foreign investors combined with some restrictions in a few strategic sectors¹⁶, and free transfer of funds and profits across borders. The AMEs remain, however, as the clearest expression of the influence and inspiration of the RIPM in ANCOM.

B. MAIN CHARACTERISTICS OF THE AMES

According to Chapter I of Decision 292, investors need to fulfil certain formal requirements when constituting an AME. Mainly, they include the incorporation of the company according to the laws of one of the member countries, the establishment of the domicile in one of the member states, a regional capital equal or higher than 60% of the total¹⁷, and an effective reflection of Andean capital in all management and decision-making areas. In

14 Previous Andean Decisions in the topic (24 and 220) sit a very strong and restrictive common policy that was modified with the enactment of the current regulation. Today, Decision 291 only contains a charter of laxer principles, which have left in the hands of member states any substantive regulation in the investment area.

15 See footnote 3.

16 Nevertheless, this exception to the general rule of free entry and establishment are definitely less restrictive than the majority of developed countries. See PATE, J. (1991) p. 1285.

17 If there are only investors from only two member countries, the sum of the contributions of the investors of every country shall not be less than 15% of the whole capital of the Corporation.

addition, the Articles of Incorporation must contain terms and provisions that assure to shareholders the use of their preference rights and other anti-takeovers mechanisms¹⁸. In terms of capital contributions, the Decision states that foreign and regional investors can do it in cash or tangible or intangible rights, goods or infrastructure.

On the other hand, Chapter III contains a list of incentives granted to companies that have adopted the AME's model. These benefits are national treatment in government procurement; access to sectors reserved in national laws for local investors; free transfers of profits after taxes; national treatment in taxation; access to export promotion instruments; double taxation relief; and national treatment for foreign qualified personnel quotas.

Thus, both requirements and benefits define the essence of AMEs as one of the engines for fostering investment within ANCOM. They aim to assure that regional companies have a real Andean component in their structure and management, and adequate incentives to enter into the regional market as a form of supranational business organisation. Domestic legislations of member countries have harmonised internal laws to include such special provision and preferential treatment to regional investors. Likewise, ANCOM's General Secretariat and the five member countries have defended and protected the existence of AMEs in the current negotiations of trade blocs such as the Free Trade Area of the Americas (FTAA)¹⁹.

IV. THOUGHTS AND REFLECTIONS ON THE AME REGIME

The adoption of the transnational model does not seem to have convinced the entrepreneurial community in ANCOM. After 34

18 However, the investors can resign to these rights.

19 Members of ANCOM have decided to have a common voice in the negotiations in the FTAA. In their documents submitted have asked for the survival of the AME as an exception of the chapter in investment (See ANCOM, General Secretariat (2003) pp. 40-43 and 50).

years from the first Decision regulating the AMEs, such enterprises are almost inexistent. Unofficially, there are around 80 companies incorporated under the supranational scheme²⁰ and most of them are not very significant market players. This clearly shows a failure of the idea of fostering intraregional investment through the Andean RMEs, though it does not mean that this inward investment has not existed at all. Statistically, the Andean countries have showed an impressive improvement of the flow of investment between them, rising 74 times over their accrued intra-community investment during the period 1970–2001²¹. This indicates that regional entrepreneurs have ignored the alternative of the AME and have decided to take different pathways for the expansion of their business to other member states.

Indeed, a large part of the RIPM's philosophy seems outdated for a regional organisation pretending to deepen in a strong process of liberalisation. The Andean process of integration was framed at the beginning by a set of rules based on a policy of import substitution that inspired the creation of the AMEs regime. In addition, at the time of creation of the AMEs regime, the Calvo Clause was influencing the entire Andean region, restricting therefore the entry of FDI. Thus, a system of regional enterprises with selected benefits was a halfway measure to attract foreign investment from friend countries and disincentive flows of capital from the world's economic superpowers. However, the general policy of ANCOM has changed during its 35 years of existence, reflecting an evident bias to open markets even in the area of investment. A justification of the AMEs based on the development of the RIPM seems no longer valid in the current state of integration. Nowadays, the spirit of Decision 291 and the open policy promoted by member states, reflect a different

20 The Legal Office of ANCOM, in a written communication with the author, confirmed that there is not a centralised register to control the number and characteristics of the existent AMEs.

21 ANCOM, available at <http://www.comunidadandina.org/ingles/stadis/ind70-2001.htm>

approach that, as said before, eventually combines the models identified by UNCTAD for entry and establishment of FDI²².

Therefore, despite AMEs are justified on the RIPM²³, the existence of regional multinationals might nowadays find its rationale in other policies such as regional business facilitation and the improvement of general conditions for free movement of capital. In general, after a further reform, investors would find AMEs to be a solution for the main difficulties when moving industries to new locations within the sub-region — e.g. lack of harmonisation, bureaucratic procedures for entry and establishment, double taxation, transit of capitals and workforce, etc. Unfortunately, the AME scheme does not fulfil these expectations in its current terms. In contrast, the excessiveness in requirements and the limitation of the benefits make the model unattractive, provoking, consequently, its systematic rejection.

A. DIFFICULTIES WITH THE REQUIREMENTS

First, the procedure to establish an AME is burdensome in all member countries. Civil servants at national registration offices are not sufficiently informed about the requirements and conditions inherent to the model. This produces continuous delays in the registration process; preparation of extra documentation by potential multinational investors; enquiries to different authorities about interpretation of the norms; etc. Hence, the system itself fosters bureaucracy when it was supposed to eradicate it for these particular cases.

What is more, the problem of disinformation about the AMEs regime is not only in the registration offices of the member countries. The bulk of businesspeople in the region also ignores the existence

22 See footnote 3.

23 See ANCOM, General Secretariat (2003) p. 43.

of the model or lacks enough information about its characteristics. Promotion and diffusion are definitely the weakest point of the model.

Second, the high percentages of intraregional investment²⁴ also discourage the use of the model. Many investors want to establish subsidiaries or branches of their corporations in member countries, but according to the current regulation they do need a local partner to join them if they want to entry as an AME²⁵. This means that regional parent companies involved in real transnational transactions within the region cannot acquire the condition of multinational if they want to keep the same business structure. Even when a regional investor agrees to enter into a partnership with a local investor, the process of finding that commercial partner could be arduous and in some cases, due to the speciality of the business, impossible. Thus, promotion of intraregional investment is decidedly reserved for joint ventures and not, as the term “AME” suggests, for all Andean multinational commercial entrepreneurs. Furthermore, those interested in a joint venture may find excessive the percentage of 15% of local capital in the total. This situation clearly shows how the influence of the RIPM obliges investors to participate in a programme of reallocation of resources and promotion of local industries in host states.

In third place, and in relation with the last point, the regulation not only requires the association with more regional investors but also requires the participation of them in the management of the company²⁶ when they participate with 15% or more of the capital of the enterprise. According to this, if the capital of Company X is 75% Colombian and 15% Venezuelan, and there are 3 directors, one of these must be Venezuelan. As a result, the proportion of directors of Venezuelan nationals would be of more than 33%, a

24 Decision 292, art. 1(d) and (e).

25 Decision 292, art. 5 and 6.

26 Decision 292, art. 1(e) which establishes that for every country whose nationals own not less than 15% of the total stock of the company must have at least one director representing them.

figure that does not reflect the real state of the game within the corporation. Moreover, in many of these enterprises, management skills appear as one of the comparative advantages to compete in other regional markets and entrepreneurs are not always interested on renouncing to this factor. Again, this situation discourages the use of the AME as a vehicle for investment and suggests that any investor is better off with the normal FDI mechanisms offered by every member at a domestic level.

Not to mention the weaknesses of article 1(f) that establishes that sub-regional majority should be reflected in the technical, managerial, financial and commercial direction of the enterprise. The article is vague enough and can conduce to different interpretations that compromise the flow of FDI of third countries through AMEs. These “pro-regionalists” norms harm the confidence to the scheme by potential qualified or active investors from more developed countries. The uncertainty on the interpretation or application of these norms by local authorities or local courts reduces any intention of use of the model, leaving investors, again, better off with the “juridical certainty” of domestic laws.

B. SPECIAL TREATMENT PROVISIONS

One might think that behind the curtain is awaiting an attractive group of benefits that could encourage investors to adopt the supranational business form despite the harsh requirements. However, the incentives do not constitute a sound trade-off for the fulfilment of the requirements contained in Chapter I of the Decision.

Among the main reasons that entrepreneurs have to enter into the corporate model is the avoidance of double taxation²⁷. Nevertheless, the special norm of the Decision suffers the same ill of misinformation within the relevant authorities in the member states. Entrepreneurs prefer not to use the tax facilitation rule and

27 Decision 292, arts. 19 and 20.

avoid any further sanctions from the taxation authorities. Moreover, the recent steps of ANCOM to improve common regulation on double taxation show that this benefit would be applicable to any investor without regard to its qualification as AME.

Another topic that deserves further attention is crossborder transit of workforce. If the free movement of people will continue as a simple ideal within the region, it would be necessary to enhance the national treatment to all qualified sub-regional personnel in terms of foreign labour quota regulations²⁸. This important norm could be strengthened with a companion visas regulation that facilitates the expedition and renewal of travel documents²⁹. In addition, the introduction of a harmonic regional social security regime for personnel that moves from one jurisdiction to another one is a necessity not only for investors or for promoters, but also for workers in general.

Although all other benefits available in Decision 292 have to remain in a further reform, they do not offer an exceptional special treatment. The participation in sectors reserved for nationals and the access to government procurement bids are important incentives for regional investors, along with the trade facilitation provisions and free movement of capitals. However, since the enactment of the Decision in 1991, domestic legislations have opened the investment and government procurement markets in such a way that today those benefits are almost available to any foreign investor³⁰. Internal regulations for state purchases permit the participation of regional and international bidders in the majority of the cases and allow foreign investors to move their profits freely after the payment of the relevant taxes.

28 Decision 292, art. 21.

29 Article 22 of the Decision contains a norm for the quickening of the visa procedure for those promoters, executives or main investors of the companies. However, specific common regulation has yet to be enacted.

30 Today, the security sector is the only one reserved in all the countries for local investors.

A further reform needs to focus on a process of legal harmonisation aimed to create a supranational structure of norms that avoid the problems of conflict of laws in the area of corporate law and regional transnational corporations. Thus, when the company wants to move its headquarters within the region, report taxes or deal with the provisions that establish protections to shareholders and creditors, it would be an instrument applicable in all domestic jurisdictions within the region. Simultaneously, there is a need for simplification of transactions and the avoidance of double procedures for entry and establishment in other member states. This legal certainty and a less burdensome business environment can definitely be the main benefit expected by entrepreneurs in the Andean region³¹.

V. CONCLUSIONS

Although a supranational business organisation is a desired instrument for regional investors, the AME regime is unsustainable, unattractive, and limited in its current terms. Therefore, a substantial reform of the model—together with other structural ANCOM issues—is necessary to accomplish the real necessities of regional investors. ANCOM lawmakers need to decide if they want to continue with a scheme based on a simple RIPM or if they want to inject a dynamic model, where the regional business facilitation appears as the objective for fostering intraregional investment. A new instrument in the area of Andean multinational corporations will enhance the transit of capital within the region and improve the today uncertain and confused legal environment.

ANCOM will have an important and challenging task when reforming the AME regime. The economic world has changed since 1991, year of the enactment of the current Decision 292, affecting

31 The *Societas Europaea* contains all this facilitations for regional investors. See CHETCUTI CAUCHI, M., (2001).

also the investment arena. Today, the organisation will need to take into account issues such as the entry into force of the WTO agreement with its GATS and TRIMS instruments; the negotiations of the FTAA and the US-Andean free trade agreement; and the consolidation of new important principles and topics in the investment area (e.g. international arbitration on investment issues and corporate social responsibility). This latter issue is of the utmost importance as it might conciliate the tension between an approach of business facilitation and the need for regional development.

There is no discussion about the complexity of a reform of Decision 292. Nonetheless, the results of a well-shaped regime will be rewarding for the business community and the region in general, which sees how their corporate champions grow without meaningful instruments to consolidate their entrepreneurial power in neighbouring countries.

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