Rules for Global Players?

Governing multinational corporations in developing countries

By Thorsten Benner and Jan Martin Witte

Sweatshops, human rights violations, environmental havoc: Global players are increasingly coming under fire for their business conduct in developing countries. Neither across-the-board condemnations nor PR smokescreens present a way forward. Voluntary initiatives must be embedded in a framework of binding rules that support multinational corporations in their contribution to sustainable development.

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Angola: Total Elf operates deep water oil drilling platforms 140 miles off the coast. The revenues from the joint venture with Angola's state-owned oil company Sonangol keep afloat a corrupt regime that operates with little regard for the needs of its population, one of the world's poorest. Oil revenues account for 80 percent of the government's budget, lubricating its clientelistic machinery while bringing little benefit to the population at large, a situation criticized by nongovernmental organizations.[1] In Latin America, NGOs decry human rights violations in the global apparel industry, including among Adidas suppliers. Under the slogan "Paper doesn't blush," they contrast the promises of the Adidas code of conduct with the realities on the ground in the Honduran *maquilas* that supply Adidas.[2] In Asia, Global Witness accuses a Malaysian logging company operating in Cambodia of ignoring basic social and environmental standards.[3]

These three snapshots from three continents highlight different facets of the same question: What rules should multinational corporations (MNCs) observe when operating in developing countries? This is an old debate that dates back to the time of the British East India Company and the British South Africa Company. In the 1970's the discussion about a binding code of conduct for MNCs was a source of bitter divides at the United Nations. Then, with the failure of the "New International Economic Order," the debate over the responsibilities of MNCs died down for a while. This changed in the mid-1990's. As part of the globalization debate, the activities of MNCs once again ranked high on the global agenda. Today the actions of more than 70,000 MNCs with 700,000 subsidiaries and millions of suppliers provide significant fuel for debates.

Ten years into this debate, the results are disappointing. The three dominant approaches to the problem fail to provide convincing answers. Neither antiglobalization rhetoric, nor libertarian thinking along the lines that "the business of business is business," nor an *à la carte* approach to corporate social responsibility offer sustainable options for governing the operations of MNCs in developing countries. It is therefore high time to flesh out an alternative: a multidimensional approach that combines binding rules, voluntary initiatives, incentives and sanctions.

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1) John Reed, "How low can they go?" *Financial Times*, March 23, 2005.
2) "Arbeit in Würde. Menschenrechtsverletzungen in der globalisierten Bekleidungsindustrie," *Die Tageszeitung,* March 30, 2005.
3) "Globalisation with a Third World Face," *The Economist,* April 7, 2005.

The Shortsightedness of the Three Dominant Schools

Many advocates of the first school, such as the antiglobalization activists organized in the World Social Forum, argue that MNCs are bad on all counts, on human rights, on labor and environmental standards and on development at large. According to these activists, multinationals only form islands of profitable production in developing countries. This assessment overlooks how multinationals can and do contribute to sustainable development and do not necessarily trigger a race to the bottom in developing countries. At the same time, the antiglobalization activists ignore that in many countries a weak or corrupt state and criminal elites, not MNCs, are at the root of the problem. Well-founded criticism exposing the mistakes and abuses committed by multinationals provides a crucial basis for informed public debate. NGOs play an important role here. However, the icons of the antiglobalization movement fail to go beyond 1970's-style calls for putting limits on MNCs through top-down global regulation.

Advocates of the second school, a laissez-faire approach, believe in the self-regulatory virtues of the market. They base their beliefs on a selective reading of Adam Smith and on Milton Friedman, who remarked in 1970: "The social responsibility of business is to increase its profits."[4] Friedman argues that all rules and regulations beyond basic corporate governance are unnecessary impediments to economic freedom. In the present debate, writers such as the former OECD chief economist David Henderson have followed in Friedman's footsteps. Henderson asserts that "imposing international standards [...] restricts the scope for mutually beficial trade and investment flow" and will therefore hurt development in poor countries.[5]

This laissez-faire approach is politically unsustainable. Harvard international relations scholar John Ruggie, building on Karl Polanyi's *The Great Transformation*, coined the term "embedded liberalism."[6] Ruggie argues that a liberal economic order is bound to collapse unless it is embedded socially and politically in a shared set of values. Today, the rise of economic nationalism (much more than the antiglobalization protests on the streets of Seattle and Genoa) demonstrates that globalization is not an unstoppable *perpetuum mobile* if it is not embedded in a set of values shared by the majority of society.

MNCs find themselves at the center of this challenge. Increasingly, MNCs are perceived as footloose soldiers of global capitalism that conduct their business without concern for jobs in their Western "home" countries nor for human rights and labor standards in developing countries. Therefore, from the perspective of individual corporations, relying on a laissez-faire approach entails significant risks. Many in the public see MNCs as economic and political heavyweights. "With great power comes great responsibility" is the dominant view within society, which does not fail to note that the 200 largest corporations account for a quarter of the world's gross domestic product. In light of this, Ian Davis, head of McKinsey's

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4) "The Social Responsibility of Business," *New York Times Magazine,* September 13, 1970.
5) *Misguided Virtue. False Notions of Corporate Social Responsibility*, (Institute of Economic Affairs 2001), p. 17
6) "International regimes, transactions, and change: embedded liberalism in the post-war economic order," *International Organizations* 36 (2), pp. 379-415.

global consulting operations, emphasizes: "In many instances, a 'business of business is business' outlook has blinded companies to outcomes [...] which often could have been anticipated."

Corporations have increasingly promoted corporate social responsibility (CSR) as a third school. One example is Carly Fiorina, the then-celebrated star CEO of Hewlett Packard, who declared in 2001 that, "we must remake our businesses to be far more active corporate citizens—creators not only of shareowner value, but also of social value, in ways that are systemic, and sustainable."[7] Her solemn words are the trademark of many proclamations on CSR, which many consider to be the guiding light for a new age of responsible business. All too often in practice, however, CSR means an ill-defined mix of glossy brochures on sustainability reporting, philanthropic activities, stakeholder dialogues and community projects. Useful initiatives such as social and environmental audits and pure PR activities are often pursued under the same umbrella. For CSR insiders and the larger public alike it is hard to distinguish between actions and initiatives that are "must have" (because of the law and/or binding obligations) or "need to have" (because of risk management) and those that are "good to have" (because of business development) or merely "nice to have" (because they improve the public image). At the same time, companies and the public alike often lack sophisticated tools for measuring the impact of CSR activities.

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Until now, a clear majority of CSR advocates in the business community agrees on one point: that CSR is purely voluntary and that it is up to companies to pick and choose their version of CSR. This à la carte approach to CSR is not sustainable. The four drivers of CSR—pressure from employees, consumers, activists and investors—are not enough to ensure that CSR goals and concerns are implemented in all key business operations. Most employees in precarious and dependent relationships often have no leverage to demand responsible business conduct. The large majority of consumers base their choices on considerations of price, quality of the product and convenience rather than ethical concerns. Naming and shaming by activists can make a difference but the resources and reach of activists are limited. For most business analysts, sustainability reports are not an important factor guiding their recommendations for investors. Due to the relative weakness of these drivers, CSR activities are likely to remain "ghettoized" in many companies and subject to the vagaries of the business cycle. Efforts to "push CSR down the supply chain" are likely to have only limited success.

A purely voluntary "pick and choose" approach to CSR is also bound to fail because of a lack of credibility. In the short run, CSR activities might reap public relations gains. In the medium and long run, a purely voluntary approach will not withstand public scrutiny. This will hurt those companies that take CSR seriously and uphold high environmental, social and human rights standards while operating in difficult circumstances in developing countries. These companies hope for gains in the market because they are seen as good corporate citizens. However, these gains cannot be realized if the whole CSR approach loses credibility. Many business representatives as well as the International Chamber of Commerce still oppose binding

7) http://www.hp.com/hpinfo/execteam/speeches/fiorina/minnesota01.html

international rules for MNCs. Instead they advocate voluntary measures such as codes of conduct. The current proliferation of voluntary codes offer few reliable guidelines for the public and will only contribute to undermining the overall credibility of CSR.

Binding International Rules

A multidimensional approach that combines binding rules, incentives and voluntary initiatives offers an alternative vision. The implementation of this approach should be based on the principle of vertical and horizontal subsidiarity: vertical through combining activities at the national, regional and international level; and horizontal by way of including governments, companies and civil society. Binding rules at both the national and international level serve as foundations for such a multidimensional approach. The first pillar is effective regulation at the national level. Bilateral und multilateral donors should offer support for building up national regulation systems. There should be no doubt that developing country governments bear the main responsibility for upholding human rights and the rule of law in their territory. At the same time, industrialized countries should help set the right incentives for MNCs, for example, by making corruption a crime instead of making it tax deductible. The social and environmental record of companies should also factor into the decisions of export credit agencies.

Regulation at the national level is key, but problems arise when effective regulation is not in place and when governments are unable or unwilling to guarantee basic human rights and social standards. This is why binding international rules need to form the second pillar of the multidimensional approach. Which fora could be used to develop such a binding framework? The current efforts to devise a CSR standard under the auspices of the International Organization for Standardization (ISO) are unlikely to suffice because the standard will not be certifiable. Introducing binding social and environmental clauses through the WTO would only overburden the organization politically and institutionally. The OECD Guidelines for Multinational Enterprise can serve as a useful starting point. However, given its limited membership, the OECD is not the right forum for negotiating binding global rules. For the time being, the UN, despite its well-known shortcomings, offers the best available forum for negotiating binding rules. The work of the UN special representative for human rights and transnational corporations, John Ruggie, who will present the final report on his two-year mandate in 2007, should serve as a starting point. Ruggie describes his own position as that of "principled pragmatism."[8] This pragmatism will hopefully help to move the UN debate out of the current impasse following the adoption of the UN Draft Norms by the UN Commission on Human Rights in 2003.

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It is likely that demands for a foundation of binding rules will increase—also on the part of companies taking their responsibilities seriously. These businesses have realized that without a binding set of rules, allegations will be tried in the court of public opinion where NGOs and critics determine the boundaries of the responsibilities of corporations. Corporations then often discover that the concept of cor-

8) Interim Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, February 22, 2006.

porate social responsibility is infinitely elastic if the division of responsibilities between the public and private sectors is not spelled out clearly. As a consequence, more companies are likely to follow the example set by DaimlerChrysler. Earlier this year, a senior DaimlerChrysler representative called for binding international rules in the hope of achieving a level playing field and increasing legal certainty and predictability. Another effort leading in the same direction is the work of the Business Leaders Initiative for Human Rights which has experimented with instruments for implementing binding human rights standards in corporations.

In addition to binding regulation at the national and international level, market-based mechanisms and voluntary initiatives can make important contributions too. Certification schemes such as Rugmark or the Forest Stewardship Council, emission trading or increased listing requirements at stock exchanges, are key market-based instruments. At the same time, the investor community possesses important leverage that has not been sufficiently exploited. Alongside investors, reinsurance companies such as Swiss Re or Munich Re can play crucial roles in triggering changes in behavior by forcing companies to confront their "hidden liabilities." Sector-specific initiatives can also make important contributions, such as Responsible Care for Chemicals, the Kimberley Process Certification Scheme for the diamond industry or the Equator Principles on project finance in the banking sector. The example of the Equator Principles shows that an effort at private self-regulation by the banking sector can indeed temporarily fill a governance gap.

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However, in the medium term the Equator Principles adopted voluntarily by a number of banks need to be based on binding rules. The creation of a level playing field that is underwritten by binding rules will become more urgent with a number of banks from emerging economies moving into the project finance business—banks that are much less likely to abide voluntarily by high standards. Sustainability reporting can also contribute to improve transparency. It will be important for trade unions, NGOs, the investor community and politicians to find ways to better use the information coming out of glossy reports. At the same time, we need to further standardize and significantly expand the reach of sustainability reporting. Simultaneously, learning platforms such as the Global Compact can facilitate the exchange of best practices.

Governments and international organizations have important roles to play. They should lend their support to principled initiatives. Earlier this year, the European Commission went down the opposite path with its European Alliance for CSR. As emphasized by the Commission, "there are no formal requirements for declaring support for the alliance, and the European Commission will not keep a list of companies that support it." In other words: there will be no official membership, no common principles and no values. This sends exactly he wrong signals. Wherever international organizations or governments lend their support to initiatives, basic values and principles must be clearly defined. The experience of the Global Compact is a case in point. During its first years of operation, the Global Compact faced severe criticisms for selling out the UN logo to companies without demanding anything in return. The Global Compact has since developed clear rules for membership. Member companies who do not report on their progress in implementing the ten principles enshrined in the document are publicly listed as "non-reporters."

The End of Business as Usual?

While the building blocks of a multidimensional approach are clear, the stumbling blocks for implementation are equally obvious: intellectual laziness, ideological tunnel vision, short-term thinking and a lack of leadership. In this situation, we all the more urgently need a principled pragmatism to advance both the debate and the realities on the ground. This is all the more important since there are a number of unresolved issues: How can we avoid scrutinizing only those corporations which publicly declare their observance of high standards and social responsibility, while letting other companies off the hook who continue with business as usual? How can we influence companies attributing little importance to their reputation and public standing and who are therefore immune to established practices of naming and shaming? How in particular can we hold the increasing number of (often state-owned) global players with roots in developing countries and emerging economies to account, such as Chinese oil companies or the Malaysian logging company? How can we avoid public pressure forcing Western-based companies to abandon operations in zones of conflict only to see their places taken by other companies abiding by lower standards—as happened in the Sudan where Chinese oil companies took over the oil operations of major Western players?

The present situation recalls the assessment advanced almost 30 years ago by Raymond Vernon, the pioneer of the study of multinational enterprises: "at this juncture it is hard to detect among the leaders of government and business any disposition to begin serious work on building an acceptable international regime. But the time for constructive response has not yet run out. And these leaders may yet be persuaded that the existing strands of national and international policy add up to a situation that could inflict injury on all the interests concerned."[9]

Predicting the next "storm of the multinationals" is mere guesswork. However, it seems evident that Vernon's words still hold true for the present age. The writing on the wall is very clear concerning both the credibility of MNCs and the credibility of the often invoked "international community" in meeting the Millennium Development Goals. These are two convincing reasons for agreeing on a multidimensional governance framework that combined binding and voluntary elements while at the same time leveraging the enormous contribution of multinationals to sustainable development and global governance. This presupposes the ability of politicians, CEOs and NGO activists to look beyond the next election, the next quarterly report or the next fundraising campaign. Business as usual is not a sustainable option for any of the key protagonists, be they corporations, governments, NGOs or international organizations.

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9) "Storm over the Multinationals: Problems and Prospects," *Foreign Affairs*, January/February 1997, pp. 243-262.