

Public and Private Interests in Global Regulation: An Overview of the Issues

THE PUBLIC AND MOST POLITICIANS are just beginning to engage in serious debate over the conditions under which industry self-regulation makes sense in the era of globalization. This debate requires more understanding of the driving forces behind this trend—forces that reflect the relative power of governments to rule, industry to gain authority in new spheres, and the public to influence policy. Many people have decried the effects of globalization and argue that power is shifting dramatically into the hands of corporations. William Greider titled his recent book *One World, Ready or Not*; David Korten called his book *When Corporations Rule the World* (Greider 1997; Korten 1995). The examples they give present a picture of politicians bowing to the demands of big business, often in a corrupt way.⁵ Internationally, corporations are accused of skipping lightly from country to country in search of the most accommodating political environment. But if this is true, then any efforts by MNCs to restrain their own behavior—however weak those restraints may be—must be considered an anomaly. Why do it?

To begin to answer this fundamental question, this chapter first defines self-regulation and its elements and then examines the context in which industry self-regulation is taking place. The next section turns to the issue of how globalization is changing the character of business, forcing it to take on new roles in the public domain. It then offers a brief survey of international regulatory efforts to date. Finally, it identifies and explores the factors that are driving industry to self-regulation.

The Context for Industry Self-Regulation

Technically, regulation is action or behavior that is required by governments—it is not voluntary, and the regulators are public authorities.⁶ But in broader, more practical terms, regulation is the formal rules or standards that dictate what is acceptable and required behavior, putting limits on what is permissible.⁷ Self-regulation occurs when those regulated—in this case, corporations—design and enforce the rules themselves. The rules that govern their behavior are adopted voluntarily, either going beyond current regulatory requirements or establishing new standards in areas in which government rules or standards are lacking. Although they are adopted voluntarily, the rules may be backed up with a variety of formal and informal enforcement mechanisms including written agreements among companies or between companies and other groups. The basic document of such an initiative typically is a “corporate code of conduct.” A recent description of the nature of agreements between states could just as well apply to corporate codes, especially when they involve more than one firm:

The agreements vary widely in scope, number of parties, and degree of specificity, as well as in subject matter. Some are little more than statements of principle or agreements to agree. Others contain detailed prescriptions for behavior in a defined field. Still others may be umbrella agreements for consensus building in preparation for more specific regulation later. Often they create international organizations to oversee the enterprise. (Chayes and Chayes 1998, 1)

Two types of industry standard setting are often held up as models for business self-regulation, and they influence the character of the trends we see today. First, from a business perspective, the way to develop international standards is the way they have always been developed for technical advances or market promotion. These standards specify the physical qualities required for the sale and use of industrial or commercial products and services, or the terms under which business exchanges will occur. Industry associations have a long history of designing and promoting good design practices for their members and

have taken the initiative to develop new standards for emerging technologies. These are intended to facilitate international exchange of goods and services, enhance the reputation of the industry as a whole, and reduce the costs of doing business. For instance, the pharmaceutical industry has strict standards for marketing drugs, because bad practices will undermine consumer trust and potentially weaken the market. International bodies such as the International Organization for Standardization (ISO), whose members are a mix of government and nongovernment representatives, negotiate agreements that specify the rules, guidelines, and characteristics for materials, products, processes, and services. For some forms of contemporary self-regulatory activity, this technical model dominates industry thinking.

The second model comes from the activist initiatives of the 1970s and 1980s and is much more foreign to the business mind. This model is based on social or political demands from outside the business community. The Sullivan and MacBride Principles, for apartheid South Africa and conflict-ridden Northern Ireland, respectively, are two early examples. Despite their mixed record, both efforts brought to the attention of a wide audience the possibilities for achieving social reform through a change in corporate behavior. They thus set the stage for the next phase in corporate regulation. That next phase is what we are seeing now, a “corporate accountability” movement in which civil society groups pressure companies to develop codes of conduct or to adopt commitments developed by others (Broad and Cavanagh 1998). In many cases, a crisis such as an oil spill or the exposure of sweatshop conditions in a factory triggers the mobilization of pressure groups and leads to the development of new industry principles. For instance, the *Exxon Valdez* oil spill eventually led a small group of environmentalists and sympathetic business executives to develop and adopt the Coalition for Environmentally Responsible Economies (CERES) Principles on environmental responsibility. In this case, industry developed standards not to address technical concerns or make it easier to exchange goods and services, but rather in response to social demands.

The trend toward self-regulation went relatively unnoticed until recently. This may be in part because the phenomenon itself is difficult to see. We tend to assume that regulation is an activity of governments, therefore blinding ourselves to other varieties of rule. Much self-regulation occurs as a matter of course within industry associations

and is viewed as simply a process of determining business “best practices” or as something that leads to obscure technical standards.⁸ Corporations increasingly have begun to adopt codes of conduct that lay out their rights and responsibilities, but they have done so in such an ad hoc fashion that it is difficult to determine the scope of the codes. Only recently have different projects begun to collect and analyze corporate codes. Social and political partnerships among corporations, international organizations, governments, and nongovernmental actors have expanded in number, but their purpose is often such a mix of providing public goods and services, setting industry standards, and obtaining private benefits that their regulatory aspect is hard to see.

The main participants in self-regulation are MNCs based in the industrialized countries.⁹ Changes in the international system provide them with increasing access to a large number of markets hitherto closed to them. The most dramatic opportunity is China’s entry into the World Trade Organization (WTO) portending a great reorganization of the world economy. Both large and small firms have an international presence through trade, joint ventures, strategic alliances, outsourcing of production to local manufacturers abroad, and in recent years, via the Internet (Oman 1984; Gomes-Casseres 1994).¹⁰ Intense competition for markets pushes all firms to produce at lower cost, with higher quality, and to respond to changing consumer demands almost instantaneously. In their operations in developing countries, firms face myriad conflicting cultures, often-weak national governments, and markets so thin of economic activity that foreign corporations easily dominate them. They also find themselves dealing with a tangle of law and regulation at multiple levels of government on a variety of policy issues. Many corporations that invest and transact business internationally are torn between a desire for harmonization and standardization of the rules of the game, and strategic calculations about the competitive edge that they could gain from taking advantage of such a mixed system.¹¹

Corporate leaders consistently express anxiety at the thought of government intervention, especially in the most competitive sectors. This concern exists even though deregulation, privatization, and market-oriented policies have become widely accepted around the world in the past two decades. Governments increasingly view their own roles as that of facilitators of market expansion and competitive-

ness.¹² Politicians of both the left and right advocate smaller government and more market-friendly regulation, including delegation of tasks to the private sector.¹³ Former U.S. president Bill Clinton famously declared that “the era of big government is dead.”

Despite this overall liberalizing trend, we now see the public in many countries demanding that government deal with the downside of globalization.¹⁴ Riots in Seattle over the WTO, protests in Washington, D.C., over World Bank and International Monetary Fund (IMF) policies, and activist mobilization for any major international economic gathering reflect a growing uneasiness with the economic forces unleashed in the past few decades. Those forces are embodied in the MNC. In a May 1999 poll in Great Britain, over 50 percent of those surveyed disagreed with the statement that the profits of large companies make things better for everyone who uses their products and services—a percentage that had steadily increased over the past decade (MORI 1999).

The demands of consumers, activists, and the media—which are all active transnationally—are expanding. Nongovernmental advocacy organizations in particular have become more effective in constructing transnational issue networks to press their causes in many different political arenas at once (Florini 2000; Mathews 1997; Keck and Sikkink 1998; Simmons 1998). For some issues, activists who are blocked in their efforts to persuade governments to regulate and punish corporate transgressors now target the business community directly (Broad and Cavanagh 1998). They use the media to expose corporate violators, protest against a company, bring lawsuits against specific companies or industries, and generally raise the costs—economically and politically—of doing business.¹⁵ They mobilize consumers and investors as a strategy to effect corporate change. Consumers demand high quality and low cost in the products and services they buy, but they also increasingly expect business to produce them in ways that do not have negative consequences for society. Investors also pressure corporate leaders by investing in socially responsible companies and bringing shareholder resolutions to annual meetings. Shareholder activism is increasing in the United States and Europe, and to some degree the “shareholder” perspective on corporate governance is giving way to “stakeholder” perspectives.¹⁶ This is the context in which businesses are turning toward self-regulatory strategies.

Globalization and Changes in the Character of Business

Industry self-regulation is one element of globalization. Continuous debate about the causes and consequences of globalization has yet to lead to any consensus about the nature of the phenomenon. The core of the debate, however, can be summed up by the term *convergence*. Some people debate whether global economic integration forces all governments to adopt similar policies, such as free trade or loosened restrictions on foreign investment (Berger and Dore 1996; Boyer and Drache 1996; Prakash and Hart 1999). Others argue over whether globalization forces political parties to adopt similar platforms, and whether there is a convergence in partisan politics (Garrett 1998). Many point to the decline in state power as a hallmark of globalization, affecting all countries, even the most powerful (Hirst and Thompson 1995; Ohmae 1995; Strange 1996; Mathews 1997). A small number of scholars have tried to assess whether global economic pressures lead to convergence in the organization and market behavior of firms (Doremus et al. 1998). Even fewer address systematically whether globalization leads to convergence in the political roles adopted by firms, and how this might affect the relationship between the public and private sectors in governing the world economy.

This project starts from the empirical observation that many MNCs are adopting a variety of self-regulatory policies and are doing so at an increasing rate. Self-regulatory policies include: corporate codes of conduct that lay out the social commitments the company makes; management and accounting systems that translate those commitments into specific roles and responsibilities within the organization; implementation programs that involve the expenditure of resources to achieve specific goals; and monitoring, auditing, certification, and labeling programs that testify to successful achievement. Industry self-regulation also shades into “co-regulation” at times, when the policies and programs are developed in cooperation with governments. Much of this activity falls under the more popular headings of corporate social responsibility, corporate citizenship, and business ethics.

The Organization for Economic Cooperation and Development (OECD) recently analyzed a sample of 233 corporate codes of conduct.

This analysis demonstrated that a growing number of companies either adopted or revised their codes of conduct in the past decade (OECD 1998). In a recent survey, KPMG reported that of 1,000 large Canadian companies 86.4 percent have codes stating their values and principles, and 72.7 percent conduct programs focusing on promoting ethical values and practices (KPMG 2000). A recent International Labor Organization (ILO) report on voluntary initiatives found the same upward trend in the number of codes addressing labor issues. Indirectly, corporate interest can be gauged by the increasingly large audience for the annual meetings of Business for Social Responsibility (BSR), a U.S.-based business membership organization. The Prince of Wales Business Leaders Forum (PWBLF) in the United Kingdom, made up of British firms, has gained more and more visibility and influence in promoting corporate social responsibility. The Sullivan Principles, originally developed for companies in apartheid South Africa, have been revised to become general global guidelines, and many companies are signing up. The UN Global Compact, under which corporations commit to uphold nine principles drawn from UN agreements, is beginning to attract major MNCs. Membership in the U.S.-based Association of Ethics Officers went from only twelve in 1993 to over 700 today, as more firms feel the need to have ethics and compliance officers (Ethics Officers Association 2000).¹⁷ The number of business conferences devoted to business ethics, corporate social responsibility, codes of conduct, and related topics has mushroomed (although no exact figures are available). Even the U.S. Chamber of Commerce—not usually viewed as a progressive organization—recently established a Corporate Citizenship Center.

Corporate codes of conduct are generally the most visible measure of industry self-regulation. However, there is now an array of other elements in this emerging self-regulatory system. An increasing number of management programs support the implementation of conduct codes within the corporate bureaucracy. These internal management systems include auditing, accounting, monitoring, and reporting requirements. In fact, there has been such a proliferation in environmental reporting alone that the UN Environment Program (UNEP), in partnership with business organizations and NGOs, has convened a Global Reporting Initiative (GRI) in an effort to standardize and make sense of the competing formats. Hundreds of international firms have

adopted environmental management systems, including the ISO 14000 standards, which require companies to develop links between a corporate environmental code and actual implementation throughout the organization.¹⁸ Monitoring and auditing of performance have become so common that the major auditing and accounting firms now have well-established practices in this new market, with PricewaterhouseCoopers taking an early lead in the market for social audits of factories. Businesses have created new associations to develop and implement standards, often partnering with NGOs, for example, in the Fair Labor Association for apparel manufacturers in the United States. Many companies have moved from simple codes of conduct developed by top management to bottom-up policy processes within the entire company. Still others have moved from codes developed in-house to collective efforts within an industry or business group. Others have developed more elaborate systems that institutionalize new practices and certify their implementation. For example, Mattel has established an independent monitoring organization that publishes its report on practices in overseas suppliers' factories.

What is particularly noteworthy about the current trend, however, is the degree to which the private sector is pursuing self-regulatory actions in areas that are typically *not* viewed as essential to their core economic activities. Voluntary codes and standards do not address narrow technical issues alone. They also do not entirely fit under the heading of traditional philanthropic programs, although some corporate executives think of them this way. They address what might be called the externalities of corporate activity—the side effects of modern production, distribution, sales, and service. The existence of these externalities is often given as the justification for government intervention to correct this “market failure.” To date, however, governments have not been very effective at intervening at the international level to regulate corporate behavior on social and environmental issues.

How should we view these developments? Do they signify a new trend in how corporations behave and what expectations society has of them? Or are they simply an effort to distract attention from an underlying disconnect between the interests of the private sector and those of the public?

A Survey of International Regulation of Multinational Corporations

The regulation of private sector activity historically has traded back and forth between public and private hands. Industry self-regulation, especially for cross-border exchanges, is not an entirely new phenomenon, but it periodically falls out of favor. During the sixteenth century, when long-distance trade became common throughout Europe, merchants developed their own system of rules for exchanging money and goods and for settling disputes that were independent of political jurisdiction (Braudel 1981–1984). Over the course of the next few centuries, as political leaders consolidated the new sovereign nation-states in Europe, they often adopted and codified this merchant law, gradually drawing a line between private activity and public rule making. By the mid-twentieth century, the area of private rule making gave way to an expansion of the public sector in many dimensions. Only in the past twenty years has the separation between the public and private sectors become less rigid, as state intervention in economic affairs has been reversed by a wave of privatization and deregulation. Much of the new private sector governance responds to gaps in global governance that stem from the lack of overarching, comprehensive regulation of corporations at the international level.

Governments have repeatedly tried in the past few decades to develop an effective regime for regulating international corporate behavior but have never successfully negotiated a strong and comprehensive system. Since MNCs first emerged as a significant force after World War II, regulation of them has generally been by individual countries and not by international law and organizations, although this issue has certainly been on the agenda during the entire post-World War II era. The effort to use international law to regulate corporations reached a high point in the 1970s, when the United Nations sponsored negotiations over a proposed voluntary Code of Conduct on Transnational Corporations, the OECD developed its Guidelines for Multinational Enterprises, and the ILO adopted its tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy. Governments also negotiated sectoral agreements as a result of contentious debates over specific industry practices, such as the mar-

keting of infant formula in developing countries. In Latin America, countries responded to the entry of foreign investors with the creation of a set of regional investment codes (Lipson 1985).¹⁹ Both developing nations and trade unions in the 1970s agreed that the power of international business needed to be reined in as part of a New International Economic Order, but their efforts failed (Kline 1985).

The climate of the early 1970s played an important role in capturing the collective attention of the United Nations and others on the issue of corporate behavior. Corporate influence on national politics had become a pressing concern, particularly in newly independent states still uncertain of their sovereignty. Scandals had erupted, for instance, over the role of the International Telephone and Telegraph company (ITT) in Chile. In response to developing country demands, the Economic and Social Council of the United Nations (ECOSOC) in 1972 adopted a resolution to monitor closely the behavior of transnational corporations (TNCs). ECOSOC established the Commission on Transnational Corporations in 1974 with the mandate to negotiate a code of conduct for TNCs. Under the proposed UN Code, states would pledge to ensure that foreign investors respected national sovereignty and human rights, disclosed relevant information to host governments about their operations, refrained from transfer pricing, and resolved other points of contention.²⁰ From the very start, the United Nations assumed the end result would be a comprehensive, single international instrument.

Developing countries, empowered by the success of the Organization of Petroleum Exporting Countries (OPEC) oil embargo in 1972, insisted that the industrialized world make the code mandatory and apply it only to TNCs and not to the governments that host them. The major industrialized nations, however, supported a voluntary code that addressed both host government and corporate behavior. In the early negotiations, the issues of nationalization and compensation of foreign corporate assets and the national treatment of foreign companies tied up the discussions. The UN debate over a corporate code became a flash point for conflicts between the developing and industrialized countries, exacerbated by Cold War tensions and the ideological fight between capitalism and communism. The negotiations dragged on throughout the decade.

By 1985, efforts to develop an international corporate code had stag-

nated (Kline 1985). In both the United States and the United Kingdom the political wind had turned by the 1980s, and new governments ardently pursued free market policies that went against further regulation of corporations. Many developing countries were suffering through a debt crisis and under the guidance of the IMF adopted deregulatory policies themselves. They were no longer very interested in the UN Code negotiations. In 1991, the Bush administration argued that private corporations played a critical role in the world economy and therefore should not be regulated. In 1992, despite agreement on about 80 percent of the content of the code, the international negotiations ended.²¹

Simultaneously with the UN negotiations, the OECD managed to negotiate and adopt Guidelines for Multinational Enterprises in 1976 as part of a broader Declaration on International Investment and Multinational Enterprises. The member states—the industrialized nations—negotiated principles that governments would apply voluntarily to the private sector. The guidelines covered issues from financing and taxation to employment and environmental protection. They had little influence and visibility, however, despite the fact that the OECD revised them twice in the following decades.

A year after the initial guidelines were adopted by the OECD, the ILO also formulated and adopted a Declaration of Principles Concerning Multinational Enterprises and Social Policy. The declaration established voluntary guidelines covering employment, training, working conditions, and industrial relations. As in all ILO conventions, the declaration applied to governments and relied on them to ratify and implement its provisions. The ILO instrument places more restrictions on MNC activity than the OECD document but is not as comprehensive as the UN Code would have been. Both the OECD Guidelines and the ILO Declaration did not have much direct and measurable effect, but they laid the groundwork for later efforts.

The concern over multinational corporate behavior did not pass with the formulation and adoption of the OECD Guidelines or the ILO Declaration. Although interest in developing a multilateral code of conduct waned in the 1980s, specific issues did grab the headlines. The most significant was the movement to use corporations as levers to change the apartheid regime in South Africa. In 1977, the Reverend Leon Sullivan, a member of the Board of General Motors and an ac-

tivist against apartheid, developed a set of principles to guide companies operating in South Africa, hoping the private sector could change the system from within. By 1984, 128 of about 350 U.S. companies operating in South Africa had agreed to abide by these principles. Despite this affirmation by so many U.S. companies, Sullivan himself began to lose faith in the efficacy of the principles because too many companies did not implement them and because the apartheid regime appeared so firmly entrenched. He began to advocate divestment from South Africa, as many others did. Yet, in hindsight, the Sullivan Principles were an important piece in the ultimately successful movement against apartheid. Both the Sullivan Principles and the divestment movement demonstrated the potential of using corporations as tools to pursue political objectives (Klotz 1995).²²

In the past decade, smaller groups of states have been able to negotiate and implement rules governing corporate behavior. These regional regulations are fairly comprehensive, covering both corporate rights and responsibilities. The two major advances in this area are the Social Protocol of the European Union (EU) and the labor and environment side agreements of the North American Free Trade Agreement (NAFTA). These two agreements, despite significant weaknesses, establish wider acceptance of the idea that corporations must be held to high standards. Some EU member states disagree on whether labor and environmental standards should be harmonized and have opted out of the Social Protocol (there is much less disagreement, however, over the strong human rights protections in EU law). The NAFTA side agreements adopted in 1993 specifically addressed some of the social and environmental side effects of cross-border investment within North America. The main treaty, enforceable under international law, covers property rights and national treatment for foreign investors. The NAFTA side agreements and the institutions established to monitor them have no authority over domestic regulatory systems but essentially commit member governments to live up to their own current law and regulation. Both the EU Social Protocol and the NAFTA side agreements apply to what some might call the “easy” cases—multinational corporate behavior in relatively advanced, industrialized countries, with high standards already written into law. Most of the big problems with multinationals occur in the developing world.

In the 1990s, as the backlash against globalization and corporate power gained strength, the OECD launched two new efforts: one, to revise the existing Guidelines for Multinational Enterprises, and two, to sponsor negotiations over a comprehensive and enforceable MAI. The MAI would lay out such principles as national treatment for foreign investment, protection of property rights, and arbitration requirements. It was a complicated document full of trade-offs to protect the interests of different industries and countries, and it garnered only weak support among the member governments. The United States alone had approximately 500 pages of reservations to the proposed treaty. A loose coalition of environmental, human rights, and anticorporate organizations put the final nail in the coffin of the proposed MAI by mobilizing energetically against an agreement that they argued protected the rights of corporations without paying equivalent attention to their responsibilities.²³

In contrast, the OECD successfully concluded another revision of the original Guidelines for Multinational Enterprises in June 2000, strengthening its provisions significantly. The new OECD Guidelines have wider acceptance, with some non-OECD newly industrializing countries such as South Korea and Brazil indicating a desire to adopt them. These guidelines will be monitored through national contact points in each country (Aaronson 2000). It is too early to tell whether they will eventually become a strong instrument of corporate regulation, but the history of earlier efforts leads one to doubt it.

This brief survey of international regulatory efforts demonstrates the waxing and waning of interest in them in the past three decades. The UN, ILO, and OECD all attempted to develop comprehensive frameworks for corporate behavior, but these early initiatives had little impact. In recent years, all three organizations have revitalized their attention to corporate activities. At the same time, however, the private sector has not remained immune to the pressures of their changing social environment. The public's expectations regarding corporate behavior have changed, and many companies are responding to these changes with their own principles, guidelines, practices, and codes.

Factors Driving Industry Self-Regulation: Risk, Reputation, and Learning

What factors are driving the private sector to step forward with proposals to put limits on their own behavior? Even if those limits are not very constraining or only weakly enforced, why do they even feel compelled to talk about this now? We can identify three major factors that influence corporate decision making in this area: risk, reputation, and learning. Self-regulatory strategies are chosen to reduce risk, enhance reputation, and respond to new ideas within the business community.

Risk: Political and Economic Challenges and Uncertainties

The idea that business strategy is influenced by assessments of risk is not a new one. Economists and business scholars have been analyzing risk in corporate decision making for a long time. They examine the risks involved in launching new products, entering new markets, and reacting to the competitive strategies of other firms. In the past few decades, a number of scholars have also begun to explore the influence of political risk on decisions and outcomes. Political risk includes the probability that a corporation setting up operations in a foreign country might face the threat of expropriation, nationalization, war, or profound changes in the legal environment.²⁴ The more dramatic threats usually make corporate executives reconsider their decision to invest in a country or may encourage them to leave. The problems addressed by self-regulation arise when a company decides to go in and stay, despite potential political risks.

The risk of loss due to violence from war, civil war, riot, rebellion, and terrorism can be one of the most difficult challenges facing any business. Such risk entails destruction of property, shutting down of business operations, and direct harm to corporate personnel. In Nigeria, for instance, rebels have sabotaged oil pipelines and held oil platform workers hostage. In Colombia, a pipeline managed by Western oil companies is blown up on a regular basis. Nevertheless, some companies continue operating despite the violence. They can do this if the

conflict is geographically isolated and contained or if it is not too severe. They may also decide that the government's policies toward the private sector are so favorable overall that the benefits outweigh the costs of conflict. If the industry is unlikely to be targeted by rebels or criminals, or can be structured financially in a way that reduces bottom-line risk, then the calculations may favor investment even in conflict-ridden territories (Berman 2000; Haufler 1997).²⁵

In the extreme cases, for instance, the oil companies that continue operating in Burma despite the repressive military government there, activists pressure the companies to withdraw entirely (Earth Rights International 2000). But if a company makes the calculation to stay, its management may develop a corporate code to establish guidelines for its operations under those extreme conditions, similar to the guidelines established under the Sullivan Principles for apartheid South Africa. Certainly, outside pressure from activists will help push them in that direction. Shell executives faced this sort of calculation after the intense criticism they faced for their perceived complicity with the military government in Nigeria after the hanging of Ogoni activists there.

Extreme situations involving violence are not the only ones that force companies to consider adopting self-regulatory guidelines. Most business leaders also constantly assess the likelihood of government regulation as one of the major political risks they face. They view government regulation as a burden and a cost to be avoided if at all possible. There are, of course, situations in which an industry or set of firms prefers government intervention to restrain competition or promote consumer confidence. But this typically happens at the national level, where industry representatives may feel they have more control over the political process. They face more uncertainty about the transnational aspects of their corporate operations. The company may face the possibility of at least three sources of regulation: regulation in one or more host countries where the company operates; regulation by the home country of activities both at home *and* abroad; and international regulation.

How high is that risk currently? In recent years, most governments have sought to liberalize, deregulate, and privatize national economies. As one legal expert noted, "Almost all of these reforms are market-oriented; that is, they either substitute markets and the private sector

for regulatory regimes or have public agencies use market approaches, structures and incentives to achieve their regulatory goals” (Aman 1999, 267). The re-regulation that has occurred is oriented toward making the state more competitive and often involves public-private partnerships or co-regulation. The EU, for instance, now delegates much regional standard setting to the private sector, and the U.S. government also has reduced or eliminated government action in some areas in favor of the market (Egan 1998; Harrison 1999).²⁶ At the national level, the political risk of regulation generally has declined, but recent changes tend to favor and encourage self-regulation by business interests. In many cases corporate voluntary initiatives are designed to reaffirm that indeed the government does not need to intervene; it is a defensive mechanism to prevent regulation. This attitude is most clear in new information technology sectors, which are not highly regulated, and industry players plan to keep it that way if they can.

One would expect most transnational companies to favor global rules, so that they would not have to deal with such a welter of conflicting national regulatory systems.²⁷ But the process of negotiating intergovernmental agreements can be slow, clumsy, often wrong-headed, and highly political, which means the design of rules—even rules that the private sector desires—can be fraught with risk. Some corporate decision makers may prefer instead to calculate how to use the differences in national regulation to gain a competitive advantage. For instance, different companies can take advantage of variations in the way that national regulatory systems affect the skills and wages of the labor pool.

In recent years, governments have been relatively successful at concluding new international agreements. Some of the most significant require action by the private sector. The Montreal Protocol on Substances that Deplete the Ozone Layer, negotiated in 1987, requires corporations to eliminate the production or emissions of ozone-depleting gases. The new Chemical Weapons Convention, negotiated in 1992, places strict new reporting requirements on the chemical industry.²⁸ At the regional level, the EU is harmonizing a host of regulations that affect its member countries, which also puts limits on European firms. In North America, the United States insisted on incorporating environmental and labor side agreements into the NAFTA treaty and recently has concluded a free trade agreement with Jordan that has simi-

lar conditions. Member governments of the OECD recently revised the Guidelines on Multinational Enterprises, successfully agreeing on a comprehensive international framework.²⁹ These all indicate a renewed risk of international regulation. Given this trend, some business leaders will consider implementing self-regulation in an effort to slow down or stop these intergovernmental efforts.

The final and newest factor in the political risk equation is the risk of transnational activist pressure. Until recently, most companies discounted the effect of social mobilization on their operations. They calculated that they could win their position through lobbying national governments, litigating in the courts, or stonewalling. Recent successes by activist groups in raising the costs of doing business through boycotts, shareholder activism, media campaigns, and litigation have changed this calculation (Broad and Cavanagh 1998). Shell lost a substantial amount of business when it tried to dispose of an old oil platform in the North Sea and Greenpeace launched an extensive and successful European campaign against it, using both media exposure and boycotts. In the United States, activists are using the Alien Tort Claims Act to bring companies to court over human rights violations abroad, effectively using litigation as a tool against the companies (Amon 2000; Morrin 2000).

Shareholder activism is on the rise as well. Socially responsible investment (SRI) funds, which screen out corporations deemed illegitimate in some way, are growing ever larger. Some major institutional investors, such as the California Pension System (Calpers), are now considering social screens too.³⁰ This kind of shareholder activism is primarily found in the United States, United Kingdom, Canada, and Australia.³¹ In the United States, over \$2 trillion is now handled by SRI funds, and over 120 institutions and mutual fund families have used their ownership of assets to bring shareholder resolutions on social issues (Social Investment Forum 2000). The U.S.-based Interfaith Center on Corporate Responsibility (ICCR) coordinates the shareholder votes of 275 religious institutional investors and has submitted hundreds of shareholder resolutions at company annual meetings (Oxford Analytica 2000). SRI had been small scale in Great Britain, but a recent survey of the top 500 British occupational pension funds showed that 59 percent of them, representing 78 percent of assets, had some form of SRI policy (Moon and Thamotheram 2000). Another survey in

2000 found that 71 percent of the financial community in London believes social and ethical considerations are more of a consideration for them today than five years ago, and 77 percent expect them to become more so in the coming five years (Opinion Leader Research 2000, 6).

The trigger for all these different forms of social mobilization might be the actions of a repressive government in a country where a foreign company operates, as in the case of Shell in Nigeria. Or, it might be some high profile action by the company itself, such as the Union Carbide chemical disaster in Bhopal, India. In turn, this mobilization can lead to a higher risk of government regulation. In many cases, corporate executives have great difficulty evaluating the potential impact of activism against them and what the costs might be. Many of them get it wrong. Shell had no idea that anyone would care if it dumped a retired oil platform in the deep sea and was blindsided by the Greenpeace campaign. As one recent corporate consulting report put it, there is “no hiding place” today for any business (Bray 1999). One response to these risks is to engage in more dialogue with activist groups and to try to meet their concerns through codes and guidelines that set standards for corporate behavior.

Joining these political risks, and interacting with them, are a number of significant economic risks that can also drive a company to adopt higher standards. One of the most obvious is the competitive position of the company or industry on a global basis. When markets are highly competitive, every added cost is harder for management to justify in terms of bottom-line profits and market share. Self-regulatory programs often entail significant financial costs and may undermine a firm’s competitive position—especially if no other major market player adopts similar standards. This is the reason why it is difficult for a single corporation to adopt a highly restrictive code of conduct. When corporations can agree on setting standards together, however, the competitive position of each is maintained. Consequently, oligopolistic markets might be the most likely candidates for collective self-regulatory action, because it is easier to get a smaller number of firms to agree (Olson 1965). At the same time, the costs of self-regulation can be offset by significant benefits in terms of new markets for high-quality goods and services, or lower costs of production. For instance, if a company sets a higher standard for the elimination of industrial waste it may discover greater efficiencies in the production process.

Another economic risk that influences the decision to self-regulate is the degree to which the business of a company is tied to a specific locale, people, or production process (what economists call “asset-specificity”).³² Assets tied in this way are difficult if not impossible to disentangle. For instance, extractive industries such as mining are literally tied to the places where the minerals exist. They cannot really engage in a competitive race to the bottom, since they cannot move. The investments that mineral companies make are very large and usually long term. They are unlikely to leave a particular location voluntarily, even when the political situation around them deteriorates. This puts them in a unique political and economic position, subjecting them to more attention from activists and more regulation from governments. A company that cannot pick up and move must learn to manage the risk of transnational activism and government regulation. Other industry sectors, such as consumer goods manufacturing, have very low asset specificity. These firms often collaborate closely with a chain of suppliers around the world and yet maintain their distance and ability to drop one supplier and pick up another fairly easily. They can reduce the risk of too much specialization or dependence through outsourcing and business partnerships. These more flexible organizations should be less subject to political pressure of all kinds; for this very reason, long supply chains are themselves the object of intense criticism.³³

Neither competitive pressures nor the threat of government regulation and public activism, however, can entirely explain the convergence across sectors and issues on a self-regulatory strategy. For one thing, in many cases the threat of government regulation has been relatively low. For another, transnational activism can be erratic, and the costs of dealing with it can be difficult to evaluate or relatively small compared to the scale of transnational business operations. Competitive pressures in most markets have increased, not decreased, in the past few decades. Yet we see corporations adopting codes and other practices in some of the most highly competitive markets today, including the information technology sector. Asset-specific production as a proportion of total production has declined as many economies shift to a postindustrial, information-based structure, and many consumer-oriented companies are part of a large and constantly evolving network of producers. The wave of mergers and acquisitions in the 1990s

may mean that markets are highly concentrated, dominated by a few mega-corporations. But corporate codes are common even in markets with many competing firms and little concentration of economic activity. Two further factors are key elements of the self-regulatory trend: reputation and learning.

Reputation as a Global Corporate Asset

When a company develops a reputation for making a quality product, this gives the company a stronger brand name. Increasingly, we see competition in many markets based not just on how cheap a product is but also on the quality of the product. Corporations that are close to the consumer and sell directly to them are likely to feel bottom-line effects when consumers shun them if they believe the firm has behaved reprehensibly. There may even be emerging in some markets a “race to the top” among firms in global markets, instead of a race to the bottom, as each firm tries to become a market leader based on its reputation (Spar 1998). Reputation affects not just sales to customers, but also a range of other relationships on the production side as well. A company with a positive reputation is also attractive to potential employees; in tight labor markets, it can be an advantage in hiring those who favor working for firms with a strong positive image.

A company with a good reputation may also be able to make deals with other businesses more easily, because potential partners will want to be associated with the reputable firm or may simply trust it more.³⁴ Reputation matters in business-to-business relations, especially for industries that are organized in networks, in which trust facilitates contractual relations (Gomes-Casseres 1994). Particular sectors depend on reputation for their very existence. For instance, the financial sector depends on public confidence in the banking system, and it has been at the forefront in developing self-regulatory initiatives through industry associations (Cutler, Haufler, and Porter 1999).

In addition to consumers, employees, and business partners, a company’s reputation also influences its relationship with government. In general, a good reputation makes it more likely that policy makers will try to avoid regulating an industry, or will regulate it in ways that are market friendly. The bad reputation of the tobacco industry has made

it increasingly vulnerable to extensive government regulation—both national and international. A reputation as a good corporate citizen can lighten the regulatory burden on a company, make it more likely that government will be willing to delegate authority to the industry, or make them more accepting of industry self-regulation as an alternative to traditional command-and-control regulation. One reason that the U.S. government has been so favorable to self-regulation by information industries is that these industries have gained a reputation for innovation and economic dynamism, but they are still too new to have any old “baggage” from bad behavior in the past. In countries that have an institutional culture that tries to separate the business and political worlds, such as in the United States and United Kingdom, this kind of reputation may be more important than in countries with long histories of close cooperation between business and government on regulatory matters, such as continental Europe.

Once reputation becomes a significant asset of a company, that company will be more vulnerable to activist campaigns. Many NGO critics use the leverage of corporate reputation to try to influence the company’s behavior. In response, a company may try to enhance its reputation even further by setting high standards in a variety of areas. This can be a two-edged sword: a firm that tries to develop a reputation for social responsibility often attracts attention—both to its successes *and* to its failures. However, it is often through developing a good reputation that a company can seek out NGOs for partnership and dialogue. In any case, the more a company values its reputation, the more likely it will be to try to preserve it and promote it through a variety of corporate codes and other voluntary initiatives.

Information, Knowledge, and Learning

The trend toward industry self-regulation would not be pushed forward very far without the spread of knowledge, information, and ideas within the business community regarding the relative costs and benefits of voluntary initiatives. Any self-regulatory system requires some consensus on what the rules ought to be and expertise on how to implement them (Gordon 1999, 9). In the case of self-regulation, corporate leaders are developing common knowledge that they use to

change their policy projects and political strategies.³⁵ Industry self-regulation is still at a relatively early stage of development, so there are only scattered areas of consensus that vary across issue areas. In those areas where there is some agreement over appropriate norms and standards, managers are more likely to self-regulate. Where consensus is deep, self-regulation is likely to be negotiated and implemented collectively.

The role of leadership in this process should not be underestimated. Leading executives may adopt new strategies, lobby other business leaders to join them, and even put economic pressure on business partners through their business relationships, such as supply networks. These leaders can be especially effective if they dominate their markets. For instance, when it comes to the issue of climate change, John Browne of BP Amoco has taken a prominent stand in favor of early action to stop global warming. Others take a broader view, instead of focusing on one specific issue they argue in favor of taking a “triple-bottom-line” approach to business, in which the bottom line is measured in terms of the company’s profits, effect on social values, and impact on the environment (Elkington 1998). These new ideas and approaches can be reinforced by business education programs. Certain business schools now teach required courses in business ethics and social responsibility. In addition, trade magazines address issues of best practice as an aspect of quality management within a firm, and many consultants and authors regularly publish articles or give lectures on how a firm can gain value by setting high standards.

In the past few decades, businesses have created organizations dedicated to spreading information and knowledge about these ideas while highlighting their leadership on these issues. The World Business Council for Sustainable Development (WBCSD), composed of leading MNCs, requires its members to commit voluntarily to promote sustainable development, which the WBCSD defines quite broadly. There are no sanctions for those members who violate this commitment and there is little monitoring. But the WBCSD provides training, guidance, technical assistance, and information on sustainable practices to its members and highlights the importance of adhering to good business practices. Business leaders and industry associations establish business “best practices,” and these influence what other managers view as the normal range of options available to them.

THE VOLUNTARY ADOPTION of social standards by an increasing number of companies presents a different picture of the role of the corporation in world affairs. Observers and participants alike point out that the standards these companies establish are often higher than national or international ones. They address contentious public policy issues and not just technical standards that only concern industry. When companies establish their own rules and standards in socio-political areas, these can complement or supplement government regulation, especially in countries with weak capacity to regulate. International standard setting fills in the gaps where national regulatory systems conflict or remain silent. Where governments do not govern, the private sector does—often in response to the demands of public interest groups who find themselves unable to move national governments. And when governments are unwilling or unable to govern effectively, political leaders may see private governance as a valuable tool to achieve public ends.

National policy makers are beginning to pay attention to the possible benefits of industry self-regulation. They may hope that as business improves its behavior abroad then government will be under less pressure to act against the private sector at home or abroad. They may also hope to use corporate social responsibility as a tool to promote “soft” foreign policy goals, such as human development. The United States, United Kingdom, and Canada have promoted better international business practices in the past decade. Canada has developed an International Code of Ethics for Canadian Business, the United States has its Model Business Principles, and the United Kingdom has launched an Ethical Trading Initiative—all aimed to set high standards for corporate behavior overseas. Probably the most significant initiative in this regard is the Global Compact between the United Nations and multinational business. UN Secretary-General Kofi Annan in 1999 challenged business to adopt the principles enunciated in UN conventions regarding labor rights, human rights, and environmental protection.³⁶

Industry self-regulation of corporate activities abroad is driven by a number of cross-cutting factors. These factors include the risk of being

targeted for regulation or for attention from transnational activists. They also include the growing importance of corporate reputation in relations with consumers, business partners, employees, and policy makers. Policy makers and the public at large might support and promote these efforts simply because of the lack of capacity of many foreign governments to govern effectively or democratically, and the fact that traditional foreign policy tools such as sanctions rarely change any government's policies. The increasing visibility of differences in living conditions across countries as modern media enter the homes of millions has led to a backlash against globalization and a compelling need to do something to mitigate its effects. In this context, many different groups see the potential for leveraging the corporation by manipulating corporate risks, reputation, and learning.

Governments that want to promote industry self-regulation can do so by leveraging their power to threaten to regulate. They can also facilitate transnational activism by ensuring that information about corporate actions is available to the public. Policy makers also can heighten the effectiveness of reputation as a tool of regulation by supporting the monitoring, accounting, and certification programs that help measure and reinforce reputation. A key element of industry self-regulation is that business leaders must be educated about the value of raising their own standards, about the costs of refusing to act on those standards, and about the appropriate standards and implementation measures they should undertake.

There cannot, however, be a one-size-fits-all approach. Industry self-regulation is in general a positive development, but it cannot resolve all the thorny international political issues. In many cases, the problem is the weakness of governance at the international and national levels. Private sector governance, then, is only a second-best solution. There is broad public consensus on overarching norms and principles for international business behavior, but little agreement on how to implement them on the ground.