

# **THE PRIVATE REGULATION OF GLOBAL CORPORATE CONDUCT: STENGTHS AND LIMITATIONS**

by

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## INTRODUCTION

This paper explores the dynamics of regulatory change associated with the effort to develop new forms of transnational business governance associated with civil business regulation and corporate social responsibility<sup>1</sup> It begins by defining civil regulation, describing its growth and placing its development, structure and purposes in a broader historical and institutional context. The second section of the paper explains the development of civil regulation as a response to the shortcomings of international global and national governance of global firms and markets. The ‘demonstration effects’ associated with these policy failures have in turn created a demand for the development of new regulatory vehicles to control the social conduct of international firms. The third section of the paper describes how various policy entrepreneurs, led by NGOs and often supported by some national governments and international organizations, have, through a complex process of conflict and cooperation, persuaded some firms to participate in and/or support the development of new ways of governing global firms.

The growth in the supply of civil regulation reflects and has contributed to new expectations, values and ideas regarding both the shortcomings of existing regulatory mechanisms as well as the need for new strategies for ameliorating them. In this sense, activists have effectively challenged the legitimacy of existing regulatory arrangements. Public pressures on firms as well as demonstrations of the business benefits of more responsible corporate

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<sup>1</sup> The term civil regulation comes from Simon Zadek, *The Civil Corporation* London; Earthscan, 2001. It is also used by D.F. Murphy and J. Bendell *Partners in Time?* Geneva: United Nations Research Institute for Social Development, 1999.. There are now five books on this subject by political scientists, four published since 2004: Benjamin Cashore, Geame Auld, Deanna Newsom, *Governing Through Markets: Forest Certification and the Emergence of Non-State Authority* Yale University Press, 2004; Virginia Haufler *The Public Role for the Private Sector: Industry Self-Regulation in a Global Economy*, Carnegie Endowment for International Peace, 2001; Ronnie Lipschutz with James Rowe, *Globalization, Governmentality and Global Politics; Regulation for the Rest of Us?* Routledge, 2005; Aseem Prakash and Matthe Potoski, *The Voluntary Environmentalists: Green Clubs, ISO 14004*,

behavior, have, to some extent, “changed the mid-set of [at least] some former agents of capture, reshaping their understanding of what regulatory arrangements are best for them [and potentially] bolstering a more public-interest basis for regulation.”

This in turn raises a critical question: to what extent and under what circumstances has the demand for new approaches to global business regulation been accompanied by new governance or institutional mechanisms capable of effective monitoring and enforcement? In other words, how effective have been civil regulations in addressing the shortcomings of global business regulation – which include both industry capture of existing regulatory institutions as well as business opposition to their expansion and effective enforcement - that prompted the political demand for their emergence in the first place? Supply does not create its own demand: the ability of regulations to achieve their public interest objectives also requires adequate mechanisms of enforcement and accountability.

Because such mechanisms are lacking for many civil regulations, their success in challenging the regulatory status quo has been both limited and uneven. The problem they face is primarily due to the lack of sufficient economic and political ‘demand’ for more responsible global corporate conduct on the part of both firms and governments. This limitation has constrained the ability of pro-regulation activists to develop effective vehicles for participating in and thus changing how global firms are governed. NGOs and their supporters have been relatively effective in demonstrating the shortcomings of the regulatory status-quo, in mobilizing sufficient political support to create new regulatory mechanisms and in changing both business and public expectations about how corporations should respond to the political and market failures associated with economic globalization. They have created a wide array of new

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*and Voluntary Environmental Regulation* Cambridge University Press, 2006; and David Vogel *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility*, Brookings Institution Press, 2005.

regulatory instruments by securing the support of some firms, as well as some governments and international organizations. But they typically lack sufficient resources to overcome the major shortcomings of global economic governance.

The uneven impact of civil regulation, and the factors that underlie it, are explicitly explored in six case-studies. These studies demonstrate that it has proven far easier to develop new regulatory instruments than to either persuade significant numbers of firms to adhere to them or to develop effective monitoring and enforcement mechanisms.

Civil regulations have formally affected the way many global firms, industries and markets are governed. Global civil regulation – and the principles and practices of global CSR to which it is often linked – has become a highly visible and legitimate dimension of global economic governance. It has provided important new vehicles for non-business constituencies, primarily in western countries, to participate in the regulation of global firms and markets, and forced some global firms to internalize some of their negative social and environmental externalities. To this extent, civil regulation has *partially reduced* the democratic deficit and regulatory failures created by economic globalization..

But while civil regulations can compensate for some of the shortcomings of national and international state governance, they are not a substitute for effective governmental institutions. The long-term future of private global business regulation depends on the extent to which its standards for business conduct and its mechanisms for holding firms accountable and are integrated with, reinforced by, and compliment state-based and enforced regulatory policies at both the national and international levels.<sup>2</sup>

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<sup>2</sup> For a discussion of the dynamics of the relationship between private codes and state regulations, see Errol Meidinger, “Multi-Interest Self-Governance through Global Product Certification,” unpublished paper

## DEFINING CIVIL REGULATION

Civil regulations employ private, non-state, or market-based regulatory frameworks to govern multinational firms and global supply networks. A defining feature of civil regulation is that its legitimacy, governance and implementation is not rooted in public authority. Typically operating beside or around the state rather than through it, civil regulations are based on ‘soft law’ or private law rather than legally enforceable standards: violators typically face social or market penalties rather than legal sanctions.<sup>3</sup> Civil regulation extends regulatory authority “sideways” beyond the state to global non-state actors.<sup>4</sup> Its recent growth reflects an expanded “public role for the private sector,” as well as the growing importance of “private authority in global governance.”<sup>5</sup> Global corporate codes constitute part of an “emerging global public domain.” Civil regulation does “not replace states, but . . . (rather) embed(s) systems of governance in broader global frameworks of social capacity and agency that did not previously exist.”<sup>6</sup>

At the same time, there are important linkages between civil and state-based regulations. The former typically include commitments by their corporate signatories to obey host country laws and many private regulatory standards are based on those of inter-governmental organizations such as the Organization for Economic Cooperation and Development (OECD), the International Finance Corporation (IFC) of the World Bank, and the International Labor

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<sup>3</sup> For excellent analysis of the role and importance of ‘soft law’ in global governance see John Kirton and Michael Trebillock, “Introduction: Hard Choices and Soft Law in Sustainable Global Commerce, in *Hard Choices, Soft Law: Voluntary Standards in Global Trade, Environment and Social Governance* John Kirton and Michael Trebillock, eds, Ashgate 2004, pp. 3 – 33; and the essays in *Soft Law in Governance and Regulation*, Ulrika Moth, ed, Edward Elger. 2004. Both edited volumes contain essays on both private and public soft law.

<sup>4</sup> Virginia Haufler, “Globalization and Industry Self-Regulation,” in *Governance in A Global Economy: Political Authority in Transition*, Miles Kahler and David Lake, eds. Princeton University Press, 2003, p. 226

<sup>5</sup> See Haufler, *The Public Role for the Private Sector*, and *The Emergence of Private Authority in Global Governance* Rodney Hall and Thomas Biersteker, eds. Cambridge University Press, 2002.

<sup>6</sup> J.G. Ruggie, “Reconstituting the Global Public Domain – Issues, Actors and Practices,” *European Journal of International Relations* Vol. 19, no. 4, 2004, p. 519

Organization (ILO). A number of developed country governments, including the United States, the European Union (EU), Great Britain, Belgium, France, Austria, and Germany have promoted the establishment of industry codes of conduct, as have inter-governmental organizations such as the OECD, the World Bank, and the United Nations.

There are also important structural similarities between civil regulations and a sub-set of government regulations. The market-based regulatory mechanisms typically employed by civil regulations, namely producer certification, product labeling, third-party auditing, and information disclosure are also often used by governments, especially in the area of environmental policy.<sup>7</sup> Many governments employ voluntary agreements as a vehicle of business regulation. However, many ‘voluntary’ agreements between firms and governments are voluntary in name only, as the state retains final legal authority.<sup>8</sup> This is not the case for civil regulations for which there is typically no state ‘back-up:’ the labeling, disclosure, auditing, and certification components of civil regulations are not subject to state scrutiny, nor are there any state penalties for non-compliance .

The main difference between private governance beyond the state and domestic governance is that the former exclusively relies on voluntary compliance.. As Grant and Keohane observe, “When standards are not legalized, we would expect accountability to operate chiefly through reputation and peer pressure, rather than in more formal ways.”<sup>9</sup> In addition, while regulatory alternatives to command and control typically govern only domestic producers,

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<sup>7</sup> See for example, Neil Gunningham and Peter Grabosky, *Smart Regulation: Designing Environmental Policy* Clarendon Press, Oxford, 1978 and *Voluntary Approaches for Environmental Policy* OECD, 2003

<sup>8</sup> For a detailed and sophisticated analysis both private and public voluntary codes and the relationships between them, see *Voluntary Codes: Private Governance, the Public Interest and Innovation* Kernaghan Webb, eds, Carleton Research Unit for Innovation, Science and Environment, 2004.

<sup>9</sup> Ruth Grant and Robert Keohane, “Accountability and Abuses of Power in World Politics,” *American Political Science Review* Vol. 99, no. 1, p. 35.

many civil regulations address the international dimensions of business conduct, for which there are fewer effective state regulations..

Still, the boundaries between ‘voluntary’ and mandatory regulations, state and non-state regulations, private and public law, and hard and soft law cannot always be sharply drawn.<sup>10</sup> It is also a fluid one: soft laws can become ‘harder,’ and norms can become more law-like.<sup>11</sup> For example, the Uruguay Round WTO agreement granted international legal recognition to the food safety standards of the Codex Commission, while standards of both the Forest Certification Council (FSC) as well as ISO 14001 have been accorded legal recognition by some national and local governments. In several countries, formerly voluntary corporate social reporting has become mandatory. In a few exceptional cases, civil regulations have been backed by government trade sanctions.

## **THE POLITICAL DYNAMICS OF CIVIL REGULATION**

Throughout the history of capitalism, business self-regulation has existed in parallel with government regulation; indeed historically the former often preceded the latter. The medieval guilds exercised a wide variety of regulatory functions, including price, market entry, and quality controls. In contemporary economies, private regulations govern a wide variety of business activities, most notably in the areas of electronic commerce, maritime transportation, bond ratings, and financial services. Numerous technical standards have been developed by private organizations and these play an important role in the global economy.<sup>12</sup>

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<sup>10</sup> See, for example, *Voluntary Environmental Agreements: Process, Practice and Future Use*. Patrick ten Brink, ed. Greenleaf Publishing, 2001, which explores the role of voluntary regulations at the EU and national levels.

<sup>11</sup> Jon Birger Skjaereth, Olav Schram Stokke and Jorgen Wessestaad, “Soft Law, Hard Law, and Effective Implementation of International Environmental Norms” *Global Environmental Politics*, Vol. 6, no. 3, pp. 104-120.

<sup>12</sup> For the importance of international standards, see Walter Mattli, “Public and Private Governance in Setting International Standards,” in *Governance in a Global Economy* Miles Kahler and David A. Lake, eds, Princeton University Press, 2003, pp. 199-225; and a Special Issue of *The Journal of European Public Policy* on “Governance

But civil regulations are distinctive from most traditional forms of industry self-regulation in three important respects. First, in contrast to many technical standards whose primary purpose is to lower the transactions costs of market transactions, civil regulations require firms to make expenditures that they would not otherwise make. They typically seek to protect interests not directly involved in the market chain by ameliorating some of the negative externalities of market transactions. They primarily represent a response to the market failures associated with globalization and the inadequacies of existing regulatory mechanisms. Civil regulations represent “an innovative form of governance that arose in large part owing to the legitimacy and performance limitations in traditional forms of inter-state governance.”<sup>13</sup>

Second, compared to traditional forms of business self-regulation, civil regulations are more likely to be politicized: they have typically emerged in response to political and social pressures on business, often spearheaded by national and trans-national activists who have embarrassed global firms by publicizing the shortcomings of their social and environmental practices. Third, compared to traditional business self-regulation, the governance of civil regulations is more likely to be transparent, contested, and to either formally or informally involve non-business constituencies.

Civil regulation does not privatize business regulation in the sense of removing it from public scrutiny. Rather it is associated with new non-state, political mechanisms for governing global firms and markets. “Private governance helps empower global civil society by providing activist groups with political levers that exist outside state systems.”<sup>14</sup> The expansion of global

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and International Standards Setting, Walter Mattli, guest editor, Vol. 8, no. 3. 2001. See also the case-studies in *Private Authority and International Affairs*, Cutler et al. eds

<sup>13</sup> Steven Bernstein, “Legitimacy in Global Environmental Governance,” *Journal of International Law & International Relations* Vol. 1, nos, 1-2, p. 160

<sup>14</sup> Robert Falkner, “Private Environmental Governance and International Relations: Exploring the Links,” *Global Environmental Politics* May 2003, p. 79

civil regulation is closely linked to the emergence of a global ‘civil society,’ an increasingly sophisticated and extensive international network of non-governmental organizations (NGOs) primarily based in North America and Europe, that monitor and influence a wide range of global business practices.<sup>15</sup>

“NGO’s role and influence have exploded in the last-half decade.”<sup>16</sup> They have also become more global in scope: more than a thousand draw their membership from three or more countries. Many such organizations have become influential and legitimate global political actors. While much of their political activity has focused on public policies and institutions, over the last decade they have increasingly sought to directly influence the practices of many firms, markets and industries. The participants in the movement for global corporate accountability are wide-ranging: they include unions, environmental organizations, human rights and labor activists, religious and consumer groups, student organizations, consumer groups, as well as social or ethical mutual funds and socially oriented institutional investors.

Western activists primarily seek to improve business practices in developing countries by placing public pressures on global firms that have a highly visible presence in the United States and Europe – in effect bypassing both their own governments and those of developing countries. Civil regulation thus turns globalization on its head, making the global scope of business activity into a source of political vulnerability for global firms – rather than an economic advantage. A key objective of western activists is to politicize consumer and financial markets in developed countries in order to socialize market practices in developing ones.

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<sup>15</sup> For the emergence and impact of global civil society and global citizen activism, whose focus frequently includes but also extends beyond private corporations and issues involving business, see, Robin Cohen and Shirin Rai, *Global Social Movements* Continuum, 2000; *Global Citizen Action* Michael Edwards and John Gaventa, eds. Lynne Rienner, 2001, Margaret Keck and Kathryn Sikkink, *Activists Beyond Border* Cornell University Press, 1998; and *Transnational Civil Society*, Srilatha Batliwala and L. David Brown, eds. Kumarian Press, 2006

<sup>16</sup> Jessica Mathews, “Power Shift,” *Foreign Affairs* January/February, 1997 p. 53

Many civil regulations are essentially engaged in fostering a non-state or market-based variant of ‘trading up.’ By transmitting more stringent regulatory standards from developed countries to firms, industries and markets in developing ones, they are attempting to privatize the ‘California effect’ - a term coined to describe the dynamics of the transmission of more stringent standards via international trade among states.<sup>17</sup> Their emergence and impact has been facilitated both by the growth of global brands – which make firms more vulnerable to threats to their reputations in important consumer markets – and the expansion of international communications – which enables activists to more easily acquire information about global business practices, and then to rapidly disseminate it.

The number and scope of global civil regulations began to expand significantly during the 1990s. Private regulations that define standards for ‘responsible’ business practices now exist for virtually every global industry and internationally traded commodity, including forestry, fisheries, chemicals, computers and electronic equipment, apparel, rugs, coffee, cocoa, palm oil, diamonds, gold, toys, minerals and mining, energy, tourism, financial services, and athletic equipment – though most formally govern only a portion of these products or sectors.<sup>18</sup>

There are now more than 250 industry or product codes, nearly all of which address labor or environmental practices. Many sectors and products are governed by multiple codes. More than 3,000 global firms now regularly issue reports on the social and environmental practices and many of these firms have developed their own codes and/or subscribe to one or more industry or cross-industry codes. The largest private regulatory code, the UN Global Compact, has more

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<sup>17</sup> David Vogel, *Trading Up; Consumer and Environmental Regulation in Global Economy*, Harvard University Press, 1995.

<sup>18</sup> For the growth of civil regulation, see Gery Gereffi, et al, “The NGO-Industrial Complex,” *Foreign Policy* August 2001, pp. 56 – 65; Mathias Keonig-Archibugi, “Transnational Corporations and Public Accountability,” *Government and Opposition* 2004, pp. 234-259; Ans Kolk and Rob van Tulder, “Setting new global rules? TNCs and codes of

than 3,000 corporate signatories, while more than 2,300 global firms have endorsed the Business Charter for Sustainable Development developed by the International Chamber of Commerce.

During the 1960s and 1970s, interest in the global dimensions of CSR was primarily an American phenomena. However, over the last decade civil regulation has become more internationally based. In fact, in a number of respects, global CSR is now more important in Europe than in the U.S.<sup>19</sup> Ethical brands or certifications for coffee, rugs, flowers, and wood products have larger market shares in many European countries than in the U.S. London has replaced New York as the global center of CSR activism, research, reporting and monitoring. Europe is also home to more global NGOs than is the U.S. The ‘Europeanization’ of CSR is an important development as it has significantly expanded the international scope of civil regulations and number of global firms that have adopted them.<sup>20</sup>

## **GOVERNANCE FAILURES AND THE RISE OF CIVIL REGULATION**

Why has civil regulation grown? The growth of global civil regulation in part represents a political response to the recent expansion of economic globalization and the firms and industries that have fostered and benefited from it.<sup>21</sup> During the last two decades, the dynamics of economic globalization have significantly transformed the international economic landscape in two respects. First, they have shifted the locus of manufacturing from developed to developing

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conduct,” *Transnational Corporations* Vol. 14, no. 3 December 2005, pp. 1- 27; Rhys Jenkins, “Corporate Codes of Conduct; Self –Regulation in a Global Economy,” UN Research Institute for Social Development,” April 2001.

<sup>19</sup> For a good comparative overview of government efforts to promote CSR, see *Corporate Responsibility in the Global Village: The Role of Public Policy* by Susan Ariel Aaronson and James Reeves, National Policy Association, 2002. For the role of European governments in promoting CSR, and the importance of CSR in Europe, see *Developing Corporate Social Responsibility: A European Perspective*, Francesco Perrini, Stafano Pogutz and Antonio Tencati, eds. Edward Elger, 2006.

<sup>20</sup> For the growth and impact of CSR in Europe, see also *Corporate Responsibility Across Europe*, Andre Habisch, Jan Jonker, Martina Wegner and Rene Schmidpeter, eds, Springer, 2005.

<sup>21</sup> See Gary Gereffi and Frederick Mayer, “Globalization and the Demand for Governance” unpublished paper, June 2006

countries. Second, the production and supply networks of global firms increasingly transcend national boundaries: most international trade is now among firms or inter-firm networks, with the higher value-added components of the value chain primarily located in developing countries and the lower value-added portions in developing ones.

The emergence of global civil regulation has been motivated by a widely held perception that economic globalization has created a structural imbalance between the size and power of global firms and markets, and the capacity and/or willingness of governments to adequately regulate them. According to this argument, economic globalization along with the influence of neo-liberal values and policies, has undermined the ability of governments to make global firms politically accountable. Accordingly, transnational corporations are said to “wield power without responsibility. They are often as powerful as states and yet less accountable.”<sup>22</sup> Another critic observes: “Corporations have never been more powerful, yet less regulated.”<sup>23</sup> Civil regulation proposes to fill the regulatory gap between global markets and global firms on the one hand, and government regulation of multinational firms on the other. It is intended to “compensate for the decreasing capacities of national governments for providing public goods [as]. . . internationalization yields an increasing gap between territorially bound regulatory competences at the national level and emerging problems of international scope.”<sup>24</sup>

The extent to which global economic integration and international competition have constrained the ability of governments to regulate the conduct of global firms and markets is debatable. The scope and extent of business regulation continues to expand in many countries, as well as at the international level. But arguably the global economy is characterized by systemic

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<sup>22</sup> Peter Newell, “Environmental NGOs and Globalization,” in *Global Social Movements*, p. 121

<sup>23</sup> J. Vidal, quoted in *ibid*.

<sup>24</sup> Christoph Knill and Dirk Lehmkuhl, “Private Actors and the State: Internationalization and Changing Patterns of Governance,” *Governance* January 2002, p. 42, 44.

regulatory failures or a structural ‘governance deficit.’<sup>25</sup> For there are four important ways in which additional or more effective government controls over global firms and markets could address many, if not all, the criticisms of economic globalization. *It is the inability or unwillingness of states to adopt or enforce them that have contributed to the development and growth of non-state based governance institutions.*

The first potentially important public policy mechanism is trade policy. Developed countries with relatively stringent and extensive domestic product and production standards could, in principle, restrict imports of products produced by ‘irresponsible’ labor or environmental practices, or from countries with poor records on human rights while rewarding countries with better practices with preferential market access. Some governments have in fact done so. For example, the US has restricted imports of both tuna and shrimp harvested in ways that violated American animal protection standards. Both the U.S. and the EU have imposed restrictions on trade with Burma because of its human rights policies while the US has restricted American investments in the Sudan. Both the EU and the U.S have extended preferential trade privileges to countries with stronger domestic labor and environmental standards and human rights practices.<sup>26</sup> However, the cumulative impact of trade policy as either a carrot or a stick to strengthen the regulations of developing countries remains limited, in part because few western governments have been willing to effectively link trade liberalization to improvements in the regulatory practices of their trading partners.

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<sup>25</sup> The phrase is from Peter Newell, “Managing Multinationals: The Governance of Investment for the Environment,” *Journal of International Development* Vol. 13, 2002, p. 908.

<sup>26</sup> See Emilie M. Hafner-Burton, “Trading Human Rights: How Preferential Trade Agreements Influence Government Repression,” *International Organization* Summer 2005, pp. 593-629; and Der-Chin Jorng, “The Human Rights Clause in the European Union’s External Trade and Development Agreements,” *European Law Journal* December 2003, pp. 677-701

Moreover the rules and rulings of the World Trade Organization (WTO) constrain the ability of governments to link trade liberalization to domestic social and environmental practices - even if more were willing to do so.<sup>27</sup> As many critics of the WTO have noted, there is a clear imbalance between the scope of the WTO's jurisdiction over domestic policies that protect producers and those that regulate them. WTO rules and rulings permit countries to impose trade restrictions if their trading partners do not adequately protect intellectual property rights, if domestic regulations constitute technical barriers to trade or if they are based on standards that lack adequate scientific justification. But WTO rules limit the use of trade restrictions if a nation's trading partners do not protect domestic working conditions, human rights or environmental quality. International trade law "takes as a given that the responsibilities of a government toward its citizens is a matter to be determined by each government, not by the international community."<sup>28</sup>

WTO rules could certainly be changed so as to more closely link global trade liberalization to domestic environmental, labor or human rights practices.<sup>29</sup> Many western activists have strongly supported such a change in WTO rules, and, in the case of labor standards, so have many western labor unions. Domestic firms facing competition from less expensive imports from developing countries have supported extending the legal basis for trade restrictions. But global firms have strongly opposed such linkages on the grounds that they would raise their costs and disrupt their supply chains. Equally importantly, many developing

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<sup>27</sup> See Ken Conca, "The WTO and the Undermining of Global Environmental Governance," *Review of International Political Economy*, Autumn 2000, pp. 484-494

<sup>28</sup> Remarks of Steven Charnovitz, quoted in Susan Ariel Aaronson, "A Match Made in the Corporate and Public Interest: Marrying Voluntary CSR Initiatives and the WTO," unpublished paper p. 20

<sup>29</sup> For some specific suggestions as to what these changes would look like, see Michael Trebilock, "Trade Policy and Labour Standards: Objectives, Instruments, and Institutions," in *Hard Choices, Soft Law*, pp. 170 – 188;. For an analysis of how WTO rules could be (re) interpreted to govern corporate human rights policies, see David Kinley and Junko Tadaki, "The Emergence of Human Rights Responsibilities for Corporations at International Law," *Virginia Journal of International Law* Vo. 44 no. 4, pp.1005-1015

countries regard trade agreements that seek to link their access to western markets to their domestic environmental, human rights, or labor practices as a disguised form of protectionism. To date the preferences and influence of MNCs and developing country governments have prevented a change in WTO rules that might strengthen linkages between international trade and national environmental, labor, and human rights practices.

A second way in which governments could more effectively control the conduct of global firms and ameliorate the negative social impacts of global markets is by expanding the scope and improving the effectiveness of international regulations. While scores of environmental treaties exist, they still cover a relatively small portion of global trade and production. Most include few enforcement provisions and many of those that do are poorly enforced. Moreover, the adoption of additional international environmental agreements has often proven difficult. For example, the International Tropical Timber Organization has refused NGO requests to adopt a forest certification and labeling system, largely due to opposition from developing countries.<sup>30</sup> . When former US Secretary of Labor Robert Reich proposed that the ILO develop a system for labeling garments based on the labor conditions under which they were produced, his initiative was opposed by developing countries who viewed it as a disguised form of protectionism. Compliance with the ILO's labor standards is entirely voluntary and this international treaty contains no enforcement mechanisms. To date, the scope of international human rights treaties does not extend to international firms.<sup>31</sup>

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<sup>30</sup> Ronnie Lipschutz, "Why Is There No International Forestry Law?" *UCLA Journal of Environmental Law and Policy*, Vol. 19. 2000/2001, pp. 155-182

<sup>31</sup> For an analysis of how global firms might be made legally accountable for human rights, see Steven Ratner, "Corporations and Human Rights: A Theory of Legal Responsibility," *Yale Law Journal*, December 2001, 443-545.

A legally enforceable international code of conduct for global firms has been under discussion in various international forums.<sup>32</sup> During the 1970s, the ILO, the UN Commission on Transnational Corporations and the OECD all attempted to adopt legally binding codes of global corporate conduct. None of these efforts was successful. The OECD did adopt comprehensive guidelines for multinational corporations, but they are non-binding.<sup>33</sup> In 1992, the issue of transnational corporation (TNC) regulation was dropped from the agenda of the United Nations Conference on Environment and Development (UNCED), largely due to the strong opposition of global firms. The dearth of legally binding standards for multinational firms also reflects a lack of international consensus about the content of such codes as well as how sanctions against non-compliant companies would be enforced.

A third way governments could better govern global business activity is to regulate more of the international behavior of global firms headquartered in their countries. The US government has done so in one important policy area: the Foreign Corrupt Practices Act restricts the bribery of foreign government officials by American firms in any country in which they do business. Thanks to American pressures, in 1999 the OECD required all its members to impose similar restrictions. But two-thirds of the countries that signed this anti-bribery convention “have achieved little or no enforcement.”<sup>34</sup> In addition to corruption, American law restricts investments in some countries on either national security or human rights grounds. But the U.S. has not sought to broaden the scope of its legal controls over MNCs based in the U.S. to govern

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<sup>32</sup> See Ans Kolk and Rob van Tulder, “Setting new global rules? TNCs and codes of conduct,”

<sup>33</sup> Muchliniski, quoted in Newell, “Managing Multinationals,” p. 909

<sup>34</sup> Hugh Williamson and Michael Peel, “Nations ‘shamed’ over bribery,” *Financial Times* June 27, 2006, p. 4. For an update, see Jose Angel Gurria, “Rich must set the example in bribery,” *Financial Times* September 3, 2006, p. 5

other aspects of their conduct outside American borders.<sup>35</sup> For its part, the European Union did consider adopting a legally binding “Code of Conduct for European MNCS Operating Abroad,” but due to strong business opposition, it decided instead to make it voluntary.

The fourth and most important way in which the negative impacts of economic globalization could be ameliorated is for developing countries themselves to enact and enforce laws to better protect the welfare of their citizens and their domestic environment. This certainly has been the historical pattern in developed countries, whose controls over business labor and environmental practices became progressively stronger as they industrialized and extended the franchise. Presumably, many developing countries will eventually adopt a similar broad array of controls over both foreign and domestic firms that sell or produce within their borders as these countries become more affluent and their governments more democratic and accountable. Some are already doing so, but many are not. In most cases, the problem is not so much the lack of regulations, but the inability or unwillingness of governments to adequately enforce them.

Moreover, these governments often face trade-offs: for example, many fear that tighter or better enforced domestic labor or environmental standards would restrict foreign investment or outsourcing by geographically mobile MNCs, thus reducing much needed capital inflows and reducing domestic employment. Equally importantly, some developing country governments, restrict or discourage civic institutions, such as independent trade unions or non-government organizations, that could play an important role in making both foreign and domestic firms more politically accountable. In the case of ‘failed states,’ public authority itself is problematic:

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<sup>35</sup> There have been several attempts to use the American judicial system to hold global firms legally accountable for human rights abuses under the provisions of the 1789 Alien Torts Claims Act, but they have largely been unsuccessful. See for example, Kerrie Taylor, “Thicker Than Blood: Holding Exxon Mobil Liable for Human Rights Violations Committed Abroad,” *Syracuse Journal of International Law and Commerce* Vol. 31, no. 2, pp. 273-297

many resource rich governments lack the capacity and in many cases, any interest, in protecting the welfare of their citizens.

In sum, regulatory failures at the global and national level are pervasive, in large measure because both global firms and national governments have been either unable or unwilling to develop adequate mechanisms to effectively govern the social and environmental dimensions of global commerce. The growth of civil regulation reflects an effort to *extend* regulation to a wide range of global business practices for which the scope or effectiveness of national and international government authority is currently either weak, limited, or non-existent.<sup>36</sup>

### **THE POLITICAL DEMAND FOR CIVIL REGULATION**

Where have civil regulations come from? Who has initiated them? The organizational or institutional sources of civil regulations vary widely.<sup>37</sup> They include NGOs such as the World Wildlife Fund, Greenpeace, the Clean Clothes Campaign, Amnesty International, the Council on Economic Priorities, and Oxfam; trade associations for coffee, chemicals, mining, apparel, electronics, toys, and cocoa; trade unions such as the International Textile Workers Association; and international standards bodies such the International Standards Organization. Some civil regulations have been established with the support of governments or inter-governmental organizations. For example, the United Nations Environmental Program helped establish the Electronics Industry Code of Conduct, the British and American governments worked with firms

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<sup>36</sup> For an extremely comprehensive analysis of the growth of civil regulation in the context of a global governance deficit see Mathias Keonig-Archibugi, "Transnational Corporations and Public Accountability," *Government and Opposition*, 2004, pp. 234-259.

<sup>37</sup> For detailed case studies of the political and institutional development of codes in the apparel and timber sectors, see Tim Bartley, "Institutional Emergence in an Era of Globalizations: The Rise of Social and Environmental Certification Systems," unpublished paper, and Tim Bartley, "Certifying Forests and Factories: States, Social Movements, and the Rise of Private Regulation in the Apparel and Forest Products Fields," *Politics and Society* September 2003, pp. 433-464. For forestry, see Lars Gulbrandsen, "Overlapping Public and Private Governance:

in extractive industries to develop Voluntary Principles on Security and Human Rights, the Fair Labor Association emerged from an initiative of the American Government, and the Austrian government participated in the development of the Forest Stewardship Council,. These political institutions have not participated in the enforcement of these regulations, which remain voluntary and private. Rather they have primarily served as facilitators, bringing firms and in some cases, labor unions and NGOs together, helping them agree on common standards and in some cases, providing civil regulatory institutions with initial funding.

This in turn poses two additional questions: what has motivated NGOs, governments and inter-national organizations to promote civil regulations and why have so many firms agreed to adopt or accept them? The motivation for western NGOs is straightforward: they regard civil regulations as an important source of leverage over global business activity. The international impact, and thus the potential leverage, of many large western firms is substantial. Changing the procurement policies and practices of firms such as Wal-Mart, Starbucks, and Home Depot would have major global social and environmental impacts – comparable if not greater than that of many national regulations. At the same time, many NGOs have been repeatedly frustrated by their inability to promote the strengthening of national and international regulations. Thus for global activists, lobbying corporations has come to represent a viable – if clearly second-best-alternative to pressuring for changes in public policies.<sup>38</sup> While some NGOs continue to emphasize the ‘naming and shaming’ of global firms, others have chosen to cooperate with firms and industry associations to develop voluntary standards and participate in their enforcement.

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Can Forest Certification Fill Gaps in the Global Forest Regime” *Global Environmental Politics* Vol. 4, no. 3, May 2004, pp. 75 – 99.

<sup>38</sup> For earlier examples of this strategy by American NGOs, see David Vogel, *Lobbying the Corporation; Citizen Challenges to Business Authority* Basic Books, 1978

Their willingness to enter into alliances with global firms has been critical to the emergence, legitimacy, and relative effectiveness of many civil regulations.<sup>39</sup>

As noted above, some western governments, especially in Europe, have played an important role in promoting civil regulations. Several European governments have indirectly promoted CSR by requiring companies that trade on their stock exchanges to issue annual reports on their social and environmental practices and encouraging, or in some cases, requiring public pension funds to consider corporate social and environmental practices in making investment decisions. The procurement policies of some governments give preference to privately certified products. For its part, the EU has been a strong supporter of global CSR.<sup>40</sup> Many aspects of civil regulation are consistent with the European approach to business regulation: the EU and many European governments make extensive use of voluntary agreements and soft-regulation and frequently rely on private organizations to develop regulatory standards.<sup>41</sup> For many European governments, promoting global civil regulations represents a response to pressures from domestic activists and trade unions – many of which are hostile to economic globalization - in a world whose dominant neo-liberal institutions and doctrines – as well as the political influence of global firms – have limited or constrained their formal regulatory authority.

In this context, an important advantage of civil regulations as a global regulatory vehicle is that their provisions are not currently governed by the WTO, whose rules primarily apply to

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<sup>39</sup> See Philipp Pattberg, “The Institutionalization of Private Governance: How Business and Nonprofit Organizations Agree on Transnational Rules,” *Governance* Vo. 18, no. 8 October, 2005, pp. 589-610.

<sup>40</sup> On the EU’s role, see for example Kristina Herrmann, “Corporate Social Responsibility and Sustainable Development: The European Union Initiative as a Case Study,” *Indiana Journal of Global Legal Studies* pp. 205 - 232

<sup>41</sup> See, for example, Michelle Egan, *Constructing a European Market*, Oxford, 2001, *EU Committees: Social Regulation, Law and Politics*, Christian Joerges and Ellen Vos, eds. Hart Publishing 1999; *New Instruments for Environmental Policy in the EU*, Jonathan Golub ed. Routledge, 1998, *What’s The Beef? The Contested Governance of European Food Safety*, Christopher Ansell and David Vogel, eds. MIT Press, 2006.

regulations formally adopted by governments.<sup>42</sup> For example, while eco-labels are regarded by the WTO as (potential) technical barriers to trade, private product labels and certifications are not.<sup>43</sup> Likewise, firms can demand adherence to labor and environmental standards by their global suppliers as a condition for doing business with them; governments generally cannot make such requirements a condition for market access. This means that foreign producers who have been disadvantaged by private regulations or standards have no legal remedy: they must comply with them or risk losing export markets. The reliance of civil regulations on private, market-based standards and enforcement thus represent a major ‘loophole’ in international trade law – one which some western governments and NGOs have exploited.

For the UN, the Global Compact provides it with a vehicle to address some of the criticisms of the social impact of economic globalization voiced by many activists and some developing countries – without engaging in the politically impossible task of enacting legally binding business regulations. The voluntary CSR standards adopted by the OECD and promoted by the World Bank follow a similar logic. These organizations primarily affect governmental policies through soft law; civil regulations essentially extend this same regulatory approach from governments to corporations. (The same dynamic holds for the ISO, whose development of ISO 14001, an environmental process standard, logically flowed from the recent focus of this international standards body on process standards.)

What about corporations? In some cases, industries have adopted or accepted private global regulations to avoid additional government regulation. For example, Responsible Care was adopted by several national chemical industry associations in part to forestall national laws

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<sup>42</sup> For an extensive discussion of this issue, see Steven Bernstein and Erin Hannah, “Non-State Global Standard Setting and the WYO: Legitimacy and the Need for Regulatory Space,” unpublished paper, March 2006

<sup>43</sup> For an exhaustive discussion of both private and public social and environmental labels and their role in the global economy, see *Informing Consumers of CSR in International Trade*, OECD, June 2006

establishing more stringent plant safety standards following the chemical plant explosion at Bhopal, India in 1984. An international 'Code of Pharmaceutical Marketing Practices' was developed by global drug firms as a response to the imminent threat of public regulation at the international level, including by the World Health Organization.<sup>44</sup> The International Chamber of Commerce's Business Charter for Sustainable Development was initiated by global firms who feared that the 1992 Rio 'Earth Summit' would lead to an expansion of global environmental regulations. The global confectionary industry adopted a code of conduct governing forced child labor in part as a response to the threat of American trade sanctions on imports of cocoa from west Africa. During the 1990s, many highly visible apparel producers and retailers endorsed voluntary international labor standards as part of their political strategy to secure political support by Congress for the renewal of China's most favored nation status as a trading partner.

But more typically firms have not agreed to accept civil regulations to avoid additional government regulation as there has been little prospect of additional regulations being enacted, yet alone enforced, especially at the global level or by developing countries. Nike, for example, did not agree to improve health and safety conditions in its factories in Vietnam because it wanted to prevent the government of Vietnam from strengthening its own occupational and safety standards. The more than 3,000 firms who have signed onto the UN Global Compact did not do so in order to prevent the UN from adopting legally binding regulations for global corporations since there was no likelihood that it would do so.

Why, then, have an increasing number of global firms and industries recognized the legitimacy of voluntary regulations? Most civil regulations have their origin in citizen campaigns directed against particular companies, industries and business practices. Such campaigns have

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<sup>44</sup> Karsten Ronit and Volker Schneider, "Global Governance Through Private Organizations," *Governance* Vol. 12, no. 3, July 1999, p. 252

proliferated over the last decade, focusing on such issues as working conditions and wages, child labor, the income of agricultural workers, unsustainable forestry practices, business investments that support corrupt governments, and natural resource developments that adversely affect human rights and environmental quality. These public campaigns of ‘naming and shaming’ have been directed at highly visible European and American based firms such as Nike, Home Depot, Shell, Ikea, C & A, the Gap, Tiffany’s, Nestle, Starbucks, Hennes & Mauritz, Rio Tinto, Freeport Mining, and Citibank, which then became public symbols of ‘corporate irresponsibility.’ Such widely publicized demonstrations of corporate irresponsibility have played a critical role in placing political pressures on global firms to act more ‘responsibly.’

Few of these public campaigns, even when accompanied by product boycotts, adverse media coverage, and pressures from socially concerned investors, have adversely affected either the sales or share prices of targeted firms, or their ability to attract or retain employees.<sup>45</sup> Nevertheless, many firms have chosen to respond to them by either adopting self-regulations or participating in multi-stakeholder codes involving NGOs. Their motives are complex. Firms that market to consumers are particularly at risk: they are especially vulnerable to public criticisms that might adversely affect the value of their brands. “NGOs have become highly sophisticated in using market-campaigning techniques to gain leverage over recalcitrant firms” that sell directly to consumers.<sup>46</sup> For such firms, investing some resources to develop and comply with civil regulations is prudent.

But even some global firms that do not market to consumers are concerned about their reputations: they value public approval, and dislike negative media attention. For many global firms, CSR has become a component of their risk management policies and their marketing,

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<sup>45</sup> See Vogel, *The Market for Virtue*, chapter 3: “What is the Demand for Virtue?”

public, employee, and investor relations. In some cases, the values and concerns of critics of economic globalization are personally shared by some executives, particularly those who manage corporations whose traditions and cultures have historically emphasized a strong commitment to corporate responsibility. Firms have also frequently developed or agreed to accept civil regulations in response to pressures from employees or prospective employees who would prefer not to work for an 'irresponsible' firm. For many firms, it represents a form of crisis management.

This in turn raises a more interesting question. Why don't firms simply adopt their own codes of conduct? Why do they frequently encourage the formation of, or endorse civil regulations that also govern their competitors? The two are not incompatible; many large global firms have also adopted their own regulations, and in some cases, these go beyond industry standards. But for 'targeted' firms, industry-wide regulations make business sense. In most cases, adopting higher social or environmental standards raises a firm's costs. Persuading their competitors to adopt similar standards creates a more level playing field. Moreover the public often does not distinguish among the social or environmental practices of firms in the same industry. For example, in the fine jewelry industry, when some diamond retailers were accused of selling 'blood diamonds' sold by warlords in conflict zones, the reputation of the entire industry was damaged.

Moreover, business organizations frequently adopt structures and practices similar to that of other firms in their industry.<sup>47</sup> Such 'herd effects' play an important role in disseminating

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<sup>46</sup> Gary Gereffi, Ronie Garcia-Johnson and Erike Sasser, "The NGO-Industrial Complex," *Foreign Policy* July-August 2001, p. 64

<sup>47</sup> See Paul Digaggio and Walter Powell, "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields." *American Sociological Review* .Vol. 48, no 2, April 1983, pp.147-160 and Marvin Lieberman and Sgigeru Asaba, "Why Do Firms Imitate Each Other?" *Academy of Management Review*, Vol. 31, no. 2, (2006): 366-385

many management practices, including global CSR commitments. Accordingly, when an industry leader agrees to a voluntary code, other firms in its sector often decide to do so as well. This dynamic also operates across industries. The greater the number of global industries that have voluntary codes, the more likely it is that other industries will follow their example. The growth of civil regulations among global firms and industries has thus created its own momentum. Firms care about their social reputations: few global firms or industries headquartered in the US or Europe and increasingly in other countries as well want to be regarded as less ‘responsible’ or ‘enlightened’ than their peers. As the Financial Times observed in describing the growth of industry wide social standards, “Industries seek safety in numbers.”<sup>48</sup>

Finally, as the literature on the spread of human rights norms for governments demonstrates, changes in norms can affect policy preferences. . What begins as a primarily defensive response or largely rhetorical commitment can, over time, become viewed as legitimate. “Corporate preferences are driven in part about norms about the appropriate approaches to [managing] a business.”<sup>49</sup> For many highly visible global firms, engaging in various forms of global CSR, including having a CSR office, issuing a CSR report, cooperating with NGOs, and agreeing to one or more voluntary industry codes, has become an accepted part of managing a global firm in a more politicized and transparent global economy.<sup>50</sup> The growth of civil regulation has not reduced the importance firms place on profit-maximization; rather many

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<sup>48</sup> Allison Maitland, “Industries Seek Safety in Numbers,” *Financial Times Responsible Business*, Special Report, Nov 18, 2005, p. 1

<sup>49</sup> Virginia Haufler, “Self-Regulation and Business Norms: Political Risk, Political Activism,” in *Private Authority and International Affairs*, A. Clair Cutler, et al eds, State University of New York Press, 1999, p. 201

<sup>50</sup> For a discussion of the importance of changes in business norms, see Kelly Kollman, “The Regulatory Power of Business Norms: A Call for a New Research Agenda,” unpublished paper, (2006); Claire Moore Dickerson. “How Do Norms and Empathy Affect Corporation Law and Corporate Behavior? Human Rights: The Emerging Norm of Corporate Social Responsibility,” *Tulane Law Review*, (June 2002): 26-40, and *ibid*.

global firms have now concluded that professing their commitment to ‘good global corporate citizenship’ will either give them a competitive advantage and/or prevent them from being competitively disadvantaged.

But ironically, to the extent that various CSR commitments and policies have become a business norm – for example, virtually all major global firms now issue an annual CSR report which details their myriad social and environmental programs, including the number of ethical funds that hold their shares, the codes to which they subscribe, and whatever recognition or awards they have received for their CSR programs and commitments – the competitive advantage any firm is likely to derive from its CSR practices has diminished. CSR has rarely proven to be a source of sustainable competitive advantage: it is relatively easy for any firm to identify its business mission or brand with a CSR-linked cause or issue or to subscribe to a civil regulation. This means that as soon as one firm does so, its competitors are likely to immediately do so as well. The result is a kind of CSR arms-race, with many highly visible companies wanting to make certain that they are not viewed as less “responsible” than their competitors. This has the effect of increasing the resources *all* firms devote to CSR – without necessarily improving the competitive position of any one of them. Not surprisingly, on balance business CSR policies have had little or no impact on their financial performance.

In sum, the growth of civil regulation has stemmed from a multiplicity of factors, each of which has contributed to expanding existing regulatory arrangements governing global firms and markets. Demonstration effects have been critical: the last fifteen years has witnessed a steady stream of widely publicized allegations that have effectively dramatized numerous negative externalities associated with the failures of governments at both the national and international levels to adequately protect the global environment, and the welfare of workers and human rights

in developing countries. A critical role has been played by NGOs whose anti-corporate campaigns have creatively taken advantage of the vulnerability of global firms to threats to their public reputation and the value of their brands. Playing a role similar to that of public interest groups at the national level, these organizations have effectively mobilized the diffuse interests of those adversely affected by the shortcomings of existing regulatory mechanisms.

To protect their reputations and enhance the credibility of their public commitment to CSR, many industries have either adopted their own standards or entered into alliances or partnerships with NGOs to establish new regulatory standards. What was originally largely a defensive response to public criticism has in many cases been transformed into a change in norms as civil regulation has become increasingly legitimate, and for some firms, a new business opportunity. Finally, in some cases, voluntary regulations have been supported by national governments and international organizations, such as the World Bank, OECD, the UN, and the EU, who regard them as a politically acceptable strategy for ameliorating some of the negative social and environmental impacts of economic globalization and to enable its benefits to be distributed more fairly. Increasingly, they have also been supported by many developing country governments such as Egypt and China, who view them as both a way of demonstrating their commitments to global norms of corporate conduct and as a vehicle to protect the access of domestic producers to the markets of developed countries.

### **THE RELATIVE EFFECTIVENESS OF CIVIL REGULATION**

Under what conditions have civil regulations been effective in addressing the regulatory and market failure they were established to address? A useful way of beginning to answer this critical question is to examine a few important case-studies of civil regulations. This section looks at three categories of civil regulations - those which have been relatively effective, those

whose impact has been mixed, and those that have been relatively ineffective in achieving their professed goals – and then seeks to explain these variations.

### **Relatively Effective Civil Regulations: ‘Conflict Diamonds’ and Labor Practices in Cambodia**

Two of the most important accomplishments of civil regulation have been to significantly reduce international trade in ‘conflict or blood diamonds’ and to strengthen labor standards in the textile export sector in Cambodia. The issue of ‘conflict diamonds’ first emerged during the late 1990s in connection with the civil war in Angola. In 1998, at the request of the UN, Portugal, Russia, and the U.S. the UN Security Council voted to prohibit the purchase of rough diamonds from UNITA a rebel group, as their proceeds were being used to finance its civil war against the government of Angola. Similar trade restrictions were subsequently extended to diamonds from another conflict zone, Sierra Leone. In 2000, the U.S. Congress passed the Clean Diamond Trade Act which prohibited the import of ‘blood diamonds’ from conflict zones. While both De Beers, which dominates the global diamond market (and which withdrew from Angola under pressure in 1999) , and Tiffany & Co., a major diamond retailer, indicated their full support for these measures and declared that they did not deal in conflict diamonds, several NGOs expressed concern that their systems for monitoring the sources of diamond purchases was flawed.

Both De Beers and diamond retailers had an important reputational stake in assuring the public that they were not selling irresponsible produced diamonds. In the case of DeBeers, there was an additional motivation: their business strategy rests on controlling the supply of diamonds, which meant that the presence of ‘conflict’ diamonds’ threatened both their reputation *and* their quasi-monopolistic control of the global diamond market. In 2000, a joint resolution by an

association of international diamond retailers declared a zero tolerance policy for trading in conflict diamonds and announced that any firm found to be doing so would be expelled from the World Diamond Council. That same year, the Republic of South Africa launched the Kimberley Process (KP), named after the mining town at the heart of diamond production in the 19<sup>th</sup> century. KP brings together the world's major diamond producers and retailers, as well as diamond exporting and importing countries, seventy of whom have signed this agreement. KP has established a certification system which requires that all countries that trade or produce diamonds to issue of certificates of origin that guarantees that the diamonds do not come from a conflict zone. While compliance by diamond exporting countries is not mandatory, each of them has agreed to on-site monitoring. The KP has expelled some countries for non-compliance, which effectively bars their diamond exports from states that have endorsed the KP – a trade restriction for which the WTO has granted a waiver.

Diamonds themselves are not individually certified; rather bags of them are certified by and in the countries in which they are produced. The process is far from perfect, since some non-certified diamonds are smuggled into KP member countries, mixed with legitimate stones and then re-exported. Gaps in the enforcement of KP means that illicit rough diamonds still find their way into global markets. Nonetheless, according to KP, its members account for 99.8 percent of all diamond production, though other estimates place the percentage of certified diamonds somewhat lower.<sup>51</sup> But on balance, the KP has made substantial progress in addressing a major deficit in global economic governance. Equally importantly its effectiveness appears to be steadily increasing as monitoring and enforcement is improving and fewer African diamond producing countries are affected by have civil conflicts. Accordingly, “KP stands as a

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<sup>51</sup> Nicol Innocenti “Time to review the monitoring system,” *Financial Times* July 11, 2006, p. 2

positive example of active cooperation between governments, non-governmental organizations and the private sector.”<sup>52</sup>

Labor relations in Cambodia provide a second example of a relatively effective civil regulation. Improving working conditions in factories supplying products for western retailers and manufactures has emerged as a major focus of civil regulation. Over the last decade, more than 100 private codes governing labor standards have been developed in both the United States and Europe. Such codes primarily work through business to business markets: groups of western firms establish standards for policies such as child labor, overtime, gender discrimination, wages, and freedom of association and then monitor the adherence of their suppliers through periodic inspections. While several of these codes appear to have made progress in reducing some abuses, most notably unsafe working conditions and the employment of child labor, effective and credible enforcement remains a serious problem, especially with respect to wages and forced overtime.<sup>53</sup> This is due to both the large number of suppliers and subcontractors in major sectors and the fact that western firms have conflicting incentives. They want to protect their reputations, but at the same time face competitive pressures to keep their costs as low as possible and to assure a rapid and continual flow of goods from their suppliers to retail outlets.

Between 1994 and 1998, apparel exports from Cambodia grew from virtually zero to more than one half billion dollars. The success of this industry attracted the attention of American textile unions for two related reasons: the unions were concerned about reports of abusive working conditions and they wanted to bring these exports under the American textile quota system in order to protect domestic employment. While the U.S. had previously entered

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<sup>52</sup> Nicol Degli Innocenti, “A positive example of co-operations on conflict stones,” *Financial Times* June 22, 2005, p. 4. For more on the problems of conflict diamonds from the Ivory Coast, see Nicol Degli Innocenti, “Accord on conflict diamond smuggling,” *Financial Times* November 16, 2005, p. 4.

into a number of trade agreements that provided for penalties unless appropriate labor standards were enforced, it had never established positive incentives for countries that did so. It now decided to employ an economic carrot: the U.S. agreed to increase Cambodia's annual textile quota, provided that the Cambodian government was able to ensure substantial compliance with national labor laws and international agreed labor rights by *all* its apparel factories.<sup>54</sup>

Both parties recognized that monitoring compliance presented a formidable problem. The Cambodian government lacked any enforcement capacity. While several private organizations were already monitoring the labor practices of suppliers to western firms, their inspections lacked sufficient credibility to satisfy the American government. Accordingly, both the U.S. and Cambodia turned to the ILO, which for the first time agreed to establish a system for monitoring workplaces. (Previously, this inter-governmental organization had only reviewed the conduct of governments). Financial support for the ILO was in turn provided by the American and Cambodian governments and western apparel firms. For its part, the ILO agreed to make the results of all its inspections public.

At the outset, supplier participation in the ILO inspection program was voluntary. This presented a serious free-rider problem since non-participating firms faced lower costs, but enjoyed equal market access, as the American quota was awarded to the country as a whole. Subsequently, the Cambodian government agreed to limit exports to the U.S. to those firms that agreed to participate in the monitoring program. Because all producers involved in the inspection program stood to suffer if any major violations were reported, all now had a common stake in adhering to the labor provisions of the trade agreement. The agreement essentially aligned the

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<sup>53</sup> For a summary of the literature on the impact and enforcement of labor codes, see Vogel *The Market For Virtue*, chapter 4: "Working Conditions in Developing Countries"

<sup>54</sup> Sandra Polaski, "Protecting Labor Rights Through Trade Agreements: An Analytical Guide," *University of California, Davis Law Review*, Vol. 10, no. 13. pp.13-25.

influence of the American government with the interests of the Cambodian government, local producers, and western retailers and manufacturers. The result was a measurable and cost-effective improvement in labor conditions in one of the world's poorest countries.

The US-Cambodia Textile Agreement formally expired with the end of the multi-fiber agreement. Yet the regulatory systems it established remains in place. Significantly, many western firms, most notably Gap Inc, the largest purchaser of garments from factories in Cambodia, as well as Nike, continue to outsource from Cambodia, even though such products no longer receive preferential trade treatment. The fact that textile production in Cambodia has continued to increase demonstrates the importance of civil pressures for corporate accountability: those firms that continue to outsource from Cambodia presumably have a stake in maintaining responsible labor standards and a credible, transparent system for monitoring the compliance of their suppliers. The latter is particularly critical:

If there is one aspect of the Cambodia monitoring program that can be singled out as indispensable to its success, it is the higher level of transparency that the ILO provided through its reports. . . . The reports served a multiplicity of purposes in the hands of different actors and reinforced the common interests they shared.<sup>55</sup>

While some private labor regulations have become more transparent, few provide the detailed plant-by-plant disclosures of specific labor practices and conditions that characterizes the work of the ILO in Cambodia.

The Cambodian regulatory arrangement has yet to be effectively replicated in any other country, in part because no other country has been able to establish a credible system for monitoring supplier compliance. There have been negotiations among representatives of different labor codes to harmonize their standards in particular countries in order to improve the efficiency of monitoring and enforcement, but to date no such agreements have been reached.<sup>56</sup>

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<sup>55</sup> Sandra Polaski, "Combing Global and Local Forces: The Case of Labor Rights in Cambodia," Global Economic Governance Programme Working Paper 2005/13, May 2005, p. 16

<sup>56</sup> However, a pilot program has been developed in Turkey. "Gap. Inc's Crusade Against Sweatshops," ICFAI case, Reference no. 707-048-1, 2006, p.10

## **Moderately Effective Civil Regulations: Fair Trade and Forest Certification**

In two other important cases of civil regulation, namely Fair Trade Labeling International (FLI) and the Forest Certification Council (FSC), the effectiveness of private global governance has been mixed. Both have attracted a significant number of business participants and have effective private compliance mechanisms. But when measured against the scope of global business activity in their respective sectors, their impact has been constrained by the limited number of producers who participate in them. Both FT and FSC are market-based: they employ private labeling and certification to align the interests of western consumers with socially responsible global producers or exporters. Each represents a private response to a serious global governance deficit: the former seeks to ameliorate the impoverishment of farmers due to low global commodity prices, while the latter attempts to fill the regulatory gap created by the absence of an effective international forestry treaty.

In 1997, seventeen national Fair Trade certification programs in Europe, North America and Japan established an international consortium, the Fairtrade Labeling International (FLI). This organization certifies products produced in developing countries and then markets them to consumers in developed countries using the 'Fair Trade' label. While this social label has been used to market hundreds of agricultural products, including bananas, cocoa, tea, flowers, oranges, nuts, sugar, chocolate, and most recently cotton, the most important ethical label is for coffee, an \$80 billion industry and the world's second most widely traded commodity. The primary purpose of FT coffee is to increase the prices paid to farmers for this commodity, many of whose expenses barely cover the costs of production. FLI guarantees these farmers above world market prices for their products – a commitment that is financed by selling FT labeled products at a premium price.

FTI exhibits both the strengths and weaknesses of consumer- based global governance. On one hand, there is a market for virtue: a growing number of consumers in the U.S. and Europe purchase FT coffee often out of a social commitment, and coffee producers, such as Proctor & Gamble as well as retailers such as Starbucks, offer FT coffee – among other kinds - to their customers. Cafedirect, which only sells FT coffee, is the sixth largest British coffee brand and nearly one fifth of the British ground and roast coffee market is FT.<sup>57</sup> A total of 35,000 firms sell FT coffee in the U.S. and sales have tripled since 1999, making it the fastest-growing segment of the specialty or premium coffee business.<sup>58</sup>

On the other hand, the economic impact of FT is limited by consumer demand for its products. Consumers typically purchase products on the basis of price, convenience and quality, not on whether they were produced ‘responsibly;’ most consumers are happy to benefit from the lower costs of production in developing countries. Sales of FT certified coffee represent two per cent of American coffee sales, and a somewhat higher percentage in some European countries. Accordingly, while ethical labels have benefited some producers in developed countries, their overall redistributive impact remains limited.

Forestry regulation provides a second example of the strengths and shortcomings of market-based civil regulations. Frustrated by the failure of the Rio 1992 Summit to develop an effective international agreement governing forestry practices, a group of NGOs attempted to develop a private global forestry ‘treaty.’ Their efforts were supported by a number of foundations as well as the government of Austria, whose effort to develop a labeling standard for tropical forestry products was withdrawn following complaints from developing countries to the

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<sup>57</sup> Margaret Levi and April Linton, “Fair Trade” A Cup at a Time?” *Politics and Society* Vol. 31, no. 3. 2003, p. 419; Alan Beattie, “Follow the Thread,” *Financial Times* July 22/23, 2006, p. W1

<sup>58</sup> Jennifer Alserver, “Fair Prices for Farmers: Simply Idea, Complex Reality,” *New York Times* March 16, 2006, Business Section, p. 5

WTO. Following several years of negotiations among foresters, scientists, and firms, the Forest Certification Council was established in 1993, and began operations three years later. Arguably the most ambitious example of the “privatization of environmental governance,” the FSC is an international private standard-setting body.<sup>59</sup> Its goal is to create a global market for wood harvested in a socially and environmentally sound manner. The FSC has developed standards for forestry management and accredits and monitors organizations that in turn carry out assessments of wood production practices. It then issues certificates that guarantee a chain of custody for wood products from certified forests to their end users.

While originally conceived as a product labeling scheme, relatively few wood products sold to consumers are actually labeled, largely because relatively few consumers value certification. Nor, in contrast to FT products, are consumers willing to pay a market premium for certified wood. Rather, as in the case of labor codes that certify producers in developing countries, FSC primarily operates in the business to business market. It relies on sales to wood product to retailers and builders, rather than to individual consumers, few of whom have ever heard of FSC. For western firms, their willingness give preference to FSC certified products often represents a key component of their public commitment to CSR; many agreed to do so only after extensive grass-roots pressures from activists, often accompanied by actual or threatened boycotts.. However, many forestry firms regard FSC certification is too expensive and burdensome, especially as certified products do not command a price premium from either retailers or builders. Moreover, forestry firms have alternative private regulatory vehicle. In large measure as a response to FSC, more than forty industry-dominated alternative certification

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<sup>59</sup> Benjamin Cashore, “Legitimacy and the Privatization of Environmental Governance: How Non-State Market-Driven (NSMD) Governance Systems Gain Rule-Making Authority,” *Governance* Vol. 15, no. 1. 2002, p. 514. see also Cashore, et al *Governance Through Markets*. More scholarly articles have been written on the FSC than on any other civil regulation.

schemes have been developed and their requirements are generally less stringent than those of FSC.<sup>60</sup> In 2006, FSC's global market share of certified wood stood at 30%, while that of the two major industry-based and governed certification schemes totaled 57%.<sup>61</sup> Worldwide, 4 percent of all managed forests are FSC certified, accounting for 7 percent of the global forest-product market. This is an important accomplishment – the number of hectares of FSC certified wood grew from 500,000 in 1994 to more than 70 million in 2006, while between 1998 and 2006, the number of chain of custody certifications increased from 268 to 4,500.<sup>62</sup> However, virtually all FSC certified forests are located in temperate zones and 84 percent of them are located in Europe and North America, where forestry practices were already extensively regulated by governments

FSC may well have improved the social and environmental management of temperate forests, especially in Europe and North America. But the most egregious forestry management practices are taking place in tropical forests, only 2.4% of which are certified by either the FSC or any other private certification scheme. The limited geographic scope of private forestry certification has seriously limited its ability to adequately address what is arguably the most critical forestry governance failure, namely the accelerating rate of tropical deforestation.<sup>63</sup> In fact, only 6 – 8% of global timber production is traded and most of this trade occurs between environmentally sensitive developed countries, rather than from developing countries to developed ones, thus weakening the international leverage of western firms and activists.<sup>64</sup>

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<sup>60</sup> Errol Meidinger "The Administrative Law of Global Private-Public Regulation: The Case of Forestry," *European Journal of International Law* Vol. 17. no. 1, 2006, pp. 47-87.

<sup>61</sup> Philipp Pattberg, "The Influence of Global Business Regulation: Beyond Good Corporate Conduct," *Business and Society Review*, Fall 2006, p. 247.

<sup>62</sup> *Ibid*, p. 248

<sup>63</sup> See Peter Dauvergne *Shadows in the Forest: Japan and the Politics of Timber in Southeast Asia* MIT Press, 1997 and *Loggers and Degradation in the Asia-Pacific*, Cambridge University Press, 2001

<sup>64</sup> Philipp Pattberg, "The Forest Stewardship Council; Risk and Potential of Private Forest Governance," *Journal of Environment and Development* Vol. 14, no. 3. September 2005, pp. 366-7.

## Relatively Ineffective Civil Regulations: Curbing Corruption

One of the most critical governance deficits in the global economy involves the misuse by developing countries of the royalty payments received from extractive industries. These payments are often squandered by corrupt government officials and, as a result, many of the people living in countries with the most abundant deposits of oil, natural gas and minerals are the among the world's most impoverished.<sup>65</sup> In 2002, a global coalition of 200 NGOs launched a 'Publish What You Pay' (PWYP) campaign to pressure global firms in extractive industries to reveal their royalty payments to host country governments.<sup>66</sup>

The results this voluntary initiative has been disappointing.<sup>67</sup> Only seven global oil companies – all based in Europe or the U.S. – have agreed to disclose their payments and to date their actually doing so has been limited, largely due to the opposition of host country governments. For example, when British Petroleum (BP) announced that it would disclose its royalty payments to the government of Angola, that government threatened to terminate BP's exploration rights and it took two years of negotiations before a compromise was reached. An equally striking limitation of PWYP is the failure of any state-based global energy firm to endorse it, even though such firms, as well quasi-private energy firms based in the Soviet Union and Asia, account for a growing share of foreign investments in this sector, especially in Africa.<sup>68</sup> As a result, resource-rich governments that benefit from the misuse of royalty payments

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<sup>65</sup> See Erika Weinthal and Pauline Jones Luong, "Combating the Resource Curse: An Alternative Solution to Managing Mineral Wealth," *Perspectives on Politics*. March 2006, pp. 35-53.

<sup>66</sup> "The paradox of plenty," *Economist* December 24, 2005, p. 46-47

<sup>67</sup> Peter Davis, "Extracting Transparency Promises," *Ethical Corporation* May 2005, pp. 35 – 36.

<sup>68</sup> See for example, Andrew Yeh, "China ventures on rocky roads to trade with Africa," *Financial Times*, June 20, 2006, p. 2

can continue to offer exploration or production concessions to global firms that have less demanding ethical standards.

The challenge faced by energy companies attempting to behave more responsibly in failed states is graphically demonstrated by the experience of Exxon in Chad. In 1998, an unprecedented agreement was reached among the government of Chad, one of the world's poorest and most corrupt countries, the World Bank, which helped finance the 4.2 billion dollar investment project, and several NGOs. Its terms provided that all royalty payments would be monitored by a nine-person committee, with 10 percent held in trust, 80 percent earmarked for education, health and rural development, and 5 percent distributed to the oil producing regions.<sup>69</sup> The agreement was hailed as ground-breaking and a model for responsible energy development.

But in December, 2005, the government of Chad decided to take advantage of increased oil prices by breaking its terms.<sup>70</sup> It took a portion of the funds held in trust for development and allocated them to military spending, and also demanded increased royalty payments. The terms of the agreement were subsequently re-negotiated by the World Bank. There has been no effort to establish similar programs in other countries. The Chad case illustrates an important limitation of global civil regulation, namely the difficulty of promoting more responsible corporate practices when the objectives of civil regulations are opposed by host country governments.

There have also been other voluntary corporate initiatives to reduce corrupt payments. For example, concerned about numerous corruption allegations, forty-seven major global firms, representing \$300 billion in global revenues, have signed a 'zero-tolerance' pact against paying

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<sup>69</sup> Jerry Useem, "Exxon's African Adventure," *Fortune*, April 15, 2002, pp. 102-114

<sup>70</sup> Lydia Polgreen, "Chad Backs Out of Pledge to Use Oil Wealth to Reduce Poverty," *New York Times* December 3, 2005, p. A 15 and Chip Cummins, "Exxon Oil-Fund Model Unravels in Chad," *Wall Street Journal* February 28, 2006, p. A4

bribes.<sup>71</sup> But these firms represent only a small portion of MNCs and their compliance is not independently monitored. For its part, the UN Global Compact has made eliminating corruption one of its ten key provisions, and along with the World Economic Forum, the International Chamber of Commerce, and an NGO, Transparency International, it has established a private regulatory standard: Business Principles for Countering Bribery.<sup>72</sup> But these also lack any enforcement provisions or independent auditing.

Notwithstanding the endorsement of the Global Compact by more than 3,000 firms and the nearly fifty global firms who have signed a ‘zero-tolerance’ pledge, cases of corrupt payments by American and European firms continues to surface- though such payments are now more likely to be made public.<sup>73</sup> There is no evidence that the extent of such payments has declined.<sup>74</sup> The misuse of royalty payments by corrupt governments remains pervasive, as does the civil unrest such corruption often fosters. In short, the impact of these civil regulations on both business conduct and the citizens in developing countries whose welfare they were intended to enhance has been extremely modest, and, as a result, virtually all the regulatory and governance failures they were intended to ameliorate persist.

### **Explaining Relative Effectiveness Across The Cases**

The growth of much civil regulation initially follows a roughly similar trajectory. First, a governance deficit is identified and second, one or more NGOs, firms and/or governments proposes a voluntary code to ameliorate it. These demonstration effects include abusive labor practices, the funding of civil conflict by international trade, economic hardships for coffee and

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<sup>71</sup> Glenn Simpson, “Multinational Firms Unite to Fight Bribery,” *Wall Street Journal*, January 27, 2005, p. A4, A8

<sup>72</sup> Jem Bendell and Jonathan Cohen, “Not banking on Corruption,” *The Journal of Corporate Citizenship* May-June 2006, pp.11-12

<sup>73</sup> See for example, Raymond Bonner and Jane Perlez, “Controller Charges Mining Company with Filing False Statements,” *New York Times* January 26, 2006, p. A6

<sup>74</sup> Hugh Williamson, “West ‘ failing to curb bribery overseas’” *Financial Times* September 26, 2006, p. 5

other developing country agricultural producers, irresponsible forestry practices, widespread corruption, and the misuse of royalty payments by developing country governments.

Some global firms then initially agree to help establish or endorse a civil regulation that is designed to address this perceived governance deficit. These private sector ‘CSR entrepreneurs’ may be firms whose current policies or policy goals are already similar to those of the proposed code or who have been targeted by NGOs and thus support such regulations in order to make their CSR commitments more credible. It is at this point that the effectiveness of civil regulations begins to diverge. The first critical divergence emerges at the negotiation stage and is associated with the number of firms or producers that agree to be bound by a particular code. In the two most successful cases, all the relevant producers had a collective interest in supporting the terms of the proposed civil regulation, though it is important to note that Cambodia accounts for only a small share of global textile production. In the case of KP, no other civil regulation has been endorsed by such a large share of global producers – a factor to which the economic concentration of the diamond export industry clearly contributed. FSC and FTI did attract a sufficient number of firms to have a discernable impact, but these still constitute a relatively small portion of relevant global producers. While the most stringent anti-corruption code, PWYP, has attracted very few corporate adherents, other weaker anti-corruption codes have been endorsed by relatively large numbers of global firms, though these still constitute only a relatively small proportion of global producers. .

The benefits of the Cambodia labor agreement to both developing country producers and western firms were relatively clear; they provided market access to the former and reputation benefits to the latter. Likewise, diamond exporters wanted continued global market access while diamond retailers were anxious to protect the collective reputation and image of their luxury

product. The business benefits of FSC were more mixed: they provided privileged market access for some forestry firms, but for most producers these benefits were not sufficient to encourage them to bear the additional costs of securing FSC certification, especially when they had less burdensome private regulatory alternatives. FLI did provide important economic benefits to developing country producers, but the lack of adequate consumer demand for certified products has limited the number of producers who have benefited from FLI certification. The relatively large number of firms that have endorsed the various anti-corruption codes suggests that such codes did provide important benefits to many firms as well as a potential solution to the collective action problem: many global firms based in countries with anti-corruption statutes and facing intense media scrutiny would clearly prefer not to pay bribes if only they could be assured that their competitors would behave similarly. But at the same time, not all global firms face similar domestic pressures and many have not subscribed to any anti-corruption code or agreement.

However, the most important differences among codes emerge at the implementation, monitoring, and enforcement stage. What distinguishes KP from many other global producer codes and the Cambodia agreement from other labor codes, was the willingness of other actors, including national governments and international organizations to actively participate in their implementation, monitoring and enforcement. It is impossible to overstate the significance of this development: by making monitoring and enforcement credible and more effective, both the benefits of participation and the costs of non-compliance were enhanced. *The relative effectiveness of these civil regulations is in large measure due to the fact that they were embedded in voluntary agreements between or among governments with private and public enforcement mechanisms complementing one another.* In the case of KP, countries can be

expelled for contravention, making the KP highly distinctive and substantially contributing to its effectiveness. Similarly, the US could deny market access if the ILO's labor standards were violated in Cambodia. These state-backed enforcement mechanisms make these codes very atypical.

By contrast, no developed country government has denied market access to products from corrupt countries, and their enforcement of domestic anti-corruption statutes has been uneven. For their part, few developing country governments are willing or able to enforce anti-corruption policies. Elites in many countries, particularly those with substantial natural resources, continue to benefit from corrupt payments and paying bribes remains critical to doing business in many countries. This has significantly weakened the business benefits of compliance with business anti-corruption agreements and explains why the only such civil regulation whose compliance can be independently monitored, namely PWYP, has attracted the least business support.

In the case of FTL and FSC, their standards appear to be relatively effectively monitored and enforced. In essence, both operate as non-profit firms. They have developed a brand or certification standard that is both visible and valued, and which links a complex network of suppliers and retailers. As a result, numerous firms have a stake in effective monitoring and enforcement, and both organizations have developed sufficient resources and expertise to effectively regulate producers and distributors. Yet precisely because they rely exclusively on market incentives, a relatively small portion of global producers have chosen to participate in them.

In sum, in all three categories of cases, both the business case for compliance and

the establishment of effective monitoring and enforcement mechanism parallel one another, and together explain much of the divergence in their effectiveness. Both were strongest in the case of KP and the Cambodia agreement and weakest in the case of the various anti-corruption civil codes, with FTI and FSC falling in between. On balance, civil regulations have been most successful at influencing agenda-setting: they have placed a wide array of global regulatory failures on the agenda of the international community. Many have been also relatively effective at the negotiation stage, persuading relatively large number of firms to subscribe to them. But for many civil regulations, implementation, and effective monitoring and enforcement represent a serious structural weakness.

## CONCLUSION

The growth of global civil regulation and CSR has been both hailed as a highly promising solution to the shortcomings of state regulation and sharply criticized on the grounds that voluntary business regulations are inherently incapable of addressing market and regulatory failures – especially then these failures were created by global firms in the first place..<sup>75</sup> However, any realistic assessment of civil regulation should compare it not to an ideal world of effective global economic governance, but to actual policy alternatives. When compared to government regulations in developed countries, civil regulation is clearly less effective. In fact, civil regulations exhibit many of the well-documented shortcomings of industry self-regulation

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<sup>75</sup> For the former, see, for example, Andrew Savitz, *The Triple Bottom Line*, Jossey-Bass, 2006. For the latter, see Lipschutz and Rowe, *Globalization, Governmentality and Global Politics*

at the national level, with whom they share many important characteristics.<sup>76</sup> Both remain weaker than well-enforced command and control regulations in changing corporate behavior.

But the effectiveness of civil regulations *is* roughly comparable to that of many inter-governmental treaties and agreements, whose effectiveness in addressing environmental protection, labor practices, and human rights is also mixed and uneven.<sup>77</sup> In a number of cases, most notably with regard to labor standards and forestry, civil regulations, for all their shortcomings, have been considerably *more* effective than inter-governmental treaties. At the same time, their scope is much more limited: they primarily affect the way some products exported to highly visible western firms are produced.

For all their shortcomings, civil regulations are undoubtedly *more* effective than the labor, human rights, and environmental regulations of many developing countries. For some sectors in some developing countries, they constitute the only effective business regulation. The environmental, social and human rights practices of firms in developing countries that either produce for global supply chains or are directly owned by western MNCs are frequently better than those of domestic producers and this is largely due to the impact of global civil regulations. By providing a political vehicle for the export of more effective regulatory practices from developed to developing countries, civil regulation has played a role, albeit a limited one, in socializing economic globalization.

In sum, civil regulations have *partially reduced* the governance deficits and regulatory failures that characterize many global firms and markets. They are not a panacea, but neither are they an unimportant component of global governance. Moreover, many have been established

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<sup>76</sup> See, for example, Michael Lenox and Jennifer Nash, "Industry Self-Regulation and Adverse Selection: A Comparison Across Four Trade Association Programs," *Business Strategy and the Environment* Vol. 12, 2003, pp. 343-356, and *Voluntary Approaches for Environmental Policy: An Assessment*, OECD, 1999

<sup>77</sup> See fn. # 21

relatively recently, which means that their impact and effectiveness could increase over time, especially if their monitoring and enforcement can be strengthened.

What would it take to make civil regulation a more effective form of global economic governance? Two factors are critical in strengthening demand. First, the business case for compliance with civil regulations would need to become stronger.<sup>78</sup> For all the widespread and widely believed rhetoric about the ‘win-win’ case for CSR, many developing country producers regard the civil regulations imposed by western firms as a burden: it raises their costs, but provides few financial benefits. (FLI branded products are a notable though clearly limited exception.) This means that such firms have every incentive to do as little as possible to accommodate the demands of their western contractors. Many have developed an adversarial relationship with private inspectors, and often seek to deceive them.<sup>79</sup>

A similar logic holds for western firms. They have accepted civil regulations for a variety of reasons, including public and peer pressures, changes in business norms, and some cases a more sophisticated understanding of the basis for profitable business activities. But because the financial benefits of CSR remain for the most part either modest or elusive, few firms have integrated the standards of civil regulation into their core business practices. Many global CSR commitments and policies remain akin to corporate philanthropy or community or public relations, remaining on the periphery of their business strategies.<sup>80</sup> As long as more ‘responsible’ global firms do not enjoy consistently stronger financial performance than their less responsible competitors – and to date they do not – the incentives of firms to invest substantial resources into

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<sup>78</sup> For a critical assessment of the business case for CSR, see Vogel *The Market for Virtue*. Chapter 2: “Is There A Business Case for Virtue?”

<sup>79</sup> See for example, Dexter Roberts and Pete Engardio, “Secrets, Lies and Sweatshops,” *Business Week* November 27, 2006, pp. 50 - 58

<sup>80</sup> See for example, Michael Porter and Mark Kramer, “Strategy and Society,” *Harvard Business Review* December 2006, pp.78-92

complying with civil regulations will remain limited, and the incentive of some firms to free ride on industry codes will remain a serious problem. Whatever, the particular business benefits of a specific firm's CSR policies, their overall financial impact is typically overshadowed by more conventional business risks and opportunities..

In many global industries, a handful of highly visible firms based in the North America and Western Europe have emerged as CSR leaders, making good faith efforts to comply with relatively high standards for respect of labor, environmental protection, and human rights, and often seeking to persuade other firms in their industries to behave more responsibly. But to the extent that their competitors are either less able or unwilling to effectively comply with the civil regulations to which they have nominally agreed, these firms' own efforts to behave more responsibly are constrained. Peer and public pressures have promoted business adoption of many civil regulations, but in most cases such pressures have not been an effective tool for promoting compliance with them. The growing economic prominence of MNCs based in non-western countries, who face fewer domestic pressures from NGOs and who have been less willing to adopt civil regulations, has also exacerbated the competitive challenges faced by more responsible western firms.

The second critical determinant of the future impact of civil regulation has to do with their relationship to governments. Some developing country governments, such as Cambodia, recognize the value of civil regulation; others, such as Chad, do not. Unfortunately, the latter is more typical than the former: most developing countries tend to be indifferent to voluntary labor standards, and many are not supportive of codes that seek to reduce corruption. KP is a notable exception, but that is primarily because it can be enforced by trade sanctions. In the case of FSC, the pattern is more mixed: some developing country governments closely cooperate with its

rules, while others are indifferent to them.<sup>81</sup> The laws of some countries, such as China, do not permit local firms to comply with labor codes that guarantee the right of workers to choose their own representatives, while in some Central and Latin American countries, governments have harassed labor unions. In the long-run, civil regulations must be more closely integrated into the domestic regulatory policies and the competitive strategies of developing country governments if they are to become more effective.<sup>82</sup> Equally importantly, developing country governments need to promote, at least permit, the strengthening of civil society so that their citizens are able to define and defend their own social, political and environmental interests vis- a vis business firms, without having to rely on western activists to do so in their name.

The future effectiveness of or demand for effective civil regulations also depends on the policies of developed country governments. As noted above, many western governments have supported the adoption of civil regulations: But at the same time, they have made limited use of their economic leverage and political influence to develop and enforce effective global regulatory standards, impose and enforce legally binding standards for global firms based on their countries, or link market access to more responsible business behavior. Until the world's rich countries are willing to integrate civil regulations into their domestic and international regulatory strategies, the global regulatory failures civil regulation was intended to redress will persist.

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<sup>81</sup> For an analysis of the critical importance of the local political and economic environment in affecting the willingness of firms to comply with civil regulations, see Ralph Espach, "When is Sustainable Forest Sustainable? The Forest Stewardship Council in Argentina and Brazil," *Global Environmental Politics*, Vol. 6. no.2, May 2006, pp. 55-84.

<sup>82</sup> For a comprehensive discussion and analysis of how some developing countries are seeking to integrate civil regulation into their competitiveness strategies, see *Responsible Competitiveness: Reshaping Global Markets Responsible Business Practices* Accountability, December, 2005. See also, Alex MacGillivray, Johan Sabapathy, and Simon Zadek, *Aligning corporate responsibility and the competitiveness of nations*, Accountability and The Copenhagen Centre, December 2003. For other studies of the relationship to developing country governments to civil regulation, see fn#22

Voluntary business regulation has emerged as a response to the failures or shortcomings of existing legal mechanisms of regulatory governance in the global economy. Civil regulation has played a critical role in highlighting the ineffectiveness of existing state regulations and in persuading many firms that they have a responsibility to help ameliorate them. But ironically many of the shortcomings of global economic governance are themselves due to the political influence of the very same global firms who, while often agreeing to adopt voluntary standards, have typically opposed stronger international treaties, extra-territorial business regulations, and effective links between trade liberalization and domestic labor, environmental, and human rights practices. Global business activity can only become effectively governed if the inadequacies of civil regulation are recognized by both firms and governments. The future effectiveness of global business regulation depends on the extent to which private and public authority, civil and government regulation, and soft and hard law, re-enforce one another.