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THE PRIVATE REGULATION OF GLOBAL CORPORATE CONDUCT

by

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INTRODUCTION

This paper explores the dimension of transnational governance associated with civil business regulation.¹ Civil regulations employ private, non-state, or market-based regulatory frameworks to govern multinational firms and global supply networks. While the notion that companies have a responsibility to ‘society’ is more than a century old, historically corporate social responsibility (CSR) was associated with initiatives by firms to address social problems at the community level, often through corporate philanthropy.² More recently, CSR has become more international in scope; it now increasingly focuses on the impact of global firms and markets on working conditions, environmental quality, community development, and human rights, especially in developing countries. Civil regulations seek to imbed international markets and firms in a framework of global rules and norms by establishing standards for responsible business conduct as well as mechanisms for promoting compliance with them.

A defining feature of civil regulation is that its legitimacy, governance and implementation is not rooted in public authority. Operating beside or around the state rather than through it, civil regulations are based on ‘soft law’ or private law rather than legally enforceable

¹ 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 is an extensive literature on global civil regulation and global corporate social responsibility, to which political scientists have only recently begun to contribute. 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, 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.

² For a history of corporate social responsibility in the U.S. see Morrell Heald, *The Social Responsibilities Of Business* Transaction Publishers, 1988

standards: violators face social or financial penalties rather than legal ones.³ Civil regulation extends regulatory authority “sideways” beyond the state to global non-state actors.⁴ Its recent growth reflects an expanded “public role for the private sector,” as well as the growing importance of “private authority in global governance.”⁵ 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.”⁶ They 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.”⁷ In many developing countries, corporations have taken on responsibilities that have traditionally been the focus of international development agencies, such as promoting community development, as well as functions that were thought to be the exclusive properties of states, such as enforcing national laws.⁸

There are important linkages between civil regulations and public policies. The former typically include commitments by their corporate signatories to obey host country laws and many private regulatory standards are based on those developed by 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

³ For two excellent analysis of ‘soft law’ in global governance see John Kirton and Michael Trebilock, “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 Trebilock, eds, Ashgate 2004, pp. 3 – 33; and *Soft Law in Governance and Regulation*, Ulrika Moth, ed, Edward Elger. 2004. Both edited volumes contain essays on both private and public soft law.

⁴ 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

⁵ 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.

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

⁷ Steven Bernstein, “Legitimacy in Global Environmental Governance,” *Journal of International Law & International Relations* Vol. 1, nos, 1-2, p. 160

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

There are important structural similarities between civil regulations and many government regulations. The market-based regulatory mechanisms typically employed by civil regulations, namely producer certifications, product labeling, third-party auditing, and information disclosure are also used by governments as alternatives or compliments to command and control regulations, especially in the area of environmental policy.⁹ However, the labeling, disclosure, auditing and certification components of civil regulations are not subject to legal review and are more likely to be global in scope. Many ‘voluntary’ regulations are voluntary in name only, as the state retains final regulatory authority.¹⁰ This is not the case for civil regulations for which there is typically no state ‘back-up.’

Still, the boundaries between ‘voluntary’ and mandatory regulations, state and non-state regulations, private and public law, hard and soft law cannot always be sharply drawn.¹¹ “The distinction between mandatory and voluntary is best thought of not as a dichotomy, but as the ends of a continuum displaying decreasing degrees of corporate discretion.”¹² It is also a fluid

⁸ Rebecca DeWinter, “The Anti-Sweatshop Movement: Constructing Corporate Moral Agency in the Global Apparel Industry,” *Ethics and international Affairs* Vol. 15, no. 2, p 113

⁹ 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

¹⁰ 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

¹¹ 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.

¹² Mathias Koenig-Archibugi, “Transnational Corporations and Public Accountability,” *Government and Opposition* 2004, p. 246

one: soft laws can become ‘harder,’ and norms can become more law-like.¹³ For example, the Uruguay Round WTO agreement granted international legal recognition to the health and safety standards of the Codex Commission and some private forestry standards have been accorded legal recognition by national and local governments.

Virtually all of the policies and issues addressed by civil regulations are also the subject of government regulations at both at the national and international levels. For example, reducing corruption is a major goal of the UN Global Compact as well as several industry codes. Corrupt payments are also banned by OECD Convention on Combating Bribery of Foreign Public Officials, as well as some national governments. Fisheries and forests are regulated by national laws, international treaties, and civil regulations, as are many labor practices. Accordingly, any assessment of the impact and significance of voluntary codes must view them in a broader political and legal context: they represent *one* vehicle for governing global firms. Their growth and impact is closely related to other national and international state-based efforts to govern global firms and international markets. Some civil regulations have partially filled gaps in existing state and inter-state regulations; some were developed to avoid additional government regulations, and still others have helped strengthen the scope and/or effectiveness of state controls over business.

The purpose of this paper is to describe and explain the growth of civil regulation, describe how it functions, and assess its significance. Its assessment is mixed. On one hand, civil regulations are increasingly affecting the way many global firms, industries and markets are governed. Their impact is uneven and limited, but not inconsequential. Global civil regulation – and the principles and practices of global CSR to which it is often linked - is now an important

¹³ Jon Birger Skjaereth, Olav Schram Stokke and Jorgen Wessestaad, “Soft Law, Hard Law, and Effective Implementation of International Environmental Norms” *Global Environmental Politics* August 2006, pp. 104-120

component of global economic governance and is likely to remain so. According to Krasner's influential definition, an international regime consists of "principles, norms, rules and decision making procedures around which actor expectations converge in a given issue area."¹⁴ On this basis, many civil regulations have contributed to the strengthening of many international regulatory regimes.

But if a "private regime" is defined as "an integrated complex of formal and informal institutions that is a source of governance for an economic issue area as a whole," then few civil regulations clearly fall into this category. There are important structural limitations to the effectiveness and scope of much private global economic governance.¹⁵ Many of the strengths and shortcomings of private global regulations mirror those of inter-governmental labor, environmental, and human rights treaties and laws, which also rely on various forms of soft law, economic incentives and 'naming and shaming,' to promote compliance - the former by firms, the latter by states - and whose governance authority is also frequently problematic.¹⁶ As Keohane and Ooms predicted nearly three decades ago, "we can only expect . . . (effective) international regulation on a global scale where the principal issues pit the state against the enterprise, rather than state against state with the enterprise only as a willing or unwilling intermediary."¹⁷ Civil regulations are more likely to fall into the later category as few of their standards are supported by the governments of *both* developed and developing countries.

¹⁴ *International Regimes*, Stephen Krasner, eds. Cornell University Press, 1982, p. 2

¹⁵ A Claire Cutler, Virginia Haufler, and Tony Porter, "Private Authority and International Affairs," in *Private Authority and International Affairs*, p. 13

¹⁶ For studies of the uneven impact of international environmental agreements, see for example *The Effectiveness of International Environmental Regimes*, Oran Young, eds. MIT Press, 1999; *Institutions for the Earth: Sources of Effective International Environmental Protection*, Peter Haas, Robert Keohane and Marc Levy, eds, MIT Press, 1993 and *Environmental Regime* Edward Miles et al. eds. MIT Press, 2002. For human rights, see Oona Hathaway, "Do Human Rights Treaties Make a Difference?" *Yale Law Journal* June 2002

¹⁷ Robert Keohane and Can Doorn Ooms, "The Multinational Firm and International Regulation, *International Organization* Vol. 29. no. 1, 1975, p. 184

If accountability means that “some actors have the right to hold other actors to a set of standards, to judge whether they have fulfilled their responsibilities in light of those standards, and to impose sanctions if they determine that those responsibilities have been met” then civil regulations have undoubtedly made *some* global firms and industries *more* accountable.¹⁸ They have provided important new vehicles for non-business constituencies, primarily in western countries, to participate in the way global firms and markets are governed, and forced some global firms to internalize some of their negative social and environmental externalities. To this extent, they have *partially reduced* the democratic deficit that informs the governance of many global firms and markets.

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 of private global business regulation depends on the extent to which its standards for business conduct and its mechanisms for holding firms accountable acquire legal status and are integrated with state-based regulatory policies at both the national and international levels.¹⁹ “Market solutions can provide incentives for firms to implement codes and standards . . . But government action – in the North and the South – remains vital to effective regulation, by setting social goals and upholding the freed of civil society actors to organize and mobilize.”²⁰

CIVIL REGULATION IN CONTEXT

¹⁸ R.W. Grant and R. O. Keohane, “Accountability and Abuses of Power in World Politics,” *American Political Science Review* Vol. 99, No 1, 2005, p. 29

¹⁹ 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

²⁰ David Graham and Nagarie Woods, “Making Corporate Self-Regulation Effective in Developing Countries,” Global Economic Governance Programme Working Paper 2005/14, May 2005, p. 1. See also Halina Ward, *Public Sector Roles in Strengthening Corporate Social Responsibility: Taking Stock* The World Bank, the International Finance Corporation, January 2004 and Aron Cramer and Peder Michael Pruzan-Jorgensen, “Engaging Governments to Support Corporate Social Responsibility in Global Supply Chains,” in *The Accountable Corporation* Marc Epstein and Kirk Hanson, eds. Prager, 2006, pp. 75 -119

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 such as the European Committee for Standardization, the European Committee for Electrotechnical Standardization, the International Organization for Standardization, the International Electrotechnical Commission and the Codex Alimentarius Commission and these play an important role in the global economy.²¹ At the national level, organizations such as the Better Business Bureau and the Good Housekeeping Seal have sought to improve business consumer practices while many industry associations have developed rules and standards for occupational health and safety, consumer protection, and environmental quality.

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 seek to protect interests not directly involved in the market chain: they primarily govern the relationship of firms to *external* constituencies. Second, civil regulations are more likely to be politicized: they have primarily emerged in response to political and social pressures on business, often spearheaded by national and trans-national activists. Third, compared to traditional business self-regulation, the

²¹ 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 and International Standards Setting, Wald Mattli, guest editor, Vol. 8, no. 3. 2001. See also the case-studies in *Private Authority and International Affairs*, Cutler et al. eds

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.”²² The expansion of global 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.²³ “NGO’s role and influence have exploded in the last-half decade.”²⁴ While much of their political activity has focused on global public policies and institutions, over the last decade they have increasingly sought to influence business firms. The participants in the movement for corporate accountability are wide-ranging: they include unions, environmental organizations, human rights and labor activists, religious and consumer groups, student organizations, 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 turns globalization on its head, making the global scope of business activity into

²² Robert Falkner, “Private Environmental Governance and International Relations: Exploring the Links,” *Global Environmental Politics* May 2003, p. 79

²³ 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

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. Many civil regulations are essentially engaged in a private market-based variant of ‘trading up,’ or the privatization of the ‘California effect.’ Their goal is to transmit more stringent regulatory standards from developed countries to firms, industries and markets in developing ones – rather than from ‘greener’ to less green governments.²⁵ The emergence and impact of civil regulation 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 growth of civil regulation can also be understood as part of a broader historical effort to subject business to additional social controls. Polanyi’s *The Great Transformation* describes the challenges faced by western democracies during the 19th and early 20th century to develop new political and social institutions and rules to govern national markets and firms. Many proponents of civil regulations are engaged in a similar enterprise: they want to extend the kinds of social controls that now exist over firms operating in developed countries to those in developing ones – in essence, they want to globalize ‘embedded liberalism’.²⁶ From this perspective, the multi-stakeholder governance of many civil regulations represents the global functional equivalent of the non-state or ‘societal self-governance’ associated with corporatism at the national level, with western activists playing, or attempting to play, a role similar to that of

²⁴ Jessica Mathews, “Power Shift,” *Foreign Affairs* January/February, 1997 p. 53

²⁵ David Vogel, *Trading Up; Consumer and Environmental Regulation in Global Economy*, Harvard University Press, 1995

labor unions in the west.²⁷ Similarly, corporate and industry programs to improve labor and environmental conditions and promote community development in and around their facilities and those of their contractors in developing countries can be seen as the contemporary counterpart of the welfare capitalism practiced by many national firms during the late 19th and early 20th century in Europe and the United States.

A few global civil regulations date from the 1970s and 80s.²⁸ They include the Sullivan Principles which established labor standards for foreign investors in the Republic of South Africa during the apartheid era and Responsible Care, which was developed to improve environmental health and safety practices in the chemical industry. The distributors of infant formulas also agreed to a code to govern their global marketing practices. However the number and scope of global civil regulations has expanded significantly since the mid 1990s. Private regulations that define standards for ‘responsible’ business practices now exist for virtually every global industry and internationally traded commodity, including forestry, 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 still cover a relatively small portion of these products or sectors.²⁹ 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 2,000 global firms now regularly issue reports on the social and environmental practices and many of these firms have developed their own codes

²⁶ John Ruggie, “Taking Embedded Liberalism Global,” in *Taming Globalization; Frontiers of Governance* David Held and Mathias Koenig-Archibugi, eds, Policy Press, 2003 pp. 93 - 129

²⁷ Marina Ottaway, “Corporatism Goes Global,” *Global Governance* September 2001

²⁸ For the origins of the movement for corporate accountability, see David Vogel *Lobbying the Corporation: Citizen Challenges to Business Authority* Basic Books, 1978

²⁹ See Gery Gereffi, et al, “The NGO-Industrial Complex,” *Foreign Policy* August 2001, pp. 56 – 65, Mathias Koenig-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 conduct,” *Transnational*

and/or subscribe to one or more industry or cross-industry codes. The UN Global Compact has more than 2,300 corporate signatories, while more than 1,000 corporations have subscribed to the International Chamber of Commerce's Business Charter for Sustainable Development.

During the 1960s and 1970s, interest in the global dimensions of CSR was primarily an American phenomena. Activist pressures, such as campaigns for the withdrawal of firms from southern Africa, and a boycott of companies selling infant formulas in developing countries, primarily took place in the U.S. 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. Several European governments, as well as the EU, have recently been more supportive of global CSR initiatives than has the United States.³⁰ Ethical brands or certifications for coffee, rugs and wood products have larger market shares in many European countries than in the U.S. and London has replaced New York as the global center of CSR activism, research, reporting and monitoring. Thirty years ago, social or ethical investment funds were uniquely American: now they exist in every European capital market, though their market shares are generally smaller than in the U.S. The efforts of institutional investors to influence the social or environmental conduct of firms now occur as frequently in Europe as in the United States. The 'Europeanization' of CSR, particularly on the continent of Europe, is an important development as it has significantly expanded the number of global firms who are governed by civil regulations.³¹

GLOBALIZATION AND CIVIL REGULATION

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,

³⁰ 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, see *Developing Corporate Social Responsibility: A European Perspective*, Francesco Perrini, Stafano Pogutz and Antonio Tencati, eds. Forthcoming fall 2006

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.³² 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 countries. Second, the production and supply networks of global firms increasingly transcend national boundaries: much 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.

Underlying the emergence of civil regulation is the 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 has made it difficult for national governments to hold corporations accountable: the expansion of global markets and firms has undermined the ability of many governments to adequately protect the welfare and interests of their citizens, especially in developing countries. Transnational corporations are said to “wield power without responsibility. They are often as powerful as states and yet less accountable.”³³ Another critic observes: “Corporations have never been more powerful, yet less regulated.”³⁴ 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

³¹ For the growth and impact of CSR in Europe, see *Corporate Responsibility Across Europe* Andre Habisch, Jan Jonker, Martina Wegner and Rene Schmidpeter, eds, Springer 2005

³² See Gary Gereffi and Frederick Mayer, “Globalization and the Demand for Governance” unpublished paper, June 2006

³³ Peter Newell, “Environmental NGOs and Globalization,” in *Global Social Movements*, p. 121

³⁴ J. Vidal, quoted in *ibid*,

“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.”³⁵

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 power of global firms does not dwarf that of national governments: sovereignty is not at bay and the power of states is neither declining nor in retreat. Nor is there any evidence that economic globalization has produced a regulatory “race to the bottom.”³⁶ The scope and extent of business regulations continues to expand in many countries, as well as globally. But arguably the global economy does confront a ‘governance deficit.’³⁷ 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

³⁵ Christoph Knill and Dirk Lehmkuhl, “Private Actors and the State: Internationalization and Changing Patterns of Governance,” *Governance* January 2002, p. 42, 44

³⁶ For a summary of the extensive literature on this issue, see David Vogel and Robert Kagan, “Introduction: National Regulations in a Global Economy,” in *The Dynamics of Regulatory Change: How Globalization Affects National Regulatory Policies*, David Vogel and Robert Kagan, eds. University of California Press, 2004, pp. 1-42.

³⁷ The phrase is from Peter Newell, “Managing Multinationals: The Governance of Investment for the Environment,” *Journal of International Development* Vol. 13, 1002, p. 908

that violated American animal protection standards. Both the US and the EU have imposed restrictions on trade with Burma because of its human rights policies. Both the EU and the US have often extended preferential trade privileges to countries with stronger domestic labor and environmental standards and human rights practices.³⁸ The North American Free Trade Agreement and Central American Free Trade Agreement, as well as a number of bi-lateral trade agreements negotiated by the US, require signatories to maintain and enforce domestic environmental and labor standards. However, the cumulative impact of trade policy as either a carrot or a stick to strengthen the regulations of developing countries remains modest, in part because few western governments have been willing to effectively link trade liberalization to improvements in the regulatory practices of their trading partners.

Moreover the rules and rulings of the World Trade Organization constrain the ability of governments to link trade liberalization to domestic social and environmental practices - even if more were willing to do so.³⁹ 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

³⁸ 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

³⁹ See Ken Conca, "The WTO and the undermining of global environmental governance," *Review of International Political Economy* Autumn 2000, pp. 484-494

its citizens is a matter to be determined by each government, not by the international community.”⁴⁰ Thus, “the GATT/WTO is not concerned with how a state treats its own citizens, but rather how it treats non-citizens who seek to trade.”⁴¹

WTO rules could certainly be changed so as to more closely link global trade liberalization to domestic environmental, labor or human rights practices.⁴² Many western activists strongly support such a change in WTO rules, and in the case of labor standards, so do many western labor unions. Domestic firms facing competition from less expensive imports from developing countries might also welcome extending the legal basis for trade restrictions. But global firms have strongly opposed such policies on the grounds that it would raise their costs and possibly disrupt their supply chains. Equally importantly, many developing countries regard proposals to link trade liberalization to their domestic environmental, human rights, or labor practices as a disguised form of protectionism. Thus the preferences and influence of MNCs and developing country governments have prevented a change in the rules that govern international trade.

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 agreements has often proven difficult. For example, the International Tropical Timber Organization has refused NGO requests to adopt a forest certification and

⁴⁰ 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

⁴¹ Aaronson, *ibid*

labeling system, largely due to opposition from developing countries.⁴³ The same result occurred in the case of global labor standards. 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, representatives from developing countries led by Egypt criticized his proposal as a disguised form of protectionism and it was not adopted. The ILO has established standards for national labor practices and most countries have signed on to them, but compliance is entirely voluntary and this international treaty contains no enforcement mechanisms.

A legally enforceable international code of conduct to regulate global firms has been under discussion in various international forums.⁴⁴ 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. But none of these efforts was successful. The OECD did adopt comprehensive guidelines for multinational corporations. While they do “represent a consensus on what constitutes good corporate behavior in an increasingly global economy,” and they have influenced the content of many civil regulations, they are non-binding.⁴⁵ 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. While Agenda 21 does incorporate recommendations that affect TNCs, it does not include a code of conduct. 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 their potential sanctions against non-compliant companies.

⁴² 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

⁴³ Ronnie Lipschutz, “Why Is There No International Forestry Law?” *UCLA Journal of Environmental Law and Policy* Vol. 19. 2000/2001,

⁴⁴ See Ans Kolk and Rob van Tulder, “Setting new global rules? TNCs and codes of conduct,”

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.”⁴⁶ Significantly, the U.S. has never considered broadening the scope of its legal controls over MNCs based in the U.S. to govern other aspects of their conduct outside American borders. In addition to corruption, its legal controls over American MNCs primarily restrict their investments in a handful of countries on either national security or human rights grounds. For its part, the European Union did consider enacting a legally binding “Code of Conduct for European MNCs Operating Abroad,” but due to strong business opposition, it decided 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 that protect the welfare of their citizens and countries. 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

⁴⁵ Muchliniski, quoted in Newell, “Managing Multinationals,” p. 909

⁴⁶ Hugh Williamson and Michael Peel, “Nations ‘shamed’ over bribery,” *Financial Times* June 27, 2006, p. 4

inability or unwillingness of governments to adequately enforce them. Moreover, these governments often face trade-offs: for example, tighter or better enforced domestic labor or environmental standards could restrict foreign investment, thus reducing much needed capital inflows and domestic employment. Some developing country governments, fearful of discouraging investments from geographically mobile foreign firms, have either relaxed the enforcement of national regulatory standards or hesitated to impose more stringent ones. Equally importantly, some developing country governments restrict or discourage civic institutions, such as independent trade unions, that could play an important role in making firms more politically accountable. In the case of ‘failed states,’ public authority itself is problematic: many resource rich governments lack the capacity and in many cases, the interest, in protecting the welfare of their citizens. .

The growth of civil regulation reflects not so much an actual *decline* in the regulatory authority or capacity of governments. Rather it represents 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 either weak, limited, or non-existent, in part for the reasons noted above.⁴⁷ For example, forestry and fishing practices are not adequately regulated by many national governments nor are they effectively governed by international treaties. The same is true of labor standards. Likewise, some natural resource investments in developing countries have had adverse environmental and social impacts and the royalty payments from global firms are frequently squandered by corrupt local elites. Accordingly, “social movements, nongovernmental organizations, and corporations – civil society in other words - have come to

⁴⁷ 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

be seen as the ‘last best hope’ by those intent on providing public governance in pursuit of the common good and help for those in need.”⁴⁸

THE EMERGENCE OF CIVIL REGULATION

The fact that there is a governance deficit with respect to many important global business activities does not necessarily mean that new mechanisms will emerge to address it. Where have civil regulations come from? Who has initiated them? The organizational or institutional sources of civil regulations vary widely.⁴⁹ 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 in extractive industries to develop the Voluntary Principles on Security and Human Rights, the Fair Labor Association emerged from an initiative of the American Government, the Ethical Trading Initiative was organized by the British Government, and the German government promoted the Common Code for the Coffee Industry.

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

⁴⁸ Lipschutz with Rowe, *Globalization, Governmentality and Global Politics; Regulation for the Rest of Us?* p. 17.

⁴⁹ 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:

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. For example, Starbucks purchases a significant amount of global coffee production, Home Depot is the largest single purchaser of wood and wood products, McDonalds controls a major portion of global beef and chicken production, and Wal-Mart is the world's largest retailer. Changing the procurement policies and practices of such firms 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 strengthen national and international regulations along the dimensions noted above. For these global activists, engaging in politics through markets represents a viable alternative political strategy: lobbying corporations has often proven more efficient and effective than lobbying governments.

‘social markets’ extend the reach of democracy and popular sovereignty [creating] . . . new, potentially quite powerful mechanisms for expressing and aggregating civic, social and political preferences. Well-ordered social markets supplement conventional channels of political expression and popular control by creating distinctive arenas of governance in which citizens participate directly, through their market choices, in influencing the behavior of powerful economic entities often resistant to other forms of social control.⁵⁰

As noted above, some western governments, especially in Europe, have played an important role in promoting civil regulations.⁵¹ In addition to facilitating their formation and organization, some have provided financial support to private regulatory programs. Several European governments have indirectly promoted private, market mechanisms of corporate accountability by requiring companies that trade on their stock exchanges to issue annual reports

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

⁵⁰ Archon Fung, “Making Social Markets: Dispersed Governance and Corporate Accountability,” in *Market-Based Governance* John Donahue and Joseph Nye, Jr. eds. Brookings Institution Press, 2002 p. 150

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, issuing a Green Paper and several other official reports and communications, funding academic research and convening several conferences for companies and other stakeholders.⁵²

The strong support of many European governments and the EU for global civil regulation partially reflects the historic ties of many European governments to their former colonies. In addition, 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.⁵³ For many European governments, extending the scope of civil regulations represents a neo-liberal, global version of social corporatism or social democracy; it enables them to encourage or pressure global firms headquartered in Europe to behave more ‘responsibly’ in a world whose neo-liberal institutions and doctrines have limited their formal regulatory authority.

In this context, an important advantage of civil regulations as a global regulatory vehicle is that their labeling and certification provisions are not governed by the WTO, whose rules only apply to regulations formally adopted by governments. For example, while eco-labels are

⁵¹ See Francesco Perrini, Stefano Pogutz and Antonio Tencutti, *Developing Corporate Social Responsibility: A European Perspective* forthcoming 2006

⁵² 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

⁵³ 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

regarded by the WTO as (potential) technical barriers to trade, private product labels and certifications are not.⁵⁴ 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 market access. The reliance of civil regulations on private, market-based standards and enforcement thus represent a major ‘loophole’ in international trade law – one which European governments and NGOs chosen to exploit.

For the UN, the Global Compact provides a vehicle for this organization to address some of the criticisms of the social impact of economic globalization voiced by many activists and some developing countries. It is politically impractical for the UN to regulate global firms directly. Civil regulation represents a practical alternative strategy: the UN can work cooperatively with global firms to help promote global economic development and social justice – without antagonizing either these firms or the governments that support them. The voluntary CSR standards adopted by the OECD follow a similar logic. Both organizations primarily affect governmental policies through soft law; civil regulations essentially extend this same regulatory strategy to corporations. The same is true for the ISO, whose development of ISO 14001, an environmental process standard, logically flowed from its increasing focus on process standards.

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

⁵⁴ 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

more stringent plant safety standards following the chemical plant explosion at Bophal, India in 1984. An international ‘Code of Pharmaceutical Marketing Practices’ was adopted by global drug firms as a response to the imminent threat of public regulation at the international level, including by the World Health Organization.⁵⁵ The International Chamber of Commerce’s Business Charter for Sustainable Development was developed by global firms who feared that the 1992 Rio ‘Earth Summit’ would increase global environmental regulations.

But these examples are atypical. In most cases, 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, in the first place. 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. Nor did Shell attempt to improve its environmental and social practices in Nigeria because it was worried that the government of Nigeria would compel it to do so. Home Depot did not change its standards for the procurement of wood products because it feared that the governments of the United States or Chile would mandate more responsible forestry practices. The more than 2,000 firms who have signed onto the UN Global Compact did not do so in order to prevent the UN from adopting international 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 agreed to be bound by voluntary regulations? Many civil regulations have their origin in citizen campaigns directed against particular companies, industries and business practices. Such campaigns have proliferated over the last decade, focusing on such issues as working conditions and wages, child

⁵⁵ Karsten Ronit and Volker Schneider, “Global Governance Through Private Organizations,” *Governance* Vol. 12, no. 3, July 1999, p. 252

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. Often these public campaigns were initially directed at highly visible companies such as Nike, Home Depot, Shell, Ikea, C & A, the Gap, Nestle, Hennes & Mauritz, Rio Tinto, Freeport Mining, and Citibank, which then became public symbols of ‘corporate irresponsibility.’

Few of these public campaigns, even when accompanied by product boycotts, adverse media coverage, and pressures from the financial community, have adversely affected either the sales or share prices of targeted firms, or their ability to attract or retain employees.⁵⁶ Nevertheless, many firms have chosen to respond to them by adopting their own codes of conduct, negotiating with NGOs, and most importantly, by accepting civil regulations. Their motives are complex. Firms that market to consumers are highly risk averse: they are extremely sensitive 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.⁵⁷ 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 integrated into their risk management and public relations strategies. Finally, the values and concerns of critics of economic globalization are personally shared by some executives, particularly those managing corporations whose traditions and cultures have historically emphasized a strong commitment to CSR. They would like the firms they own or manage to play a more constructive role in addressing various global social and environmental problems.

⁵⁶ See Vogel, *The Market for Virtue*, chapter 3: “What is the Demand for Virtue?”

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. Thus if, for example, one apparel manufacturer is accused of employing child labor, the behavior of other apparel firms is also likely to become suspect. This is even more true in the case of an accident in a chemical or nuclear power plant. In the fine jewelry industry, when some diamond retailers were accused of selling 'blood diamonds' mined by warlords in conflict zones, the reputation of the entire industry was damaged. To the extent that the reputations in all firms in a particular sector suffer if any one of them acts less responsibly, all may benefit from adopting similar regulations. By agreeing to common standards, firms can also learn from one another and develop a clearer understanding of what is expected of them; they can also pool their resources to reduce the costs of compliance. As the *Financial Times* observed in describing the growth of industry wide social standards, "Industries seek safety in numbers."⁵⁸

⁵⁷ Gary Gereffi, Ronie Garcia-Johnson and Erike Sasser, "The NGO-Industrial Complex," *Foreign Policy* July-August 2001, p. 64

⁵⁸ Alison Maitland, "Industries seek safety in numbers," *FT Responsible Business, Special Report* November 18, 2005, p. 1

Students of management have long noted that ‘herd effects’ play a role in disseminating many management practices.⁵⁹ Such effects have also affected the pattern of business support for global civil regulations. The more firms in an industry that subscribe to a voluntary code, the more likely other firms may decide that it is also prudent for them to do so. This dynamic also operates at the industry level. The greater the number of global industries that agree to adopt voluntary codes, the more likely other industries will do likewise. The growth of civil regulations among global firms have created its own momentum: few global firms or industries headquartered in the U.S. or Europe want to be regarded as less ‘responsible’ or ‘enlightened’ than their peers.

Finally, as the literature on the spread of human rights norms for governments demonstrates, changes in norms can affect policy preferences.⁶⁰ “Corporate preferences are driven in part about norms about the appropriate approaches to [managing] a business.”⁶¹ For many highly visible global firms, engaging in some form of global CSR, including participating in voluntary industry codes, has become a business norm - an accepted component of managing a business in a more politicized global economy.⁶² The growth of civil regulation has not make firms less interested profit-maximization; rather many firms now regard it as appropriate to demonstrate their commitment to ‘good global corporate citizenship’ by subscribing to one of more business codes of conduct, as well as developing their own CSR programs.

A survey of more than 4,000 executives in 116 countries reported that, “eighty-four percent of respondents agree that high returns to shareholders should be combined with

⁵⁹ Marvin Lieberman and Sgigeru Asaba, “Why Do Firms Imitate Each Other?” *Academy of Management Review*, Vol. 31, no. 2. 2006, pp. 366-385

⁶⁰ *The Power of Human Rights: International Norms and Domestic Changes* Thomas Risse, Stephen Ropp, and Kathryn Sikkink, eds Cambridge University Press, 1999

⁶¹ Haufler, “Self-Regulation and Business Norms,” p. 201

⁶² For a fascinating 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

‘contributions to the broader public good.’”⁶³ Only a little more than a decade ago, a senior manager at Nike, when asked why he had not investigated claims about abuses in factories producing products for Nike replied, “I don’t know that I need to know They are our subcontractors. It’s not within our scope to investigate [allegations of labor violations.]”⁶⁴ In the current political climate, no manager working for a visible global firm with a substantial market presence in Europe or the United States would make such a public statement. According to John Ruggie a political scientist who helped develop the UN Global Compact, “the principle is taking hold that transnational firms . . . ought to be held accountable not only to their shareholders, but also to a broader community of stakeholders who are affected by their decisions and behavior.”⁶⁵

THE IMPACT OF CIVIL REGULATION

What has been the importance of civil regulation? Under what circumstances has it or is it likely to contribute to more effective governance of global firms, industries and markets? A useful way of answering these important questions is to discuss a few representative case-studies of the governance and impact 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 – and explores the factors underlying their varying impacts.

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

⁶³ Alison Maitland, “The frustrated will to act for public good.” *Financial Times* January 25, 2006, p. 10

⁶⁴ John Ruggie, “Reconstituting the Global Public Domain: Issues, Actors and Processes” Working Paper, Kennedy School of Government, July 2004, p. 21

⁶⁵ Quoted in Vogel, *The Market for Virtue*, p. 3

Two of the most important accomplishments of civil regulation have been to significantly reduce international trade in ‘conflict 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 US, the UN Security Council voted to prohibit the purchase of rough diamonds from UNITA a rebel groups, 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 De Beers, which dominates the global diamond market, indicated its full support for these measures and declared that it did not deal in conflict diamonds, several NGOs expressed concern that the system 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 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 19th century. KP brings together all major diamond producers and retailers, and diamond exporting and import countries, seventy of whom have signed the 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. In turn, numerous other countries agreed not to import non-certified diamonds, a trade restriction for

which they were granted a waiver by the WTO. While compliance by governments is not mandatory, each of the nations producing diamonds agreed to on-site monitoring. In 2004 KP expelled the Republic of Congo-Brazzaville, whose diamond exports were 100 times greater than its domestic production, effectively barring this country's diamond exports from international markets.

For their part, DeBeers and the major diamond retailers have cooperated in monitoring diamond purchases. 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 not perfect: some alluvial conflict diamonds from the Ivory Coast continue to reach international markets, packaged together with certified ones. Recently, NGO campaigners demanded an overhaul of Brazil's inspection system – one of the first allegations of non-compliance by a non-African country. They claimed that many of Brazil's KP certifications are fraudulent as it is selling large numbers of diamonds harvested from an indigenous people's reserve where mining is illegal.⁶⁶ Despite having been suspended by KP for a year, Lebanon appears to be again importing non-certified diamonds for its polishing industry. Nonetheless, despite their enforcement gaps, the KP has made substantial progress in addressing a major deficit in global economic governance: According to KP, its members account for 99.8 percent of all diamond production.⁶⁷ “KP stands as a positive example of active cooperation between governments, non-governmental organizations and the private sector.”⁶⁸

⁶⁶ Nicol Degli and Jonathan Wheatley, “Call to overhaul Brazil diamond certifications,” *Financial Times* March 3, 2006, p. 6

⁶⁷ Nicol Innocenti “Time to review the monitoring system,” *Financial Times* July 11, 2006, p. 2

⁶⁸ 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

Labor relations in Cambodia provide a second example of relatively effective private-public cooperation in addressing a governance deficit. 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.⁶⁹ 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 while assuring 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 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

⁶⁹ 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"

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.⁷⁰

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 had a common stake in adhering to the labor provisions of the trade agreement. The agreement thus essentially aligned the 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.

⁷⁰ Sandra Polaski, "Protecting Labor Rights Through Trade Agreements: An Analytical Guide," *University of California, Davis Law Review* Vol. 10, no. 13. pp.13-25

The US-Cambodia Textile Agreement formally expired with the end of the multi-fiber agreement. Yet the regulatory systems it established remains in place. The ILO will continue to supervise factory monitoring through 2008, when it hopes to pass on this responsibility to the Cambodian government, whose inspection capacities the ILO is working to strengthen. Financial support for inspections and training for factory managers now comes from the Cambodian government, the World Bank, various aid agencies from developing countries and the garment industry itself. 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.⁷¹

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.

An important advantage of the Cambodian textile labor regulation scheme over private labor codes is its uniformity. Apparel manufacturers in developing countries typically produce for multiple western suppliers. This means that a producer who wants to have its production certified as complying with private labor standards may face a multitude of corporate and

industry codes, each with its own standards and inspection systems. At the same time, western firms can choose which of the numerous private labor standards to which it wishes to adhere – and these vary considerably in terms of their scope, stringency and auditing practices.⁷² The result is a highly complicated and often confusing array of private standards.

By establishing one uniform code for all developing country suppliers and western manufactures and retailers, the Cambodian system significantly improves the efficiency of private corporate governance. Nonetheless, the Cambodian regulatory arrangement has yet to be duplicated 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 a given country in order to improve the efficiency of monitoring and enforcement, but to date no such agreements have been reached.

Moderately Effective Civil Regulations: Fair Trade and Forest Certification

In two other important cases of civil regulation, namely FairTrade Labeling International and the Forest Certification Council (FSC), the effectiveness of private global governance has been mixed, largely due to the limited number of producers affected by them. Both FT and FSC are market-based: they employ private labeling and certification to align the interests of western consumers with global producers. Each civil regulation 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.

⁷¹ 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

⁷² Ruth Pearson and Gill Seyfang, “New Hope or False Dawn? Voluntary Codes of Conduct, Labor Regulation and Social Policy in a Globalizing World,” *Global Social Policy* Vol. 1. no.1. 2002, pp. 49-78

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 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. FTI guarantees these farmers above world market prices for their products – a commitment that is financed by selling FT labeled coffee at a premium price.

FT exhibits both the strengths and weaknesses of consumer- based global governance. On one hand, there is a market for virtue: many consumers do purchase FT coffee, often out of a social commitment. A growing number of 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.⁷³ A total of 35,000 firms sell FT coffee in the U.S. and its sales have tripled since 1999, making it the fastest-growing segment of the specialty or premium coffee business. This sales growth has enabled FTI to increase the incomes of approximately 800,000 coffee growers. Sales of all FT products in the US have channeled \$67 million to FT farmers and farm workers since 1999.⁷⁴

⁷³ 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

⁷⁴ Jennifer Alserver, "Fair Prices for Farmers: Simply Idea, Complex Reality," *New York Times* March 16, 2006, Business Section, p. 5

On the other hand, the economic impact of FT is limited by the extent of 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 coffee still represent less than one per cent of both American and global coffee sales, which means that only a small proportion of coffee growers can benefit from it. A variety of other social- product labels such as for rugs, and organic products from developing countries also have emerged, but they too operate in niche markets, primarily selling high-end goods to affluent, less price-conscious consumers. Accordingly, while ethical labels have benefited some producers in developed countries, their overall economic impact remains relatively small.

Forestry regulation provides a second example of the strengths and shortcomings of market-based civil regulation. Following several years of negotiations among foresters, scientists, and firms, the Forest Certification 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 headquartered in Mexico.⁷⁵ Its goal is to create a global market for wood harvested in a socially and environmentally sound manner by providing business incentives to support certification by both forestry firms and those who sell or use wood products. 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.

⁷⁵ 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*.

While originally conceived as a product labeling scheme, relatively few wood products sold to consumers are actually labeled. 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 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 global CSR; many agreed to do so only after extensive grass-roots pressures from activists, often accompanied by actual or threatened boycotts. For some builders, using FSC certified wood products has become a component of their green corporate image and marketing. FSC has been successful in persuading major American and European wood or wood product retailers, including Home Depot, Lowe's Home Centers, Kinkos, SCAM (a Swedish paper company), and IKEA, as well as Turner Construction, the largest American construction company, to give preference to or exclusively purchase FSC certified wood products. Globally, approximately 600 firms have joined global and forestry trade networks that commit them to buying only FSC certified wood. Several European governments as well as some American states have established procurement policies that either favor or require FSC certified wood.

If FT's challenge is insufficient consumer demand, the FSC's most formidable challenge is the insufficiency of supply. While some forestry owners are willing to become certified in order to gain preferential access to retailers or construction companies, for many forestry firms FSC certification is too expensive and burdensome, especially as certified products rarely command a price premium. As a response to FSC, more than forty industry-dominated alternative certification schemes have been developed whose requirements are generally less

stringent that those of FSC.⁷⁶ 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%.⁷⁷ 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 the number of chain of custody certifications increased from 268 in 1998 to 4,500 in 2006.⁷⁸ 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 has undoubtedly improved the social and environmental practices of forests in Europe and North America both directly, and indirectly by encouraging the formation of business forestry codes, some of whose standards have been strengthened to compete with FSC. 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. Thus the limited geographic scope of private forestry certification has limited its ability to adequately address what is arguably the most critical forestry governance failure, namely the accelerating rate of tropical deforestation.⁷⁹

Ineffective Civil Regulations: Royalty Payments and Corruption in Resource Dependent Developing Countries

⁷⁶ 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

⁷⁷ Phillipp Pattsberg, "The Influence of Global Business Regulation: Beyond Good Corporate Conduct," *Business and Society Review* Fall 2006, p. 247

⁷⁸ *Ibid*, p. 248

⁷⁹ 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

One of the most critical global governance deficits is associated with 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 world's most impoverished.⁸⁰ In 2002, a global coalition of 200 NGOs launched a 'Publish What You Pay' (PWYP) campaign whose purpose was to pressure global firms in extractive industries to reveal their royalty payments to host country governments. This advocacy campaign effort was subsequently supported the Extractive Industries Transparency Initiative (EITI), spearheaded by the British Government. Its goal was to reduce corruption by having governments agree to disclose the royalty payments they received and establish accounting systems to prevent their misuse.

The results of both voluntary initiatives have been disappointing.⁸¹ While seven global oil companies – all based in Europe or the U.S. – agreed to disclose their payments, to date their disclosures have been limited, largely due to realistic concerns that doing so would anger host country governments. For example, when British Petroleum announced that it would disclose its royalty payments to the government of Angola that government threatened to terminate BP's exploration rights. Nearly twenty countries have agreed to sign on to EITA, though do date only two, Nigeria and Azerbaijan, have actually complied with its terms. Significantly, no Latin American country, OPEC member state, or India or China has endorsed EITA. An equally striking limitation of PWYP is that no state-based global energy firm has endorsed it, even though such firms, as well private energy firms based in the Soviet Union and Asia, account for a

⁸⁰ 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

⁸¹ Peter Davis, "Extracting Transparency Promises," *Ethical Corporation* May 2005, pp. 35 - 36

growing share of foreign investments in this sector, especially in Africa.⁸² These limitations severely compromise the effectiveness of any global effort to reduce corruption. Most obviously, resource-rich governments that benefit from the misuse of royalty payments can offer 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 experiences of Exxon in Chad. In 1998, an unprecedented agreement reached between the government of Chad, one of the world's poorest and most corrupt countries, and the World Bank, which helped finance the \$4.2 billion investment project, and several NGOs. It 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.⁸³ 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.⁸⁴ It took a portion of the funds held in trust for development and allocated them to military spending. The World Bank subsequently renegotiated the agreement, increasing the percentage of revenues under control of the Chad government. But even those funds allocated to community development appear to be having little social impact, in part due to pervasive corruption at the local level. The Chad case illustrates an important limitation of global civil regulation, namely the difficulty of promoting more responsible corporate practices when

⁸² See for example, Andrew Yeh, "China ventures on rocky roads to trade with Africa," *Financial Times*, June 20, 2006, p. 2

⁸³ Jerry Useem, "Exxon's African Adventure," *Fortune*, April 15, 2002, pp. 102-114

⁸⁴ 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

the objectives of civil regulations are not supported by host country governments, or are taking place in countries that lack a viable civil society.

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 markets are inherently incapable of addressing governance failures.⁸⁵ But any realistic assessment of civil regulation must compare it not to an ideal of effective global economic governance, but to actual policy alternatives. When compared to legally binding regulations by governments in developed countries, civil regulation is clearly less effective. Civil regulations exhibit many of the well-documented shortcomings of industry self-regulation at the national level.⁸⁶ But the effectiveness of many civil regulations is certainly comparable to that of many inter-governmental treaties and agreements – whose achievements with regard to environmental protection, labor practices and human rights are also highly uneven.⁸⁷ In a number of cases, most notably with regard to labor standards and forestry, civil regulations have been considerably *more* effective than inter-governmental treaties, though their scope is more limited: they primarily affect the way branded products exported to highly visible western firms are produced. This means, for example, that in the case of labor standards, they only affect enclaves of production in developed countries; only 3% of workers in developing countries work in the textile export sector. However, for all their shortcomings, civil regulations are undoubtedly more

⁸⁵ For the former, see, for example, Andrew Savitz, *The Triple Bottom Line* Jossey-Bass, 2006. For the latter, see Lipschutz and Roew, *Globalization, Governmentality and Global Politics*

⁸⁶ 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

⁸⁷ See fn. 16

effective than the labor, human rights and environmental regulations of many developing countries. In some sectors in some developing countries, they constitute the only effective form of business regulation.

In sum, civil regulations have *partially reduced* the governance deficits 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 relatively recently, which means that their impact could possibly increase.

What would it take to make civil regulation a more effective form of global economic governance? Two factors appear critical. First, the business case for compliance with civil regulations would need to be strengthened.⁸⁸ For all the 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 produces few financial benefits. (FT branded products are a notable exception.) This means that these firms have every incentive to do as little as possible to accommodate the demands of their western contractors and many have an adversarial relationship with private inspectors, thus complicating the latter’s compliance efforts. As the experience of many developed countries has demonstrated, better labor standards or improved environmental practices can make long-term business sense. Some developed country producers are beginning to recognize this; many do not. A similar logic holds for western firms, most of whom have agreed to civil regulations for defensive reasons or because it is expected of them, not because of its demonstrated financial benefits. While some firms have integrated the standards of civil regulation into their core business practices, most have not. As long as more ‘responsible’ global firms do not enjoy stronger financial performance than their less responsible

⁸⁸ 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?”

competitors, the incentives of firms to invest sufficient resources into assuring compliance with corporate or industry codes will remain limited, and the incentive of some firms to free ride on industry codes will remain a serious problem.

The second critical determinant of the future impact of civil regulation is the relationship of developing country governments to them. Some developing country governments, such as Cambodia, recognize the value of civil regulation; others, such as Chad, do not. In the case of FSC, the pattern is more mixed: some developing country governments closely cooperate with its efforts, while others are indifferent to them.⁸⁹ Most developing countries tend to be indifferent to voluntary labor standards, with the important exception of China whose laws do not permit local firms to comply with labor codes protecting the right of workers to establish independent unions. In the long-run, civil regulations need to be more closely integrated into the domestic regulatory policies and the competitive strategies of developing country governments if they are to become more effective.⁹⁰

⁸⁹ 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

⁹⁰ 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