

Regulating Corporate Behaviour

Introduction

The need to regulate the corporate behaviour of transnational corporations (TNCs) is well acknowledged now. However, whether there should be self-regulation by companies or whether there should be codes of conduct drafted by inter governmental organisations or citizens groups is a widely debated issue. There is a belief that left to themselves, TNCs will not adopt self-regulation effectively.

Recently, Dr. Supachai Panitchpakdi, who will take over as Director-General of the World Trade Organisation (WTO) on 1 September 2002, also spoke out in favour of new codes of conduct for TNCs. Panitchpakdi feels that such codes should have tough rules to curb corporations' influence over world's trade policy making process. Codes will not just prevent undue influence of TNCs over the world's trading system but also regulate the companies' business behaviour. Panitchpakdi's statement has brought the issue of conduct codes to the forefront once again.

TNCs operate across borders, are generally large in terms of assets or sales with headquarters in developed countries. Their asset base and scale of operations allow them to exploit economies of scale and divide the production process across borders taking advantage of differences in factor costs in different countries. There is no conclusive evidence whether these attributes give them power and influence over national governments. But the belief that TNCs are more powerful than host developing countries has given rise to demand for codes to regulate the behaviour of TNCs.

Panitchpakdi, in his address to UNCTAD's Mid-Term Review Conference in Bangkok (29 April-3 May 2002), referred to sizes of some TNCs, which are larger than that of many countries. The size factor, he said, should not be of concern, if TNCs behave in a manner as to become a part of the development goals. He pointed out that often conflicts arise due to a lack of understanding and transparency, and inconsistencies between policies of TNCs and that of host countries.

The past few months witnessed a number of accounting scandals of American corporate giants. First, the US energy corporation Enron, was accused of lying about its profits and was found involved in a number of shady deals. The accountancy firm Arthur Anderson helped Enron in this malpractice. Following Enron more scandals have been exposed. The telecom giant WorldCom recently disclosed that it misrepresented billions of dollars in expenses. Subsequently, the printing and photocopying giant Xerox also admitted of financial wrong doing: the company misrepresented revenues by \$5bn during the last five years.

Due to these events, the public confidence in corporate America is at its lowest at present. The suspicion is that other countries are not free from such corporate mal-practices and people are demanding effective measures to regulate general corporate behaviour. At present there is no global code to regulate corporate behaviour. A number of codes were drafted by international organisations in the past few decades, such as the United Nations (UN) and the Organisation for Economic Co-operation and Development (OECD), as well as by individual governments. Other stakeholders such as shareholders and consumers have also drafted a number of codes since the late 1970s. Many companies have also adopted their own codes.

This briefing paper looks at the history of international investment agreements, as codes of conduct are usually discussed with reference to such agreements, broadly discusses the general principles found in different codes, outlines the debates surrounding the codes and argues for mandatory codes of conduct for TNCs.

Genesis of Investment Agreements

The history of the codes and the debate on their principles and provisions has been moulded by global, political, economic and social events over a period of more than a hundred years.

During the nineteenth century there was no effort to regulate international investment, most of which was indirect i.e. loans and floating of government bonds. There were two principles of public international law, which governed any attempt to regulate the behaviour of foreign companies.

- The principle of territorial sovereignty, asserting each state's full and exclusive jurisdiction over persons and events in its territory, and
- The principle of nationality, involving each state's interest in the proper treatment of its nationals abroad.

At the turn of the century, while the capital importing developing countries referred to the first principle, the capital exporting countries referred to the second one. The former insisted upon treating these companies at par with their domestic companies while the latter insisted that treatment of foreign companies should conform to a minimum international standard, which governs foreigners.

At the end of the Second World War, attempts were made to incorporate international principles governing foreign direct investment (FDI) into the Havana Charter (1948). The charter envisaged provisions to safeguard investors' interests and special safeguards for developing, especially Latin American, countries. The charter failed because the provisions strongly conflicted with investors' interests in developed countries mainly in the US.

During the first three decades after the Second World War, the perception of FDI among developed countries was that it was useful and beneficial, but needed to be regulated by national laws. Though as early as the 1960s, several bilateral investment treaties were signed and proved to be successful, they mainly proliferated in 1980s and 1990s.

Growth of Codes for Regulation of Business

The structure and role of TNCs was discussed for the first time in the late 1950s and the early 1960s. Experts differed in their views regarding the effects of operations of TNCs. There were three prominent views:

- transfer of technology and know-how by TNCs is beneficial for an economy;
- TNCs are monopolistic entities that grow by exploiting host economies by virtue of their competitive advantage in technology and bringing economic dislocation; and
- TNCs threaten a nation's cultural and political freedom through the influence they are able to exercise on a nation's leadership and public opinion.

All these resulted in a polarisation of views on TNCs and gave rise to several debates regarding FDI.

With the growth in knowledge and experiences of the operations of TNCs, opinions became less partisan and more informed. In many developing countries,

attempts were made to regulate the entry and operations of TNCs.

The first international codes of conduct for TNCs, which were legally non-binding, were established in the 1970s, with the lead being taken by the OECD in 1976. The OECD's council adopted a declaration on International Investment and Multinational Enterprises, which included a set of non-binding Guidelines for Multinational Enterprises.

The guidelines addressed businesses rather than host governments, while respecting host government's national policies and regulations, and established an international standard of proper conduct. The guidelines are still valid and were revised in 2000. A more comprehensive draft was prepared by the United Nations Centre for Transnational Corporations (UNCTC) in the form of draft Codes of Conduct for Transnational Corporations in 1977.

A key event in the drive for a code of conduct for TNCs was the alleged involvement of a TNC in the Chilean coup d'état in 1973. This sparked off a campaign to introduce a set of binding codes for TNC behaviour at the UNCTC. However, even after lengthy discussions and keeping a number of points open (especially in regard to host country obligations) the codes could not be adopted, even in a non-binding form.

The negotiations for codes of conduct, though not very successful, were helpful to the common understanding of appropriate codes of conduct to regulate investors' behaviour and for building public opinion in this regard. Though most of the debate surrounding the codes was concentrated on the host countries' competencies in regulating the behaviour of TNCs with their national laws, in some cases it went beyond national laws and regulations.

The debate gave rise to the idea that it is possible to establish international principles to regulate irresponsible TNC behaviour. There were situations when the need for such principles was acutely felt. However, opinions about what the guiding principles of the codes should be varied widely.

Box 1: Types of Violation of Codes

Most of the violations by companies of codes of conduct are related to

- Excessive working hours;
- Underpayment;
- Denial of the freedom of association;
- Suppression of trade union organisations;
- Inadequate occupational health; and
- Safety standards.

Source: Thai Labour Campaign (<http://www.thailabour.org>)

Growing Awareness among Companies and Consumers

TNCs have now recognised the importance of maintaining ethical standards in matters of sales, recruiting and retaining employees and boosting staff morale. In recent years several initiatives to adopt and effectively implement

codes have been taken by companies. For example, Nike and Mattel established Global Alliance, which has formed focus groups and has been conducting interviews with Asian workers in an attempt to enforce labour standards.

There is also a growing consumer concern about the impact of globalisation, particularly in developing countries, which has forced many corporations to adopt high standards in their behaviour at home as well as in host countries. Consumers and civil society groups have engaged in boycotts, negative publicity campaigns, and other activities, to force corporations to address such issues as poor labour conditions in their factories in developing countries or damage to the environment due to their activities.

Such campaigns include the anti-sweatshop campaigns conducted by the Fair Labour Association against Nike and other apparel manufacturers. In recent times, consumers have also boycotted the products of companies like Nestle and Shell in objection to their production or marketing practices.

Principles and Codes Drafted by International Bodies

The numerous attempts by international bodies to guide economic activity across borders, which directly or indirectly govern the behaviour of TNCs can be broadly grouped into three:

- The enunciation of broad principles of rights and duties such as the UN Universal Declaration of Human Rights. These are general principles addressing all sectors of

- society. They may not translate directly into policies or actions, but they help to shape norms at the global level;
- Sets of guidelines or rules for TNCs such as the Draft Code of Conduct for TNCs or the OECD Guidelines for Multinational Corporations mentioned earlier; and
- Sector or issue specific guidelines such as the International Chamber of Commerce's (ICC) Rules of Conduct on Extortion and Bribery in International Business Transactions, the ICC Business Charter for Sustainable Development, and the various ICC marketing and advertising codes.

An important point to be noted is that none of these codes is binding, although the OECD Guidelines do have an implementation mechanism. Table I classifies some codes and principles drafted by international organisations and in Table II, we look in briefly at the features of selected codes.

Annan's Message: The Global Compact

In his address to the World Economic Forum on 31st January 1999, the UN Secretary General Kofi Annan urged the global business community to adopt codes of conduct based on the observance of human rights, labour rights and environmental protection.

The Global Compact is a recent initiative by Annan, which draws attention to the link between the activities of TNCs and the fundamental principles of the Universal Declaration of Human Rights. It also draws from the ILO declaration on fundamental principles and rights at work and the Rio Declaration of the UN Conference on Environment and Development.

Table 1: Selected International Principles and Codes Governing TNCs

GENERAL STATEMENTS OF PRINCIPLES		Year
The UN Universal Declaration of Human Rights		1948
The ILO Declaration on Fundamental Principles and Rights at Work		1998
The Rio Declaration on Environment and Development and Agenda 21		1992
The Copenhagen Declaration on Social Development		1995
BROAD CODES OF CONDUCT		
The OECD Guidelines for Multinational Enterprises		1976, revised in 2000
The Global Sullivan Principles		1976
United Nations Centre for Transnational Corporation Draft Code of Conduct for Transnational Corporations		1977, abandoned in 1992
The ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy		1977
The Caux Principles drafted by a coalition of senior business executives from North America, Japan and Europe		1986
SECTOR/ ISSUE SPECIFIC GUIDELINES		
The ICC Rules of Conduct on Extortion and Bribery in International Business Transactions		Signed in 1997, Entered into force in 1999
The ICC Business Charter for Sustainable Development		Adopted in 1990
<i>Source: UNCTAD Series on issues of international investment agreements.</i>		

Table 2: Comparison of Codes of Conduct

Codes/Principles	Year of Drafting	Main Features
Global Sullivan Principles <i>(First drafted for employment practices in South Africa under the apartheid regime)</i>	1976	<ul style="list-style-type: none"> • Framed by the businesses • Directed towards the businesses • Includes the principles on <ul style="list-style-type: none"> ◆ labour; ◆ property rights; ◆ fair competitive policy; ◆ transparency in the enterprises operations; and ◆ disclosure of proper information
OECD Guidelines for MNEs	1976	<ul style="list-style-type: none"> • Framed by the Organisation for Economic Co-operation and Development (OECD) • Directed towards the businesses • Includes some general as well as specific guidelines • Includes clauses on <ul style="list-style-type: none"> ◆ the disclosure of information;, ◆ employment and industrial relations; ◆ employment; ◆ combating bribery; ◆ consumer interests; ◆ science and technology; and ◆ competition and taxation.
Draft UN Code of Conduct on TNCs	1977	<ul style="list-style-type: none"> • Framed by the United Nations Centre for Transnational Corporations (UNCTC) • Directed towards TNCs • Includes clauses on <ul style="list-style-type: none"> ◆ a nation's sovereign rights; ◆ adoption of fair business practices; and ◆ the need for proper disclosure of information on the enterprises.
ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy	1977	<ul style="list-style-type: none"> • Framed by the ILO • Directed towards governments, workers and employers organisations and transnational enterprises • Includes clauses on <ul style="list-style-type: none"> ◆ employment; ◆ training; ◆ conditions of work and life; and ◆ industrial relations • But does not include any clause on the environment
The Caux Round Table Principles	1986	<ul style="list-style-type: none"> • Drafted by a coalition of senior business executives from North America, Japan and Europe • Directed towards the businesses • Includes general and stakeholders principles • Includes clauses on <ul style="list-style-type: none"> ◆ responsible business behaviour; ◆ labour; ◆ the environment; ◆ respect for rules; ◆ support for multilateral trade; ◆ avoidance of illegal operations; and ◆ respect for the dignity of customers, investors, suppliers, communities and competitors

The Global Compact brings together all the relevant actors, including governments, TNCs, and labour and civil society organisations, and calls for the participation of all of these groups. This provides a useful framework for an approach to the challenge of formulating effective and implementable guidelines for the behaviour of TNCs.

Enforceable or Nonenforceable Codes?

There are usually two kinds of opposition to the codes from different groups, which have weakened their implementation. One is raised by consumer organisations, which consider the codes as weak because they are non-binding. The other comes from businesses, which consider even the non-binding codes as impediments to their activities.

There are many codes, rules or principles in existence that do not have binding force but which do have some influence on economic decision-making and considerable moral force.

A recent example is the Agenda 21 of the multilateral agreement of the Rio de Janeiro Earth Summit. This non-binding agreement provides guidance to businesses on environmental matters. So there should not be any problem with non-binding codes of conduct to govern the behaviour of TNCs.

The problem with non-binding codes, however, is that many TNCs and governments who lack firm commitment to rights enforcement are attracted to the codes precisely because they are unenforceable.

Opposition to making the codes binding has, not surprisingly, come from the TNCs themselves. TNCs argue that a uniform set of codes would not take into account the fact that the cultural and business environments of host countries vary widely and that the decision to adopt codes must rest with the companies only.

A serious intergovernmental dispute arose in the early 1990s between the OECD and the Group of 77 Developing Countries (G-77) regarding the codes. The G-77, on the one hand, advocated the adoption of binding codes including the right for governments to regulate corporate behaviour, and an unqualified prohibition of TNC interference in domestic affairs.

The OECD, on the other hand, advocated non-binding codes, which would take recourse to international law to ensure the fair treatment and protection of the legitimate activities of TNCs, and a qualified prohibition of TNC activities in internal political affairs.

The developments in other fora during this time reflected this debate. In 1990, some major changes were made in

Box 2: Violations in the Thai Apparel Industry

- Apparel industry face major problems of violations of codes of conduct. The codes of conduct state that workers have rights to freedom of association and collective bargaining.
- A US Department of Labor Survey found that 36 of 42 companies, which responded, adopted corporate codes of conduct, statements of principles, or compliance certificates specifically addressing child labour in overseas production.
- In companies such as Par Garment and Lian Thai and in other sweatshops in Thailand, several cases of denial of basic rights to workers have come forward.
- Workers, who are employed by sub-contractors, are
 - ♦ Under-paid.
 - ♦ Forced to work long hours without any additional pay or social welfare.
 - ♦ Consists of a large number of children employees.
 This happens because the sweatshops are unregistered and thus do not fall within local labour law.
- It is difficult to make apparel manufacturing companies follow codes of conduct. A company produces goods of a number of brands e.g. Adidas, Reebok or Nike.
- Aim of TNCs is to sell a good at the cheapest price possible, they are not willing to ask manufacturers to follow codes of conduct, as that would increase costs. While, workers suffer, companies enjoy increasing revenues and productivity.

Source: International Labour Organisation, <http://www.sweatshopwatch.org/swatch/campaigns>.

the UN draft code. Some of the strict prescriptive clauses were replaced by a set of unenforceable principles, which would serve as an ethical code for business. In February 1992, the UNCTC itself was abolished and its activities were transferred to a new division on Transnational Corporations and Management.

Despite the encouraging moves made by many companies towards raising their standards of behaviour, especially in developing countries, there are strong arguments for a binding international code of conduct, which are:

- It would increase pressure on firms to monitor the activities of their subsidiaries in developing countries closely, which do not often take place at present.
- It would ensure that firms would not be able to escape the standards, which are more costly and difficult to implement e.g. environmental standards in resource seeking industries.

Possible Measures by Governments and the Civil Society

The first step in regulating TNC behaviour must be made at the national level. Developing host country governments must ensure that the appropriate national policies governing reporting obligations of firms, transparency, corruption, and labour and environmental standards are in place.

There is an important role for the governments of home-countries of TNCs. Home country governments should adopt laws and regulations to govern the operations of TNCs in host countries, especially with regard to transparency and labour and environmental standards, so that firms have to maintain the same high standards in its units in home as well as in host countries.

Box 3: Adoption of Codes in the Defence Industry

- There were a number of defence industry scandals in the US in the 1980s. There were also several scandals on Wall Street around this time. All these led to the adoption of corporate ethical codes by a number of companies.
- Companies viewed business ethics as a way of promoting self-regulation, and deterring intervention by government or any other outside agency.
- Companies such as General Electric, General Dynamics and Martin Marietta (presently Lockheed Martin), which experienced procurement scandals, were among the first to adopt corporate codes.
- The *Defence Industry Initiative on Business Ethics and Conduct* (1986), which declares that each of the companies will review its ethical practices annually, was signed by 17 defence contractors.

Source: International Labour Organisation (<http://www.ilo.org>)

- Contribution to the local economy in various ways such as training the local labour force and forming supplier links with local firms etc.

Conclusion

The share of TNCs in the world FDI flow has rapidly risen in the last decade. TNCs often bring in the much needed advanced technology, efficient managerial practices and foreign capital in developing countries. The influence of these companies has also increased dramatically during this period.

A number of instances of misconduct by TNCs have been reported in the last few years. The idea that the behaviour of TNCs could be regulated has been evolved since the 1950s and the discussions on adoption of a binding or non-binding set of codes took place for the first time in 1970s. Several debates have taken place since then on the nature and details of the codes.

Civil organisations in home countries too have a role to play in making people aware about conducts of TNCs in host countries and in creating public opinion on ethical codes. These organisations could work in close co-ordination with home-country governments in formulating codes, and ensuring that the political process in the country is relatively free from the influence of TNCs and instances of TNC mis-conducts are not overlooked.

A set of enforceable guidelines should be a necessary counterpart to the obligations and restrictions imposed on governments and businesses in any potential international investment agreement. Investors and host countries could gain from such an agreement if the agreement includes clauses on security and better investment opportunities as well as provisions containing social, economic and environmental protection for host countries, especially developing ones.

In order to meet the needs of developing countries, codes of conduct should include clauses covering the following issues:

- Corporate disclosure rules;
- Accountability through corporate governance structures to various stakeholder groups;
- Ethical responsibility in relation to such matters as illicit payments, advertising, and product safety and quality;
- Transparency in transfer pricing;
- Restrictive, abusive and unfair business practices;
- Labour and environmental standards;
- Technology transfer;
- Commitments to respect national laws;
- The promotion of the local entrepreneurship; and

Several unsuccessful attempts have been made by international organisations to adopt codes of conduct. Some issue specific guidelines for corporations are already in operation for some time now such as the ICC Rules of Conduct on Extortion and Bribery in International Business Transactions. Ultimately the aim is to have a comprehensive set of guidelines, which would be enforced by a single international agency.

Any international investment agreement should include codes for TNCs with effective enforcement mechanism, which will prevent exploitation of developing countries by TNCs.

Many business groups and companies have adopted codes voluntarily since the 1970s to maintain their ethical image mainly under pressure from consumer organisations and media. However, the concept of ethical codes is not new to companies; as early as 1943, for example, Johnson & Johnson adopted such codes by publishing *Credo*.

Consumers and the media should be made aware of the utility of codes in regulating business behaviour of TNCs. Civil society has to be more active in spreading awareness and building public opinion on issues of mis-conducts of TNCs and the need and effectiveness of an international legally-binding codes of conduct.

Individual governments in developed and developing countries have a special responsibility in drafting codes applicable to both the foreign and domestic companies in their territories and enforcing them effectively, which could be achieved by co-operating and collaborating with other governments.

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