



DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS

**Private Initiatives for Corporate Responsibility:
An Analysis**

February 2001

*This paper will form part of a forthcoming OECD publication entitled **Corporate Responsibility: Private Initiatives and Public Goals** which will be published in May 2001. The contents have been discussed by the Committee on International Investment and Multinational Enterprises and the publication will be released on the authority of the Secretary General of the OECD.*

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and the Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

© OECD 2001

Permission to reproduce a portion of this work for non-commercial purposes or classroom use should be obtained through the Centre français d'exploitation du droit de copie (CFC), 20, rue des Grands-Augustins, 75006 Paris, France, Tel. (33-1) 44 07 47 70, Fax (33-1) 46 34 67 19, for every country except the United States. In the United States permission should be obtained through the Copyright Clearance Center, Customer Service, (508)750-8400, 222 Rosewood Drive, Danvers, MA 01923 USA, or CCC Online: www.copyright.com/. All other applications for permission to reproduce or translate all or part of this book should be made to OECD Publications, 2, rue André-Pascal, 75775 Paris Cedex 16, France.

TABLE OF CONTENTS

Executive Summary	4
I. Introduction.....	6
II. The record to date	8
II.1 Consensus -- a basic building block for the effective control of business conduct	10
II.2 Expertise: human capital and the social control of organisations.....	13
III. Costs and benefits of voluntary initiatives	14
III.1. The benefits for firms	15
III.2. The benefits to society	16
III.3 The effectiveness of voluntary initiatives: Do they change company behaviour?	17
III.4. Voluntary initiatives in a broader governance context	19
III.5. Cost uncertainty and unintended consequences.....	20
IV. Implications for International Economic Policy	22

Private Initiatives for Corporate Responsibility: An Analysis

Executive Summary

1. Voluntary initiatives in the area of corporate responsibility have been among the major trends in international business in recent years. Business surveys show that most large OECD-based multinational enterprises have participated in this trend in one way or another. These initiatives involve, first, the issuance of codes of corporate conduct setting forth commitments in such areas as labour relations, environmental management, human rights, consumer protection, disclosure and fighting corruption. These codes are often backed up by management systems that help firms respect their commitments in their day-to-day operations. More recent developments include work on management, reporting and auditing standards and of the emergence of supporting institutions (e.g. professional societies, consulting and auditing services).

2. This paper analyses the results of a fact-finding project on business approaches to corporate responsibility (see OECD/DAF/IME(2000)15 and its annexes). In so doing, it places the corporate responsibility in its broader governance setting, recognising that voluntary initiatives have a crucial, but necessarily only partial, role to play in the effective control of business conduct.

3. The paper also looks at the contribution that voluntary initiatives have made to the accumulation of two types of intangible capital that are needed to make legal, regulatory or voluntary systems of behavioural control effective. The first of these is consensus -- the widespread agreement or consent of the people and organisations covered by the controls. Consensus promotes what has come to be known in enforcement circles as “voluntary compliance”, that is adherence to behavioural norms that is not due to formal enforcement. The second is the managerial expertise that allows firms to translate general principles into coherent behaviour and response for the organisation.

4. The key findings are as follows:

- *Global phenomenon.* Voluntary initiatives are a global phenomenon, but there are significant intra-regional variations in practice.
- *Some initiatives are more voluntary than others.* Although the initiatives are often referred to as “voluntary”, some firms are under strong pressures to adopt them. Such pressures stem from legal and regulatory arrangements, from employees, from the need to protect brand or reputation capital and from civil society. For other firms, however, such pressures can be weak (e.g. for those with low public visibility).
- *Divergences of commitment and management practice.* There appear to be wide divergences of commitment even in relatively narrowly defined issue areas (e.g. labour standards in branded apparel, environmental and human rights commitments by extractive industries, fighting bribery). This is not necessarily a problem, since there can be no “one-size-fits-all” approach to commitment in business conduct. On the other hand, they may point to a need to continue the public debate on what exactly constitutes appropriate behaviour for the different ethical challenges that confront international business. Similarly, management practices in support of commitments vary significantly. Some firms have adopted advanced practices while others have yet to translate their codes into management controls.

- *First steps toward an eventual consensus on global norms for business conduct.* The corporate responsibility movement has provided a channel through which various actors -- businesses, business associations, governments, trade unions, intergovernmental organisations and NGOs -- can debate various standards of commitment. The amount of dialogue and mutual influence among these actors has been significant.
- *Accumulation of managerial expertise in ethical and legal compliance.* Voluntary initiatives in corporate responsibility have promoted the accumulation of the management expertise needed to translate legal compliance and ethical norms into the day-to-day operations of companies. The institutional supports for this expertise -- management standards, professional societies, specialised consulting and auditing services -- help lower the costs of legal and ethical compliance as well as making it more effective. Non-financial auditing and reporting standards are a more recent phenomenon and they are still relatively weak.
- *The costs of voluntary initiatives for corporate responsibility.* The fact-finding project contains little information on the costs of these initiatives in specific business settings because little is available. It is expected that, as experience with the initiatives grows, businesses will add to their knowledge of both costs and benefits. Uncertainty also gives rise to the possibility that corporate responsibility initiatives will have “unintended consequences”. In particular, this means that well-intended initiatives occasionally have adverse, unforeseen effects. This risk underscores the need to proceed carefully and with adequate knowledge of local circumstances.
- *The benefits for individual companies and for society.* The benefits of these initiatives for firms are potentially numerous. They include improved legal compliance, management of litigation risks, brand and reputation enhancement and smoother relations with shareholders and with society. Some initiatives have also allowed industries to deflect calls for formal regulation. Finally, companies use the initiatives to improve employee morale and to promote a “culture of integrity” within the firm. Societies gain inasmuch as these initiatives reflect business sector attempts to translate external pressures for corporate responsibility (law, regulation, public opinion) and internal pressures (coming from employees) into concrete business practice.
- *The effectiveness of voluntary initiatives.* It is clear that an informal system based on only word of mouth or direct hierarchical control would not be sufficient to allow large, complex companies to respect their legal and ethical commitments. These companies need to communicate effectively with thousands of employees and to use diverse compliance tools -- effectively deployed in a coherent management system. Private initiatives are the expression of managerial expertise that allows companies to blend profit pressures with non-financial pressures into coherent business activity and response. However, in the non-financial dimension, these initiatives have no more credibility or force than the social, legal and regulatory pressures that shape them. If private initiatives are successful, this attests not only to the competence of the business community, but also to the abilities of societies to formulate, communicate and channel reasonable pressures for appropriate business conduct. Thus, the effectiveness of these initiatives is closely linked to the effectiveness of the broader systems of private and public governance from which they emerge -- private initiatives cannot work well if other parts of the system work poorly.
- *A role for the OECD Guidelines for Multinational Enterprises.* As the only multilaterally endorsed comprehensive code of conduct, the Guidelines have an important role to play in this ongoing process. The Guidelines institutions could be used to strengthen and encourage the emergence of consensus and to contribute to the accumulation and dissemination of expertise.

I. Introduction

Voluntary initiatives in the area of corporate responsibility are among the major trends in international business in recent years. The initiatives include the issuance of codes of conduct, the implementation of associated management systems and, more infrequently, the adoption of special reporting practices.

There is a considerable disagreement about how meaningful these initiatives are. Some view them as the first tentative steps toward global convergence of business practices, while others see them primarily as a public relations effort by the business community.

5. As globalisation has broadened and deepened the ties linking the world's regions, the concern that the benefits of globalisation for business should be matched by requirements for responsible behaviour has been repeatedly expressed in public discussions. Although there is little agreement about the exact content and form of such requirements, a number of public and private responses have emerged. Recent public initiatives include the adoption of the ILO Convention 182 on the worst forms of child labour and the successful revision of the *OECD Guidelines for Multinational Enterprises*. Private responses to these concerns have emerged in the form of voluntary initiatives to define appropriate norms for business conduct. These corporate responsibility initiatives involve the issuance of codes of conduct, which set forth commitments and behavioural guidelines in such areas as labour relations, environment, consumer protection and fighting bribery. The codes are often backed up by accompanying management systems that help companies respect their legal and ethical commitments in their day-to-day operations. Prototypes for non-financial disclosure and reporting standards -- which help firms communicate their commitments, practices and performance to the outside world -- have emerged more recently. These initiatives draw on management principles and practices that have developed only over the past 25 years or so.

6. However, there is little agreement about exactly what these initiatives mean. Some believe that they constitute a first step in building reasonable behavioural standards from the ground up and that voluntary, decentralised approaches offer the flexibility needed to adapt to regional and sectoral circumstances and to acquire necessary knowledge and experience. Others view these efforts as little more than public relations ploys and would favour replacing them with binding rules of the game involving sanctions and government-directed enforcement mechanisms¹. Only these arrangements, they feel, will give the standards enough "teeth" to influence corporate behaviour in a meaningful way.

1 An example of this kind of position can be found in the NGO statement made at the adoption of the revised OECD Guidelines for Multinational Enterprises. The statement says: "Governments have accepted the argument put forcefully by business during the review that the Guidelines should not be "mandatory in fact or effect". The undersigned NGOs believe that this concession is fundamentally out of step with the experience and expectations of many communities around the world... As a result, NGOs will continue to call for a binding international instrument to regulate the conduct of multinational corporations." (page 23). (OECD 2000)

Recent practice in regulatory and management control emphasises the need to create the intangible assets that facilitate compliance with appropriate norms for business behaviour.

This paper focuses on two such intangible assets -- consensus or agreement with the norms and the management expertise needed to comply with them.

This paper analyses the results of a fact-finding mission on corporate responsibility that were reported in earlier papers.

7. The challenge of building up global norms largely “from scratch” places a premium on understanding the basic building blocks that support effective systems for controlling business conduct. Recent thinking emphasises the importance of intangible assets that support such systems of regulation or “softer” forms of social control of business. It says that many of the essential ingredients of any system of regulation, law or informal control of business -- those that help determine whether or not the system is effective -- are invisible to the eye. They cannot be read about in law statutes, written down explicitly in contracts or in international agreements or discerned by looking at a particular enforcement apparatus.

8. This paper focuses on two such intangible assets. The first is consensus -- or widespread agreement with and acceptance of behavioural norms among the people and organisations covered by them. The belief that compliance with behavioural norms results solely from monitoring and threats of punishment is not supported by OECD experience. On the contrary, compliance in democratic societies tends to be more voluntary than enforced. The second intangible asset is expertise -- the “human capital” that, it is argued here, has become an essential building block for successful systems of control of business conduct, regardless of whether these controls are private or public. The challenge for building global norms is to accumulate these intangible assets -- consensus and expertise -- on an international scale. One of the main findings of this paper is that voluntary initiatives are making significant contributions to the global accumulation of both, but that much remains to be done.

9. The present paper analyses the results of a fact-finding project on private initiatives in the area of corporate responsibility. That project was authorised by the CIME at its June 1999 meeting². The fact-finding results were reported to the CIME at its September 2000 meeting (DAFFE/IME(2000)15) and its six annexes³. This paper begins by reviewing and assessing the record of private initiatives to date -- in general terms, what has been accomplished and what may be accomplished in the coming years. The next session examines the question of costs and benefits. The third section draws out implications of the above for policy makers.

2 The Working Party of the Trade Committee also authorised work in this area. Annex 1 of the six annex series was produced in co-operation with Trade.

3. The six annexes are as follows -- DAFFE/IME(2000)15/ANN1 “Codes of Corporate Conduct: An Expanded Inventory”; DAFFE/IME(2000)15/ANN2 “Making Codes of Conduct Work: Control Systems and Corporate Responsibility”; DAFFE/IME(2000)15/ANN3 “Environmental Practices of European Corporations: Policy, Management Systems and Reporting”; DAFFE/IME(2000)15/ANN4 “Corporate Environmental Management Practices in Asia: Experiences of Non-Member Economies”; DAFFE/IME(2000)15/ANN5 “Public Policy and Voluntary Initiatives: What Roles have Governments Played?”; DAFFE/IME(2000)15/ANN6 “Corporate Environmental Management Practices in Japan”.

II. The record to date

The fact-finding results suggests that these voluntary initiatives form a global trend, but that there are significant intra-regional variations in practice.

Although these initiatives are referred to as “voluntary”, firms are under varying degrees of external pressure to undertake them. OECD governments have been very active in shaping the initiatives through regulatory and legal enforcement. Protection of brand and reputation capital is also an important consideration.

10. Voluntary efforts to develop appropriate and meaningful standards of conduct have been a recent prominent development in international business. The fact-finding effort suggests that this trend is global in scale, but that it also shows large intra-regional variations. The OECD inventory contains codes from the majority of member countries (see Annex 1). The study of environmental management practices (Annexes 3 and 6) shows that they are common among many European and Japanese firms, while the study of non-member Asian companies (Annex 4) also suggested significant, but variable, involvement.

11. The fact-finding mission underscores the nuances that are necessary when referring to these initiatives as “voluntary”. Webster’s dictionary defines “voluntary” as “acting or done with no external compulsion or persuasion.” The inventory of how public policy influences these initiatives highlights the fact that, often, there are powerful regulatory or legal pressures acting firms undertaking these initiatives⁴. The fact-finding paper (Annex 5) notes that private initiatives have been incorporated into public regulatory and law enforcement strategy in such diverse areas as environment (in the European Union, among others), occupational health and safety (the United States), combating money laundering (Switzerland), food safety (in the United States), competition policy (in Australia and Canada) and, in the United States, any corporate criminal activity that falls under the Federal Sentencing Guidelines. Likewise, for companies with significant brand or reputation capital, threats of NGO campaigns (of the type that have been waged against various brand-based retailers and against some extractive industry firms) confront them with potentially large capital losses⁵. Thus, firms face varying intensities of pressure to engage in these “voluntary” practices -- they may be intense on some, but relatively weak for firms with low public visibility, no brand capital and facing few regulatory or legal pressures.

4 For a more complete inventory, see OECD- PUMA (1999).

5. There are many examples of such campaigns against firms operating in such diverse sectors as apparel, toys, food and extractive industries. In the apparel industry, the campaigns have focused on retailers with brands and have largely ignored the non-branded segment of the market.

The codes address a wide range of issues from the sustainable development agenda and the issue areas most commonly discussed are labour relations and environment.

The commitments made in the codes exhibit significant divergences in their scope and in the concepts used. Even in narrowly defined issue areas, the codes do not define a de facto standard of conduct.

12. The codes in the OECD inventory cover a broad range of issues and address each of the economic, social and environmental “pillars” of the sustainable development agenda. They address many issues that are central to the debate on globalisation -- environmental management, human rights, labour standards, anti-corruption, consumer protection, information disclosure, competition and science and technology. The inventory shows that environment and labour relations are the most common issue areas in the codes followed by consumer protection and anti-corruption. Also covered are a number of “niche” issues that attract only occasional mention (animal rights, research ethics, building local partnerships etc.).

13. The inventory shows divergences in the scope and nature of commitments contained in the codes, even in rather narrowly defined issue areas (Annex 1). For example, the bribery codes are about evenly divided among those that discuss only private to private bribery, only bribery of public officials and those discussing both. Anti bribery concepts are also diverse in such basic areas as gifts and entertainment and the use of agents or third parties. Likewise, the only issue area that is addressed in all supplier codes in the branded apparel industry is child labour (although the specifics of their commitments vary widely⁶). Similar divergences are found among company codes in extractive industries. The divergences could reflect underlying differences in the companies’ business environments -- there can be no “one size fits all” approach to commitment because firms operate in different sectors and in different countries. They could reflect “cherry picking” of issues by companies (companies might commit in areas where it is not costly and ignore areas where it is). They could reflect fundamental differences of view about the nature of companies’ ethical obligations. Thus, the codes, probably for a combination of the reasons listed above, do not generally constitute a *de facto* standard of business conduct in the areas they cover.

6 Some make extensive commitments to protect any children that might be found to be employed by the companies suppliers; some mention specific ages or age ranges while others do not; some commit to the elimination of child labour but note that this may force children into less desirable occupations.

These divergences are not necessarily a problem. The codes movement provides an institutional channel for debate among various representatives of civil society.

This activity provides inputs into the progressive formation of consensus on norms for business conduct.

14. This should not be interpreted as a weakness or criticism of these private initiatives -- private business alone is not responsible for the creation of such standards. Indeed, the companies involved in this movement -- by seeking to enhance the transparency of their non-financial commitments -- may be making important contributions to the eventual formation of such standards. In effect, the code movement provides a communications channel for airing and debating ideas about norms for business conduct. The amount of dialogue and mutual influence that takes place in the codes movement is considerable and has been facilitated in recent years by advances in communication technology. Examples of the types of dialog facilitated by the codes movement are described in Box 1.

15. All of this activity provides inputs into the progressive formation of broader agreement or consensus on norms for business conduct. Economic thinking (for example, among development practitioners) and recent regulatory and law enforcement practice -- via its focus on so-called "voluntary compliance" -- recognise the economic value of consensus as one of the basic building blocks that supports economic development and effective implementation of appropriate norms for business conduct.

II.1 Consensus -- a basic building block for the effective control of business conduct⁷

We can learn from experience that management of ethical behaviour is not limited to monitoring and inspection of corruption or wrongdoing, but it is about seeking a consensus regarding good conduct and providing a direction for action and policy decisions.

Jung-Suk Yoo,

Strengthening Professional Ethics in the 21st Century

Informal conventions and norms are important intangible inputs for any economy. They complement written law and contract.

16. Informal conventions and norms⁸ about what constitutes appropriate behaviour are a pervasive feature of any economic and social system -- they are "intangible assets" that facilitate exchange and the effective functioning of organisations (see Coleman 1990; Williamson 1996). They have facilitated commerce throughout economic history and are a feature of all transaction frameworks, from barter economies to the sophisticated markets and organisations of advanced industrial societies. The first anthropological field study was motivated by the observation that primitive societies are quite orderly despite the absence of written rules and formal enforcement⁹.

7. The material in sections II.1 and II.2 draws on work already published in German by the Austria's Federal Ministry of Economics and Labour in *Osterreichs Aussenwirtschaft*, 1999-2000; see Chapter 3.6 "Rules for the Global Economy: Voluntary versus Binding Approaches" by Kathryn Gordon.

8. An "informal norm or convention" is used here to refer to a standard or guide for behaviour that is not codified in law or private texts -- sometimes they are only tacitly understood by the people that adhere to them. At times, such informal standards may underpin or precede attempts at codification.

9. The field study in question was done by Bronislaw Malinowski in the Trobriand Islands and was published in 1926 as *Crime and Custom in Savage Society*.

Some (e.g. North 1990) argue that advanced economies -- notwithstanding their tendency to formalise rules in law and transactions in contracts -- rely heavily on informal norms and conventions. This is because it is rarely possible to account for all contingencies when writing out formal rules or contracts. Informal norms tend to come into play on the many occasions when economic actors must respond to events that have not been described *ex ante* in law, regulation or contract.

Informal norms are part of social capital. Much of this social capital is rooted in national institutions and values. For the time being, there is little global social capital.

17. These informal norms are essential inputs into the transactions process -- the economics literature uses the term “social capital¹⁰” to refer to, among other things, these unwritten, but widely held beliefs and norms (Coleman 1990). The reason the term “capital” is used is that these norms -- or agreed ways of doing things -- have economic value. They allow transactions -- trades, production, hiring of productive factors -- to take place that might not otherwise have been feasible or they lower the costs of certain transactions (e.g. legal or monitoring costs). Generally, these norms are seen as complementary to formal legal arrangements -- they may facilitate contract enforcement (by allowing contracts to be drawn up with less detailed treatment of contingencies and by lowering the amount that must be spent on third party enforcement). However, since social capital is rooted in culture and other institutional, economic and societal characteristics, it tends to be specific to nations or regions -- “global social capital” is, at least for now, fairly underdeveloped.

Recent enforcement practice in law and regulation has tended to move away from an exclusive focus on deterrence...

18. Consensus about individual or business behaviour -- that is widespread agreement on how things ought to be done -- is also increasingly viewed as an essential element of law enforcement -- one that lowers enforcement costs and increases its effectiveness (see Ayres and Braithwaite 1992). Law enforcement is often thought of as a process in which a government invests resources in monitoring and deterrence, thereby creating an incentive system that shapes decisions to comply with law or to engage in criminal behaviour. In return for their investment, societies receive a certain amount of compliance. A simple “deterrence” approach to law enforcement relies on the following assumptions: 1. Legal statutes can unambiguously define misbehaviour; 2. All actors are fully informed expected utility maximisers (that is, they are *homo economicus* observed in an enforcement context); 3. Legal punishment (fines, imprisonment) provides the primary (indeed the only) incentive for compliance; 4. Enforcement agencies optimally detect and punish misbehaviour, given available resources (Scholz 1997). Thus, the operative assumptions are that “good and evil” or “legal and illegal” can be easily identified and codified and external (government) enforcers can be relied upon to uphold the “good”, while the actors covered by the

10 A general definition of social capital is given in Nahapiet and Ghoshal (1998). Social capital is “the sum of the actual and potential resources embedded within, available through and derived from the network of relationships possessed by an individual or social unit (including families, business organisations or whole societies).”

laws are naturally inclined to do “bad” if it is in their economic interest.

... because it has been found that formal deterrence often accounts for only a small fraction of law-abiding behaviour. Much compliance with law appears to stem from the fact that it is supported by social norms -- individuals believe in the law and they may be under social pressure to comply with it.

19. The “deterrence” model undoubtedly provides useful insights, but enforcement studies show that it does not come close to providing a full explanation of real-world compliance. Indeed, one of the central questions in regulatory enforcement is why compliance tends to be so high when the amount spent on deterrence is often so low. For example, Slemrod (1998) reports on studies of compliance with income tax laws in the United States. These show that people pay far more in income taxes than can be explained by a rational calculation that balances the financial advantages of not complying against its expected costs based on the probability of getting caught and the likely amounts of penalties paid if one is caught. In fact, people appear to pay their income taxes for a number of reasons, many of which have nothing to do with tax enforcement -- they may believe it is the right thing to do (personal conviction) or their friends and family may pressure them to do so (peer pressure). These findings and others¹¹ have given rise to increased interest in law and regulatory enforcement circles in the concept of “voluntary compliance”; that is, compliance that occurs because of personal belief or social pressure, rather than being due to the enforcement apparatus. In this sense, voluntary initiatives and formal law and regulation draw on the same sets of social capital (or consensus on appropriate behaviour) and, hence, are complementary.

One of the challenges for the development of global norms for business conduct is to amass the social capital on a global scale. Without this, the norms are likely to be ineffective and any supporting laws might be prohibitively costly to enforce.

20. Thus, there is a growing recognition that a critical mass of understanding, agreement and consent underpins any effective system for controlling business behaviour. In effect, it lowers enforcement costs by eliminating the need to have a policeman on every corner and an inspector in every factory. Without this agreement and implied consent, many laws would be prohibitively costly to enforce using methods that are acceptable to democratic societies. But, as noted above, most social capital is grounded in regional cultures and societies -- there is as yet little global social capital. The corporate codes movement provides one avenue through which a broad-based understanding of and consensus about norms for various aspects of international business conduct can be built. Indeed, this gradual movement toward of consensus -- though still highly incomplete -- is one of the major contributions made by these voluntary initiatives to date.

11 In the area of environmental regulation, for example, Arora and Gangopadhyay (1995) state, “Compliance with environmental standards under a schema of low surveillance and minimum fines, is in itself an interesting phenomenon. Most firms choose to comply despite seemingly lax enforcement”. Page. 290. Compliance studies in occupational health and safety suggest that compliance is not closely related to the level of penalties but was influenced by detailed inspections run jointly by labour and management representatives (Gunningham and Rees 1996).

II.2. Expertise: human capital and the social control of organisations

Newer regulatory and legal enforcement strategies draw on the inherent willingness and ability of the business community to comply. The managerial expertise that businesses bring to bear on compliance problems is an important consideration in this strategy.

The fact-finding project documented the emergence of a new class of professional manager specialising in legal and ethical compliance. Various institutions have emerged to support and spread this expertise (e.g. management standards, specialised consulting services, professional societies).

The accumulation of expertise also reflects the recognition that corporate conduct (or misconduct) is a complex phenomenon. Some misconduct, for example, might not be calculated wrongdoing. It might reflect lack of due care in managing human cognitive constraints, problems in managerial or technical controls in dealing with risky or dangerous. Defining and evaluating reasonable practices

21. The recognition of the importance of voluntary compliance tends to blur the distinction between the voluntary initiatives examined here and more binding systems of law and regulation. This blurring has become more pronounced as a result of recent enforcement trends. As mentioned in the fact-finding study (Annex 5), regulatory and law enforcement practitioners have become disillusioned with purely adversarial approaches to enforcement based on the command and control model of regulation. There is a growing recognition that managerial expertise is often a key ingredient for successful compliance with law and regulation. Newer enforcement techniques try to promote voluntary compliance in the corporate sector, but also to draw on the sector's compliance expertise and to integrate this private expertise into public enforcement strategy. Many of the voluntary initiatives examined here are the reflection and expression of growing compliance expertise within the business community (and of an associated regulatory expertise in the enforcement community).

22. Annexes 2 and 5 note the emergence of a new class of professional managers specialising in legal and ethical compliance. These managers now have rapidly growing professional societies and the majority of major business schools now offer courses in compliance. NGOs have also accumulated expertise in these areas. Activities have been undertaken in business associations and in the International Organisation for Standardisation that allow businesses to pool expertise and to share the costs of developing new management and reporting systems (Annex 5 shows that OECD governments contributed to these initiatives). Numerous private companies -- mainly specialised consulting companies or large audit firms -- provide packages of "risk management" services (legal, management control, monitoring, record keeping and reporting and public relations). Work on standardisation of non-financial reporting practices is underway in several institutional settings (e.g. the Global Reporting Initiative).

23. This accumulation of expertise reflects the high stakes underpinning compliance in many areas and the growing recognition that corporate conduct (or misconduct) is a complex phenomenon. That is, there are many possible types and motivations for misconduct and enforcement techniques that work for one type of misconduct do not work for others. For example one view of corporate misconduct (that differs from the calculated misconduct of the deterrence model) links it to basic human cognitive constraints -- often called "bounded rationality". This view emphasises the fact that misconduct can arise from error, ignorance or innate human limitations when faced with situations that are risky or uncertain. In addition to accounting for the risks and uncertainties inherent in most human activities, this approach recognises that corporate actors -- workers, managers,

in such circumstances requires considerable expertise.

executives -- have only limited amounts of the information, knowledge and resources needed to control outcomes. In such circumstances, misconduct can occur even when the perpetrators face major financial penalties in the event of say, an accident, and when they all share a strong personal conviction that misconduct should be avoided. Safety management (ie. occupational safety or public safety) is an example. Major problems may be infrequent (so that vigilance can be worn down by routine) and safety dispositions may form a system, making it difficult for any single actor to identify emerging problems. Under this view, there is often significant uncertainty or ambiguity in what constitutes misconduct or in recognising it in a real world setting. Financial and penal sanctions will often be of limited usefulness in such situations and must in any case be complemented with other methods (Scholz 1997).

This complexity creates a need for voluntary initiatives, since law and regulation could never spell out good practice in sufficient detail. Many of the codes in the OECD inventory are expressions of company's efforts to use due care in keeping risks to an acceptable level.

24. Under this approach, rules systems help define society's risk tolerance and what constitutes due care for companies in managing these risks. Rules writing and compliance in this setting are quite different than under the deterrence model described above. First of all, explicit rules -- in the form of codified laws -- may be impossible to write because of the large number of contingencies that would have to be built in to them. This creates a role for the private initiatives examined here -- that is, these initiatives help to define and clarify the implications of societal risk tolerances for the firm's operations. Many of the codes and management systems examined in the fact-finding report deal with risk management issues (see, for example, the Responsible Care code and many of the "environment, health and safety" and "consumer protection" codes).

III. Costs and benefits of voluntary initiatives

...there is one and only one social responsibility of business-- to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.

Milton Friedman, Capitalism and Freedom, page 133. 1962

This section explores the costs and benefits of these initiatives for companies and for the societies in which they operate.

25. The codes in the OECD inventory often define and describe an ethical posture for business that goes beyond legal requirements (Annex 1) and beyond the Milton Friedman's narrow view of business ethics (see quote above). As noted, some companies back these up with management and reporting systems. One might well ask why companies would bother to do this and what benefits, if any, accrue to the societies affected by these initiatives. These initiatives are presumably costly for the companies that undertake them and may give rise to broader opportunity costs (economic activity that might otherwise have been undertaken if it weren't for the initiative).

Little quantitative information is available on the initiatives' costs and benefits in particular business settings. This section provides general assessments.

III.1. The benefits for firms

The benefits for firms of undertaking such initiatives are potentially numerous. They lower risks of costly criminal prosecutions, litigation and damage to reputation...

... they help firms manage relations with shareholders and with actors in the societies in which they operate.

In some instances, they have been used to deflect momentum for government regulation.

26. This section looks at the benefits and costs of these initiatives in general, non-quantitative terms. The fact-finding results contain few quantitative assessments of benefits and costs in any given business or sectoral setting. The section also considers the uncertainty surrounding both benefits and costs as well as the risk that these initiatives may give rise to unintended consequences.

27. The benefits of these initiatives for firms are potentially numerous. Many of the initiatives are designed to improve compliance with law and regulation and to manage litigation risks by helping companies show that they have exercised due care in trying to live up to their legal and ethical responsibilities. By taking such actions, companies hope to avoid costly litigation or legal defence, criminal or civil sanctions and damage to reputation.

28. The initiatives are also a communications tool used in managing relations with various elements of societies in which the business operates -- companies use them to explain their positions and actions to civil society and customers, thereby helping them to enhance company image and reputation. For publicly traded companies, the initiatives help smooth relations with shareholders especially in view of the growing tendency for questions relating to business ethics issues to be brought up during shareholder meetings¹².

29. Other initiatives are at least partly motivated by a desire to deflect or pre-empt efforts for government regulation. The UK advertising standards initiative, a highly regarded private system for promoting truth in advertising, was designed to eliminate the need for government regulation and is regarded as being quite effective (OECD 1997). Responsible Care, an influential private initiative¹³ for promoting safety in the chemicals industry, was designed in part to deflect growing political momentum to tighten government regulation (OECD 1997).

12 For examples of why this is necessary see Global Proxy Watch March 31st for a discussion of a major French extractive industry firm's shareholder meeting in which questions on environmental management were posed. In the same issue, there is a discussion of the re-shuffling of the board of directors of a major US-based public employees retirement fund. The reshuffle is described as signalling a greater interest in socially and environmentally responsible investing. Davis (2000).

13 Although the Responsible Care Initiative started in Canada, it has since been copied elsewhere. The codes inventory contains 5 Responsible Care codes issued by firms from the United States, Mexico, Finland and Germany. The environmental database contains seventeen Responsible Care references issued by European companies.

Employees also play an important role in these initiatives.

Companies claim that they improve company morale and form the cornerstone in a broader effort to create a “culture of integrity” within companies.

30. Companies also say that these initiatives help them to improve morale and motivation among existing employees and to compete more effectively in labour markets. In a very general sense, these initiatives are a fundamental component of broader efforts to promote a “culture of integrity” within companies. This elusive aspect of corporate culture -- integrity -- is essential ingredient of management control in many business organisations. As a result of technological change and other structural pressures, companies now tend to be flat and, hence, to have fewer hierarchical checks and balances. Furthermore, “knowledge workers” often have *de facto* control of key proprietary intangible assets. Thus, organisational and technological change has tended to enhance the power of many employees -- enlarging their scope for autonomous action and their control of key resources -- and, as always, power can be both used and abused. In some sense, then, these initiatives are the most general measure used by companies to limit the likelihood of wrongdoing by company employees seeking to gain personal advantage.

III.2. The benefits to society

The primary role of business in society is to provide adequate returns to capital and, in the process, produce goods and services and create jobs.

31. The main role of the business sector in society is to provide adequate returns to suppliers of capital and, in the process, create jobs and produce goods and services that consumers want to buy. Companies often highlight this basic principle of business ethics in their codes (see Box 2). But all the codes in the inventory contain commitments that go beyond this principle.

What justifies departures from this principle? Many of the codes define the company’s position in relation to various types of market failure (e.g. environmental externalities, market power, information asymmetries in customer relations). The codes can be seen as the business sector’s response to legal and social pressures to redress the effects of market failure.

32. One way to justify departures from complete reliance on the disciplines provided by product and factor markets is to invoke the idea of “market failure”. Many of the codes explicitly address issues of market failure¹⁴. In this sense, the potential benefits for society of private initiatives are closely linked to those obtained from regulation, corporate criminal law and other policies that influence how companies conduct their business (such as taxes and subsidies). All of these -- formal law and regulation, private initiatives -- are (in principle) designed to improve situations where the market does not work well on its own. This could be due to the presence of market power (e.g. natural monopolies, network effects) or to other forms of market failure (e.g. externalities, missing markets, information

14 Examples of code language that addresses markets failures are: 1) Information asymmetry - “Provide relevant information on the hazards of chemicals to its customers (from Responsible Care); “[companies] agree not to engage in conduct that is misleading or deceptive or that is likely to mislead or deceive. “from an association code on food standards. Environmental externalities: “In the Group we are committed to: pursue the goal of no harm to people; to protect the environment; “ from an extractive industries code; Competitive practices: “Violations include agreements among competitors to fix or control prices; to boycott specified suppliers or customers; to allocate products, territories or markets; or to limit the production or sale of products.” from the code of a multinational chemical company.

asymmetries, public goods, co-ordination failures). In a very general sense, then, the benefits of these private initiatives, if they succeed in their objectives, are similar to (and complementary with) those one would hope to get from (well-designed) law and regulation -- that is, the redressing of market failures.

The codes also address ethical issues that are, in some sense, imported from the societies in which they operate (e.g. racism in the workplace, fighting bribery in countries where it is commonplace).

33. The codes also make it clear that many of the ethical challenges faced by businesses are, in some sense, “imported” from the societies in which they operate. For example, 61 per cent of the labour codes deal with discrimination (e.g. racial, religious) in the work place (Annex 1). In this way, companies try to prevent prevailing biases and prejudices from impacting on workplace or customer relations¹⁵. Many anti-bribery codes note that some countries’ tolerance of corruption means that employees routinely face demands for bribes. While it is difficult to assign tangible benefits to this type of ethical consideration for business, it is clear that businesses themselves do not feel they can extricate themselves from the broader ethical challenges facing the societies in which they operate.

Thus, the potential benefits for society include the alleviation of various types of market failure and a more focused co-operation from the business community in redressing broader ethical problems in the societies in which companies operate.

34. To summarise, the potential benefits to society of these initiatives are similar to the benefits societies hope to get from regulation and corporate criminal law, with which these initiatives are often highly synergistic and supportive. The codes are the reflection in management practice of various legal, regulatory and social pressures that motivate the company to prevent abuses of market power and to redress other sorts of market failure. The codes and associated management systems also have the potential to help the businesses contribute to redressing broader ethical problems.

III.3 The effectiveness of voluntary initiatives: Do they change company behaviour?

Critics of voluntary initiatives view them mainly as public relations ploys and insist that they be accompanied by external verification and by sanctions. However, external verification is not an straightforward process - it requires institutional supports such as auditing and reporting standards.

35. Of course, if these initiatives are mere “window dressing”, then they produce no social benefits. The question then arises as to what, if anything, makes these initiatives meaningful in terms of changing business behaviour. Some claim that, if the codes are not subject to formal deterrence (external verification and related “punishments”), then they are not credible; they call for external monitoring and enforcement, binding laws, trade sanctions and so forth. While there might be some circumstances in which such measures do have a role to play, proponents of this view seem to downplay the difficulty of external verification and of designing effective systems of deterrence¹⁶ (Annex 2) and may underestimate

15 For example, the codes of an advanced materials manufacturing company states: “We at [company name] are committed to a policy of equal employment opportunity without regard to race, religion, national origin, sex, age, disability or any other classification protected by federal state or local laws. We practice and promote this policy in all locations.”

16. As shown in Annex 2, external verification is not used in some compliance problems (e.g. bribery) because it is unlikely that an external monitor -- public or private -- would be able to detect most instances of

the importance of “voluntary compliance”, already discussed above. They may also underestimate the complexity and difficulty of ensuring that individual employees actually “internalise” the incentives created by public monitoring and sanctions.

The more general problem is to get individual employees to act in response to the incentives created by various external pressures, including possible criminal or civil sanctions for corporate misconduct. The voluntary initiatives studied here are the business sector’s attempts to translate non-financial pressures (legal, regulatory, social) into a coherent organisational response.

A crucial question is: Do these initiatives actually succeed in changing business behaviour? The answer to the question is yes -- these initiatives are a crucial ingredient for effective ethical and legal compliance in the large, complex corporations that dominate in the OECD fact-finding databases.

36. The issue of how various incentives are internalised by the individuals and groups that make up a company is central to the field of management control, a well-established business discipline that is closely linked with the voluntary initiatives studied here. In corporate finance, the counterpart of this question is: to what degree are individual incentives within the firm aligned with shareholder interests¹⁷? More generally, to what degree do the various social, technical and financial processes shaping individual behaviour within the firm form a harmonious whole permitting coherent action by the enterprise? In modern, complex corporations, formal control systems are used to align individual employee interests with shareholder interests and to balance these with other, possibly competing, considerations (e.g. the need to comply with the law). The voluntary initiatives examined in the fact-finding mission are the business sector’s response in terms of management controls to the non-financial pressures it faces.

37. The businesses in the OECD codes inventory and other data sets are often very large (sometimes exceeding 100 thousand employees) operating in dozens of countries, sometimes having hundreds of business partners, and engaging in the design, production and marketing of numerous products and services. These are not small businesses where communication can occur by word of mouth and where the owner can directly place his/her stamp on company practices. The fact-finding mission focused mainly on large, complex, professionally managed companies. In this type of company, formal compliance systems are essential. If no steps are taken to enlist the support and harmonise the actions of hundreds or thousands of employees and business partners, then there will be no managerial control in support of ethical or legal compliance (other than the spontaneous compliance that might emerge from actions by individual employees motivated by their own personal values).

bribery, especially the more sophisticated forms of corrupt practice. This position also seems to ignore the important role that verification or auditing standards play in enhancing the effectiveness and credibility of verification and the fact that, for non-financial verification, these are only in the early phases of development. Likewise the components of an effective system of deterrence depends very much on the issue at hand (Ayres and Braithwaite 1992). For example, anti-corruption, occupational safety and transport safety pose different deterrence problems and require issue specific expertise.

17 This is the central question of the branch of finance and organisation theory called “agency theory”. See for example, Jensen and Meckling (1976). Alexander and Cohen (1999) apply this model to problems of corporate crime and find that corporate crime tends to penalise shareholders. The sample is 109 US publicly traded companies convicted of US Federal crimes between 1984 and 1990.

However, the business community's main role is to provide the managerial expertise needed to reflect social, legal and regulatory pressures into business practice. It is up to society as a whole (of which business is a part) to decide what those pressures should be.

Therefore, the question of whether or not these initiatives are effective cannot be answered by looking only at what businesses do. If they are effective it is because societies manage to formulate and channel reasonable pressures for appropriate business conduct.

III.4. Voluntary initiatives in a broader governance context

Should our regulatory institutions be designed for knaves or should they be designed to foster civic virtue? Our answer has been that they should be designed to protect us against knaves while leaving space for the nurturing of civic virtue.

Ian Ayres and John Braithwaite, Responsive Regulation. Page 53.

The costs and benefits of private initiatives depend on finding a judicious combination of private and public action.

38. Thus, private initiatives reflect managerial expertise that allows companies to blend short- and long- term profit pressures, as well as non-financial pressures, into coherent corporate activity and response. However, in the non-financial dimension, these initiatives have no more credibility or force than the social, legal and regulatory pressures that shape them. If these private initiatives are successful, it is a testimonial not only to the competence and expertise of the business community, but also to the ability of societies to formulate, communicate and channel reasonable pressures for appropriate business conduct. In this sense, the success of voluntary initiatives is inextricably linked to the external pressures -- law and softer ways of influencing behaviour -- that the business faces. One oft-cited analogy is that regulation and other pressures are one wing of an aircraft, while business control systems (financial and non-financial) are the other wing. If the aircraft is to stay on course, both wings must be well designed and functioning properly.

39. Thus, it is difficult to separate the effectiveness of these initiatives from that of the social and political, legal and regulatory context in which they develop -- that is, from the suitability and effectiveness of both private and public governance. For example, private initiatives in support of legal and regulatory compliance will be undermined if they are associated with regulatory or legal systems that are inefficient, poorly designed or corrupt. Likewise, if the basic institutions of democratic societies are not in place, then the pressures coming from the media, from representatives of civil society or from the political arena will be absent. If trade unions and other institutions for promoting transparency in labour relations are suppressed, then measures designed to raise workplace standards will be hobbled. Private initiatives for corporate responsibility have an important and distinctive contribution to make as part of a broader system of private and public governance. However, they cannot work well if other parts of the system work poorly.

40. Both the costs and the benefits of private initiatives depend on whether or not societies manage to combine public and private action in effective mixes. No system for controlling business conduct -- binding or voluntary -- is perfect and each has its distinctive strengths and weaknesses. Private initiatives are not alone in suffering from credibility problems -- that is, from the belief that the initiative will not have the impact it is supposed to have. Indeed, the credibility (or lack of credibility) of many types of public policy --

fiscal, monetary and regulatory -- is frequently called into question and OECD experience with regulation shows there have been serious and pervasive problems [see OECD 1999, OECD 2000 and Gonenc et al. (2000)]. These include inflexibility, regulatory inflation¹⁸, capture of the regulatory process by interest groups, ineffectiveness and unintended consequences. Poorly designed and implemented regulation has imposed large costs on individual companies and on OECD societies.

Although the two approaches both offer distinctive strengths and weaknesses, the tendency now is to look at them as largely complementary efforts.

41. Box 3 describes the differences between binding laws and voluntary “standards” and highlights the strengths and weakness of the two approaches. But, as already noted, emerging regulatory practice within the OECD tends to treat public regulation and private initiatives as complementary, rather than competing, approaches. Judiciously used, private initiatives help to lower the costs of regulation and to enhance its effectiveness. The difficulty for both public and private actors is determining the appropriate mix of private and public action. Important questions include: To what extent should public enforcement rely on private compliance efforts? What should be done if a company is found to be operating in bad faith? Which firms should be inspected and what should the inspection consist of? Should the public enforcement authority try to impose a standardised compliance system or should it let firms develop their own systems? All of these questions must be answered on a sector- and issue-specific basis. Again, this is an area where regulatory and compliance expertise is being accumulated.

III.5. Cost uncertainty and unintended consequences

There is little quantitative information on the costs and benefits of these initiatives. It is expected that information will accumulate as experience grows in different business sectors and different regions.

42. There is often considerable uncertainty as to the size and nature of the cost and benefits of these initiatives, but they are being clarified as experience grows. For example, even in one of the better understood areas (environmental management systems), it is unclear whether initiatives in this area are a cost (reducing the value of companies) or an investment (increasing it). One web site for ISO 14001 managers implies that the net present value of its members’ “investment” in ISO 14001 implementation was positive (The ISO 14001 Information Guide, 1999)¹⁹. Thus, for that group of companies, ISO 14001 was not a cost item on average at all; rather it yielded a net financial benefit.

18 Regulatory inflation refers to the continual growth of attempts at regulation arising from the lack of constraints on the growth of rules and regulation. Attempts at producing “regulatory budgets” have so far been unsuccessful.

19 The service states that annual savings due to ISO implementation were more than \$200,000 per year with an average project length of 12 months. The ISO 14001 implementation costs were, on average, between \$25,000 and \$128, 000, depending on the size of the firm. At any reasonable cost of capital, these figures imply that the net present value of ISO 14001 implementation was highly positive, on average, for these organisations.

These initiatives can have unintended, adverse consequences. Problems associated with the initial phases of a campaign to eliminate child labour in the Pakistani soccer ball industry provide a case of point...

... and subsequent attempts to achieve the gradual elimination of child labour in the industry may have inadvertently undermined the economic position of women in the region.

This underscores the need to proceed carefully with these initiatives and with due recognition of the difficulty of predicting outcomes that involve complex interactions of social, economic and environmental factors.

43. These initiatives also occasionally have “unintended consequences”. The background associated with one of the business association codes in the OECD inventory shows how problems can inadvertently arise from well-meaning initiatives. The code emerged as a result of what is now an infamous case of unintended consequences of NGO activity -- in this case, in response to the revelation that children were involved in the production of soccer balls in Pakistan. As a result of NGO activity, soccer balls suppliers in Pakistan were instructed to stop employing children immediately, which they did. However, since many of the children had been brought in from surrounding areas to work in factory-type situations, they ended up on the streets without caretakers or family supervision.

44. In a further development of this same episode, soccer ball retailers worked extensively with the ILO and with NGOs to restructure conditions of production in the Pakistani soccer ball industry. Their aim has been the progressive elimination of child labour. This restructuring increased the market share of formal, factory-like production sites (“stitching centres”), while decreasing the market share of “cottage” or home-based production (where it is more difficult to control participation of children). But this shift also undermined the economic autonomy of adult women in the region, who are less involved in factory work than in home-based production (see UK Cabinet Office, 2000 page 161). This was another largely unintended consequence.

45. This example underscores the need to proceed carefully with corporate responsibility initiatives and to have adequate knowledge of local conditions. It also points to the difficulty of predicting outcomes for initiatives that involve complex interactions of social, economic and environmental factors. Another issue raised by these examples is the degree to which there is transparency and accountability in the NGO community. These organisations use their (sometimes considerable²⁰) resources to persuade other actors to do things that generate patterns of gains and losses in various parts of the globe (e.g. people may be thrown out of work or their businesses may be destroyed). Clearly, NGO actions have occasionally resulted in consequences that range from highly undesirable to, at the very least, questionable. Many of the NGOs themselves agree that with their “influence” comes responsibility and, hence, a need to make themselves accountable for their actions (see the web-site of “Action Contre la Faim²¹”, for example).

20 For example, the international secretariat of a well-known human rights group has a budget of nearly 17,000,000 GBP. This is in addition to the national budgets of the same group.

21 www.acf-fr.org

IV. Implications for International Economic Policy

The main political message emerging from this analysis of voluntary initiatives is a positive one. Viewed as whole, the initiatives examined in the course of the fact-finding project represent a global effort to address serious issues of business ethics. They have contributed to the basic building blocks -- consensus and expertise -- that will eventually permit global convergence of norms for business conduct.

But the job of creating global norms for business behaviour is not likely to be finished any time soon.

OECD governments have already done many things to shape these private initiatives.

46. The voluntary initiatives analysed here should be accorded an important role in the dialog between OECD governments and their constituencies about globalisation. Unfortunately, the message stemming from the initiatives is not one that lends itself to media-friendly presentations nor does it hold the promise of easy or quick solutions. Nevertheless, it is an important and positive one -- these private initiatives contribute to the basic building blocks of a system that will eventually permit meaningful convergence of economic, social and environmental standards among the countries of the world. The fact-finding mission has shown that progress varies by issue area and within and across regions, but that it has nevertheless been significant and global. These efforts represent a serious endeavour -- involving enterprises on at least four continents -- to address numerous problems of business ethics. The business community -- working with other civil society actors and with governments -- has developed principles and management methods for addressing a range of issues about which it would have been incapable of organising any systematic response even as recently as two decades ago.

47. Of course, progress is ongoing and the job of achieving appropriate norms of conduct for international business is not likely to be finished any time soon. The fact-finding report found significant variation of practice and commitment that cannot be easily attributed to differing business circumstances. Business communities in some countries are heavily involved in developing and implementing these initiatives and not involved at all in others. The fact-finding data set consists mainly of large, publicly-traded companies -- data on what other types of companies are doing in this area are scarce, but what is available suggests that adoption of such practices may be less common among small, closely held companies. Basic institutional supports (e.g. non-financial auditing and reporting standards) still need to be developed, disseminated and tested in a variety of business situations.

48. What should governments be doing to enhance the effectiveness of these initiatives? The fact-finding report suggests that OECD governments have already done a lot -- many of these initiatives are closely linked to national policy environments from which they have emerged. The relevant policies adopted to date have tended to avoid direct control, working instead through indirect influence (tax expenditures on the NGO sector, incentives under regulatory and law enforcement arrangements, etc.). So far the indirect approach appears to have been successful in encouraging the business community and governments to co-operate in making both more effective. These policies have also encouraged the acquisition of compliance expertise in the business community. Governments have also added their voices to the debate about behavioural norms through such instruments as the *OECD Guidelines for Multinational Enterprises*.

The indirect policy stance currently adopted by many OECD governments is likely to continue to be a promising one in most issue areas. It promotes and contributes debate and allows experience and knowledge to be accumulated while avoiding the potential dangers of direct government intervention (capture by interest groups, rigidity and inability to respond to changing circumstances).

Any global system of norms that will eventually emerge is likely to involve combinations of public and private action. Building a workable set of global norms promises to be an arduous process in which policy communities with issue-specific expertise will be important players. The challenge for the investment and trade communities will be to work with others while promoting their own basic values - - transparency, investment protection and non-discrimination.

In any global system that eventually emerges, there will certainly be a role for formal deterrence of some sort. But systems for monitoring and deterring misconduct on a global scale will require accumulation of global expertise.

49. In many issue areas, the indirect approach is likely to be a more effective policy stance for governments than more direct types of intervention. This contrasts with the view of some that governments need to add “teeth” to voluntary initiatives in order to make them effective. The indirect approach encourages businesses and societies to continue feeling their way forward. It allows open dialogue to take place and experience and knowledge to be accumulated while avoiding dangers of direct intervention (capture by vested interests, inability to respond to changing circumstances, etc.). The follow-up process of the *OECD Guidelines for Multinational Enterprises* has the potential to play an important role in reinforcing the indirect strategy already adopted by governments by contributing to dialogue and to the dissemination of knowledge and experience.

50. In any case, the expertise and slow movement toward consensus that voluntary initiatives are helping to promote will be useful in future international policy endeavours, regardless of the form these happen to take. Any global system of norms will undoubtedly feature important elements of co-operation between the business communities and governments. This will be true internationally for the same reasons it has been true domestically -- in many cases, adversarial approaches do not work well and are more costly than co-operation. Building a workable set of behavioural norms for international business promises to be a long and arduous process that will, for the most part, have to emerge from the policy communities with the necessary issue-specific expertise and political accountability. The challenge for the investment and trade policy-makers will be to work constructively as part of this pain-staking process. In particular, this will mean working with the issue-specific policy communities while promoting the basic values of the investment and trade communities -- transparency, investment protection and non-discrimination.

51. Of course, the critics of voluntary initiatives are not entirely wrong. It would be naïve to think that a meaningful system of global norms could exist without any formal deterrence. . The fact-finding piece has shown that many “voluntary” initiatives are underpinned by significant threats of monetary damage (legal costs, fines, loss of reputation capital) or other sanctions. However, the analytical paper has shown that the design of deterrence is not straightforward -- regulatory and compliance expertise is required to make deterrence work and the methods deployed depend very much on the compliance issue (e.g. bribery is different than control of supply chain). Thus, while there is certainly a role for deterrence, effective global methods in most areas will probably emerge slowly out of national pools of expertise and from gradual convergence of national practices. The OECD Bribery Convention -- which obliges signatory governments to enact laws and criminal sanctions against bribery of foreign public officials -- is one example where the

international policy community has been able to promote convergence of legal norms for enterprises in their global operations. Note that enforcement of this initiative is based on deterrence and compliance expertise located in adhering countries.

Credit for the success of some private initiatives does not belong only to the business community. This paper has argued that it is also due to the success of broader social, economic and political processes. The OECD's peer review and outreach activities can help OECD and non-member societies improve public governance, which will also contribute to the effectiveness of private initiatives.

52. Another important role for OECD governments -- indeed all governments -- is to initiate a process of continual improvement in public policy and to maintain peer pressure on one another in this same area. This paper has shown that any credit that might be due for the success these voluntary initiatives does not belong only to the businesses that undertake them. It is also due to the effectiveness of broader social, economic and political processes. These allow pressures -- financial, social, legal, regulatory, political -- to be focused onto the business community. Open and democratic societies increase the likelihood that governments will fulfil their roles (providing public services) and will avoid putting businesses in the position of having to address problems that stem mainly from failures of government (e.g. corruption in public services, public spending that favours wasteful expenditures on political elites to the detriment of spending on basic services such as primary education). This is area in which the OECD's peer review and outreach activities have important contributions to make.

**Box 1. Consensus-building and voluntary initiatives --
examples from the codes inventory**

Dialogue among the business, labour and NGO communities: Some of the codes represent co-operative efforts among firms, NGOs and labour unions. Thus, in the course of writing and promoting them, dialog among representatives of civil society took place. Examples of this kind of code include SA 8000 on core labour standards and CERES on the environment. Likewise, the codes that are part of collective agreements were negotiated between business and trade unions.

Dialogue within the business community: Some of the most influential codes in the inventory have been issued by business associations and represent the fruit of extensive consultation and pooling of expertise. Business association codes account for 37 per cent of the OECD codes inventory. Prominent examples of this kind of code within the OECD inventory include Responsible Care in the chemicals industry, the Business Charter for Sustainable Development on environmental management and the British Code of Advertising and Sales Promotion.

Comparing and evaluating codes: Specialised NGOs have produced databases and publications providing assessments of the content of corporate codes and of their efforts to implement these codes. Prominent examples of NGOs providing this kind of service are Ethical Investment Research Service (EIRIS) and Council on Economic Priorities. These not only inform civil society and institutional investors, but along firms to see how their commitments stand relative to other firms.

Government contributions: Various OECD governments have added their voices to the debate by issuing model codes. The revised *OECD Guidelines*, as the only multilaterally endorsed comprehensive code of conduct for multinational enterprise, contribute in important ways to dialogue and growth of consensus.

**Box 2. The Business of Business is Business --
Direct Quotes on this Theme from Individual Company Codes of Conduct**

Our first priority is to be a profitable business and that means investing for growth and balancing short term and long term interests.

From the Chairman's message in the code of a major consumer products company.

[Company name] is committed to increasing its value to customers, employees and shareholders by profitably providing beneficial products and services to world-wide markets.

From the code of a North American chemicals manufacturer

The objectives of [Company group names] are to engage efficiently, responsibly and profitably in the oil, gas, chemical and other selected businesses and to participate in the search for and development of other sources of energy. [Company group names] seek a high standard of performance and aim to maintain a long-term position in their respective competitive environments.

From the code of a major petrochemicals company

[Company name] is a growing worldwide company dedicated to excellence through quality -- creating value for customers, employees and shareholders through innovation, technology and operational expertise.

From the code of a leading metals company.

Box 3. A comparison of binding laws with voluntary initiatives

Uniformity and consistency.

Formal codified and enforced law tends to have the advantage of relative consistency and uniformity of standard (see, for example, Webb and Morrison 1996). In contrast, actors in voluntary systems sometimes (but not always) have trouble defining and achieving uniform standards. The codes showed great diversity in coverage of issues, with only half of the codes making commitments to fundamental human rights in the workplace, such as freedom of association. This diversity of commitment might stem from differing circumstances of the apparel firms, but it could also signal that different firms apply different standards.

Flexibility and responsiveness to changing circumstances.

The positive side of the non-uniformity problem posed by voluntary corporate control systems is their flexibility or their ability to adapt to the circumstances of individual firms or to the particular requirements of a sector or location (Ayres and Braithwaite, 1992). Voluntary efforts often have the advantage of flexibility and adaptability to changes in structural conditions over time. This tends to lower what economists call the dead-weight costs (i.e. the value of lost output) of the codes (relative to those associated with more rigid rules).

In contrast, public law making or enforcement authorities may far be removed from the processes that society is attempting to control. Often, they do not have the information needed to design high quality laws or to enforce them effectively (that is, with due concern for individual circumstances). In addition, both the legislative process and the enforcement apparatus may be subject to considerable inertia. As a result, the system of rules and enforcement can quickly get out of alignment with the underlying structural conditions, especially in fast moving sectors. A study of regulatory systems in the OECD (OECD 1997) characterises them as containing “enormous inventories of rules and formalities that have survived without any serious examination for years or even decades.”

Effectiveness and cost of monitoring and enforcement

There is no clear “winner” in the comparison between binding and voluntary systems in this area -- analysis noted earlier supports the view that monitoring by civil society or by private specialised agents tends to support and complement public monitoring. All external monitoring, both public and private, suffers in varying degrees from the same basic problems -- how effective are external monitors likely to be in discerning misconduct that may be cleverly disguised or inherently difficult to perceive? How independent are the external monitors from various parties that are being monitored? Imperfect monitoring and enforcement gives rise to the so-called “free rider” problem (Purchase 1996). The free rider can benefit without paying or can impose costs on others without compensation. For example, a firm might use the label of a private quality control association without actually adhering to the norms established by the association -- thus, it benefits from the scheme without fully bearing its costs. The free rider problem -- that firms say they are observing high standards, but do not -- is one of the main reasons for public doubts about the credibility of voluntary efforts.

However, most government policies, including regulation, also have credibility problems -- indeed, policy credibility is one of the most basic issues addressed in public policy analysis. In the labelling scheme just described, the free riding problem stems from imperfect monitoring (are firms really respecting the quality standards?). Clearly, public labelling schemes can pose the same monitoring problems as private schemes.

As noted in Annex 2, firms and NGOs are aware of these enforcement problems and have been busy trying to address them by building private monitoring and enforcement capacity. Efforts include establishing norms for record keeping, developing specialised training programmes, refining the use of whistle-blowing facilities and developing external monitoring services, including formal audits.

Capture by vested interest groups.

Although regulatory economics often looks at regulation as if it were governed by the benevolent objective of serving public needs, practical experience shows that this is often not the case (see Gonenc et al. for a discussion of OECD experience with regulation). One weakness of systems that are designed and/or enforced by governments is their susceptibility to capture by interests groups (for example, Peltzman (1976) and Stigler (1971)). The scope for such capture is increased when information asymmetries make it difficult for civil society to hold regulators accountable (Laffont and Tirole, 1993). Despite attempts to increase the transparency and public accountability of regulatory processes, the quality of the written law and enforcement may still suffer as the regulatory apparatus is captured by the more politically well-connected actors and made to serve their interests. Voluntary corporate efforts may be subject to influence by vested interests as well. For example, the private firms that audit corporate performance in labour and the environment have occasionally acted like vested interests in private international standards-setting fora such as ISO. However, the voluntary movement is less susceptible to vested interests because its decision-making apparatus tends to be less centralised than in government-led binding systems.

Bibliography

- Alexander, Cindy and Mark Cohen (1999) "Why do corporations become criminals? Ownership, hidden costs and crime as an agency cost". *Journal of Corporate Finance* Number 5. Pp. 1-34.
- Arora, Seema and Shubhashis Gangopadhyay (1995) "Toward a theoretical model of voluntary overcompliance". *Journal of Economic Behaviour and Organisation* Volume 28. Pp. 289-309.
- Arthur Andersen (2000) *Ethical Concerns and Reputation Risk Management: A Study of Leading UK Companies*.
- Austrian Ministry of Economics and Labour, *Osterreichs Aussenwirtschaft Das Jahrbuch 1999-2000*.
- Ayres, Ian and John Braithwaite (1992) *Responsive Regulation*. Oxford University Press. New York and Oxford.
- Clague, Christopher (1993) "Rule obedience, organisational loyalty and economic development". *Journal of Institutional and Theoretical Economics*. Volume 149 Number 2. June.
- Coleman, James (1990) *Foundations of Social Theory*. The Belknap Press of the Harvard University Press.
- Conley, John and William O'Barr (1997). "Crime and custom in corporate society: A cultural perspective on corporate misconduct" *Law and Contemporary Problems* (Summer).
- Davis, Stephen, editor (2000) GlobalProxyWatch. March 31.
- Friedman, Milton (1962) *Capitalism and Freedom* University of Chicago Press, Chicago.
- Gonenc, Rauf, Maria Maher and Giuseppe Nicoletti (2000) The implementation and the Effects of Regulatory Reform: Past Experience and Current Issues" *Economics Department Working Papers* Number 251.
- Gordon, Kathryn and Maiko Miyake (1999) "Deciphering Codes of Corporate Conduct: A Review of their contents" OECD Working Papers on International Investment Number 99-2.
- Gunningham, Neil and Joseph Rees (1997) "Self-regulation." *Law and Policy*. Volume 19. No. 4. October.
- Gunningham, Neil (1996) "Codes of practice: The Australasian Experience". Executive summary published by Industry Canada. September.
- Jensen, Michael and William Meckling (1976) "Theory of the Firm: Managerial Behaviour, Agency Costs and Capital Structure" *Journal of Financial Economics*, number 3 (October).
- Laffont, Jean-Jacques and Jean Tirole (1993). *A Theory of Incentives in Procurement and Regulation* Cambridge Mass. MIT Press.
- Liubicic, Robert (1998) "Corporate codes of conduct and product labelling schemes: the limits and possibilities of promoting labour rights through private initiatives". *Law and Policy in International Business*. Volume 30.
- KPMG (1999) *Ethics and Integrity: Business Ethics Survey*. <http://audit.kpmg.ca/>.
- Nahapiet, Janine and Sumantra Ghoshal (1998) "Social capital, intellectual capital and the organisational advantage". *Academy of Management Review*. Volume 23. No. 2.
- North, Douglass (1990) *Institutions, Institutional Change and Economic Performance*. Cambridge University Press. Cambridge.

- OECD (2000) "OECD Guidelines for Multinational Enterprises: Statements made on the adoption of the Review 2000" available on www.oecd.org/daf/investment/.
- OECD (1999) "Reducing the Risk of Policy Failure: Challenges for Regulatory Compliance" OECD Working Paper.
- Organisation for Economic Co-operation and Development (1997) *Co-operative Approaches to Regulation*, PUMA Occasional Papers No. 18.
- OECD "Codes of Conduct: An Inventory" TD/TC/WP(98)74/FINAL.
- Peltzman, S. (1976) "Toward a more general theory of regulation" *Journal of Law and Economics*, Volume 19, pp. 211-240.
- Pfeffer, Jeffrey and Gerald Salancik (1978) *The External Control of Organisations: A Resource Dependence Perspective*. Harper & Row. New York.
- Purchase, Bryne (1996) "The political economy of voluntary codes" Executive Summary Published by Industry Canada. September.
- Punch, Maurice (1996) *Dirty Business: Exploring Corporate Misconduct* Sage Publications. London, Thousand Oaks, New Delhi.
- Reitaku Center for Economic Studies (1999) *ECS 2000 Ethics Compliance Management System* Business Ethics Research Project June 30, Reitaku University.
- Scholz, John (1997) "Enforcement Policy and Corporate Misconduct: The Changing Perspective of Deterrence Theory". *Law and Contemporary Problems*. Volume 253. Summer.
- Stigler, (1971) "The economic theory of regulation" *Bell Journal of Economics*, Volume 2. Pages 3-21.
- Stiglitz, Joseph (1999) "Participation and development: Perspectives from the comprehensive development paradigm." Unpublished conference paper. Seoul, Korea. February 27.
- Slemrod, Joel (1998) "On voluntary compliance, voluntary taxes and social capital". *National Tax Journal*. Volume LI. No. 3. September.
- UK Cabinet Office (2000) *Rights of Exchange: Social, Health and Trade Objectives on the Global Stage*. Chapters 9,10, 11. Performance and Innovation Unit.
- Webb, Kernaghan and Andrew Morrison (1996) "Legal aspects of voluntary codes: In the shadow of the law" Executive Summary Published by Industry Canada. September.
- Williamson, Oliver (1996) *The Mechanisms of Governance* Oxford University Press, New York: Oxford.
- Yoo, Jung-Suk (2000) *Strengthening Professional Ethics in the 21st Century -- The Korean Experience*, Office of the Prime Minister of the Republic of Korea. June.