BEYOND GOOD DEEDS

Case Studies and a New Policy Agenda
for Corporate Accountability

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EXECUTIVE SUMMARY

The increasing pace of globalization has catapulted U.S. multinational corporations into ethical quagmires around the globe. From Burma, where Unocal works with officials who use slave labor to build a natural gas pipeline, to Thailand, where Seagate workers died from lead poisoning, U.S. companies have found themselves in the white glare of newspaper headlines—and of advocacy campaigns by shareholders, nongovernmental organizations, and community groups.

At the same time, there is a growing number of stories about the voluntary initiatives that U.S. multinationals are undertaking to improve their ethical performance. Many companies have developed environment or human rights management systems and codes of conduct, which they publicize on their websites.

But are voluntary initiatives enough? Faced with the lack of global standards and inadequate national regulation, should multinationals be entrusted with self-regulation and enforcement? What role should government play in defining norms and providing incentives for better corporate performance, both at home and abroad? What policy innovations would promote corporate accountability?

This report makes the case that now is the time for a new American public policy agenda to strengthen corporate accountability. In light of recent high profile accounting scandals, from Enron to WorldCom, many voices are calling for corporate reform. Respect for human rights and protection of the environment, both at home and abroad, should be part and parcel of these reforms.

Drawing from case studies spanning nine countries, the report examines human rights and environmental challenges faced by U.S. multinational corporations in two industry sectors—oil and information technology.

The report develops a policy agenda based primarily on strengthening the government's role in mandating and managing information about corporate performance in relation to environment, labor rights, and human rights.

The Case for Public Policy

The need for innovations in public policy to strengthen corporate accountability stems from three sources: 1) regulatory gaps; 2) the limits of voluntary initiatives; and 3) the information gap—that is, the lack of credible company-provided information about performance.

Regulation Gap

The global environmental and human rights dilemmas faced by multinational corporations (MNCs) stem fundamentally from regulatory failures. While markets and

investment opportunities span borders, there are no binding global industry standards. The environmental and social regulation of industry remains national.

Many host countries in the developing world, however, lack technical capacities, physical and institutional infrastructure and, often, political will to provide environmental and social oversight of businesses. Moreover, fundamental civil and political rights are not protected in many developing countries, muting the role of legal action and public protest in exposing and redressing regulatory gaps.

One factor that keeps national environmental, labor, and human rights standards from rising is competition for MNC investment. In the absence of global corporate standards, competition for MNC investment creates a kind of low-pressure zone in the world economy, keeping national standards “stuck in the mud.”

Companies Adopt Different Strategies

Lacking global and, often, national regulatory oversight, MNCs become rule-makers. Some adopt a *duck-and-cover* approach and simply follow local practice, no matter how inadequate. Others adopt a *no-regrets* approach and set universal, company-wide standards, usually pegged to the highest or an average of home country standards.

A third approach is the adoption of *corporate social responsibility* (CSR), a commitment to “best practice.” CSR leaders tend to have one or more fairly sophisticated systems in place for auditing and managing environmental impacts, worker health and safety, working conditions, and/or stakeholder engagement. Some companies, investors, and others argue that the embrace of CSR is not only (or primarily) about “doing the right thing,” but that it is good for business.

The Limits of Voluntary Initiatives

The business case for taking a voluntary approach to CSR suggests that good environmental and social performance generates tangible financial benefits, which can be captured by companies and investors. Benefits arise either because consumers, investors, and workers prefer and reward a responsible company, or because acting responsibly reduces production costs and improves products.

But statistical studies seeking to prove the business case for CSR have yielded mixed results. Moreover, the studies have focused on company performance in the U.S. Very little quantitative data is available about overseas performance—and there is plenty of evidence that unethical, environmentally unsound, and even illegal business practice can also boost short-term profits.

The most telling evidence about the business case, however, is the low rate of uptake. Only a few, highly visible, blue-chip companies sensitive to consumer pressure, and “green” companies that have built their reputations on eco- or ethical behavior, have embraced CSR. Even the leaders have taken on only a small part of what civil society groups argue is needed.

Information Gap

One reason that the business case may not be working to motivate companies is that markets cannot discriminate very well between good and bad performers. Without good-quality information, consumers and socially responsible investors cannot consistently and accurately voice preferences through markets. Even within companies, managers sometimes lack the information they need to improve efficiency and safety of production processes and product design.

The environmental and social information gap stems from:

- *Minimal statutory requirements* for company disclosure;
- *Company fear and refusal to voluntarily disclose* internal information, including fear of liability or other reprisal, or of being disadvantaged relative to a competitor, and divulgence of trade secrets;
- *"Greenwashing,"* by providing information as a public relations gimmick;
- *Lack of a reporting template*, which hampers comparability and generates confusion among the public and within companies; and
- *Lack of clarity in private sector responsibility for human rights norms,* causing companies to set their own benchmarks without reference to socially defined needs and expectations.

The Case Studies: Oil and High Tech Industries

Oil companies, perhaps more than any other multinationals, have been the target of scrutiny and criticism for their overseas environmental and human rights performance. Operating in remote regions and through joint ventures with governments, oil companies are often at the margins of regulatory, legal, and community oversight. In developing countries, which make up an increasing share of both global demand for and supply of oil, investment by oil companies is widely seen as a mixed blessing.

Investment by foreign high tech companies, by contrast, is highly coveted in developing countries. Generating links to the global economy, high tech firms are seen as modern, clean, and green. Operating in the midst of major urban manufacturing centers, they tend to provide well-paid employment, relative to the options in developing countries.

Focused on two sectors with different accountability challenges, the field investigations aimed to shed light on what kind of public policy would be most relevant and effective to U.S. multinationals overall.

The oil sector case studies span Nigeria, Ecuador, Azerbaijan, and Kazakhstan, as well as operations in California. They focus primarily on the record of ChevronTexaco, Occidental Petroleum, and Unocal. These studies identified the key physical environmental and social problems as widespread pollution, a pattern of social neglect, including insensitivity to human rights abuses, a gap between company promises and performance, and a low level of company transparency.

The high tech sector case studies span Taiwan, Thailand, Malaysia, and India, with a field report on Costa Rica and an overview of California and the regulatory environment in the U.S. These studies identified the key environmental and social problems as the use of highly toxic materials in production and in consumer products; a high intensity of energy and water use; inadequate labor standards, including protection of worker health and safety; and poor oversight of global supply chains. In general, despite significant efforts to reduce their environmental impacts, high tech companies have not come to terms fully with the sustainability and human rights challenges that confront them, both at home and abroad.

Lessons Learned

The oil and high tech sectors face distinctly different environmental and human rights problems. A common theme, however, is the failure of leadership and governance, by both the companies themselves and government. As a whole, the case studies provide insights about the strengths and weaknesses of industry self-regulation as a route to corporate accountability.

Leaders and Laggards

Both oil and high tech sectors are characterized by “leader” and “laggard” companies in terms of environmental and social performance. Leaders set clear benchmarks, make public quantitative data about performance, and engage with communities and other stakeholders. Leaders tend to be large and well capitalized, with highly visible brand names and reputations to protect.

Overseas and domestic performance tend to be similar, given different local contexts. When a company leads, either on a particular issue like air and water emissions, or on its general management system for labor rights and protections, it does so both at home and overseas. The same is true for laggards.

Inadequate Oversight of Environmental and Human Rights

In both the oil and high tech sectors, regulatory oversight is inadequate in developed and developing countries alike, but for different reasons. In the oil sector, the environmental regulations in place are enforced sporadically and maintain a back seat to attracting and keeping high rates of oil production. In many countries, the official development agency that enters joint ventures with oil companies can issue or negate environmental provisions in operating permits, establishing from the outset a situation of conflict between earnings and environmental compliance.

On the other hand, in the high tech sector, developing countries lack the physical infrastructure to manage the industry’s toxic and hazardous waste, and the regulatory capacity to protect worker health and safety. Moreover, the regulation of global supply chains bedevils oversight even in developed countries.

For both sectors, the cases highlighted that the limited legal protections for civil and political rights in developing countries undermine the watchdog capacity of workers and local communities and, for the oil industry, contribute to local conflict.

A multinational corporation following local law in a developing country where standards are lower than in developed countries for either reason will in fact operate under “double

standards." But even companies that follow best practice throughout the company operate under conditions of inadequate oversight. The inability of regulators, even in the U.S., to keep up with the potential health hazards in the evolving chemical stew used by semiconductor manufacturers is a good example.

Unsustainable Development

Large-scale investment by multinational corporations creates planning and resource dilemmas for surrounding communities, generally stemming from the cumulative impacts of operations by several companies in a limited geographic space.

The degradation of land, water, and air, and the perceived inequity of large oil revenues amidst growing poverty in the Niger Delta, for example, is attributable more to oil development as a whole than to the behavior of individual companies. Likewise the pollution and congestion stemming from the development of high tech clusters like Hsinchu or Silicon Valley.

Without a better public planning and goal-setting process, individual companies—no matter how advanced their codes of conduct—will not be able to adequately address sustainability in economic development.

Lack of Effective Stakeholder Engagement

One of the most strident stakeholder critiques of company social performance is the failure to adequately engage with and respond to the needs and demands of local communities. Oil companies have been particularly vulnerable to such criticism, especially when lack of engagement is coupled with widespread environmental damage, like in the Amazon and Nigeria. Where companies made a serious effort to engage stakeholders, as in Shell Oil's Camisea project in Peru or Intel's intensive consultation process in Costa Rica, better projects and plans emerged and the local perception of the company improved.

Lack of Information

Companies in both industries suffer from a lack of adequate internal and external information and data to compare how actual environmental practices and performance stack up against either the companies' own stated goals or industry benchmarks. None of the companies examined in this report make public a complete set of environmental and social performance information, including from suppliers. Many companies do not even gather such information for internal use.

Limits to Voluntary "Best Practices"

The case studies suggest that individual companies can do much on a voluntary basis to improve their own environmental and social commitment and performance. The span between the performance of leading companies, especially those committed to best practice, and lagging companies, is substantial.

However, without change in the policy frameworks that set rules and determine market incentives for all players, voluntary initiatives can go only so far. They cannot fully address the environmental, human rights, and labor standards dilemmas that multinationals face in a highly differentiated global economy, nor deliver broad social objectives such as sustainability at home or abroad.

TOWARD A NEW POLICY AGENDA

The case studies suggest that reforms to significantly improve oversight in both host *and* home countries are critical in changing the dynamic of poor corporate performance on human rights and the environment. Rather than rely only on command-and-control methods, a new policy agenda should include performance-based standards and should encourage the best of voluntary corporate initiatives. It should help to empower investors, consumers, company managers, affected communities, advocacy groups, and workers who are seeking to encourage and reward better company performance.

Our findings suggest that an immediate role for government is to improve the quality and quantity of public information about the impacts of corporate activity. Information is a public good and is key to making markets work. Information must be generated, standardized, provided, managed, verified, and disclosed to the public to fulfill its central role in making markets work efficiently and in encouraging ethical corporate behavior.

U.S. corporations now report to the government on a wide range of issues. However, while production and sales are increasingly global, reporting is limited to domestic operations. Thus, it is impossible for a U.S. investor or other outside observer to tell whether risk has been reduced or merely shifted to another locale.

U.S. Right-to-Know Reforms

The U.S. lags behind other Organization for Economic Cooperation and Development (OECD) countries in embracing a proactive role for government in encouraging CSR, and importantly, there has been little public debate or discussion about whether and how government could and should play a role in encouraging corporate social responsibility and accountability. Being a laggard is ironic: the U.S. was an early leader in the area of information disclosure and, in terms of government information, remains far more transparent than many European countries. But the laws requiring corporate disclosure to regulators or the public are piecemeal and under-enforced.

Both federal and state governments can more widely embrace measures for company reporting. One possible template is the Global Reporting Initiative (GRI). This initiative, supported by a wide array of groups and the UN Environment Programme, is working to develop and disseminate a voluntary reporting template. GRI entails company-wide reporting, embracing both domestic and global operations, but not focusing on the facility-specific information that may be of most interest to local communities.

Another coalition of NGOs has proposed expanding U.S. labor and environment-related disclosure laws to cover the overseas operations of U.S. firms and their suppliers. Their proposed *International Right-to-Know Act* would require large U.S.-based companies, stock issuers, their subsidiaries and contractors to disclose to the U.S. government and the public, information on air and water emissions, toxic releases, worker health and safety, security arrangements overseas, and community relocation policies; as well as to clarify human rights, environmental, and labor policies, and complaints against the company in these areas.

Securities Reform

Another means of improving disclosure is to expand the use and enforcement of existing laws governing disclosure by publicly traded corporations. All corporations that issue stock in the U.S. are subject to certain requirements under both federal and state securities laws.

Disclosure is required, however, only of *material* information—that which a reasonable investor might have considered important in making an investment decision. Current definitions of materiality, which largely focus on narrow economic performance measures, are inadequate. Even such mainstream organizations as the Brookings Institute and the American Enterprise Institute have jointly called for updating the information available to potential investors. Moreover, by the 1990s, socially responsible investing involved one out of every seven dollars under professional management, suggesting that corporate social performance is material to a much larger group of investors than was the case when the rules were put in place in the 1930s.

A group of NGOs and socially responsible investors have formed the Corporate Sunshine Working Group (CSWG) to develop appropriate measures for expanded disclosure to the Securities and Exchange Commission (SEC). The group's current proposal would require companies to disclose: a list of the countries where they have facilities or operations; corporate political contributions and lobbying activity; data on product recalls and product-related claims and settlements; data on percentage of unionized workforce; data on compliance with occupational health and safety, anti-bribery, labor rights, and anti-discrimination laws; and security arrangements with state or private police and military forces.

Creating Data Management Systems

Disclosure is only half the story. Too much raw data can overwhelm and befuddle, rather than enlighten, the public and policymakers. Data must become information, and then knowledge, and the government should play the role of information manager. It should gather, store, and organize the information available in accessible, searchable, and useful formats and databases. Different formats can help to serve different needs—for scientific research, community monitoring, environmental advocacy.

Government agencies themselves may not be the only, or even the best, processors of data. Government can support independent research organizations to process the raw data in various ways and help the government to independently analyze and distribute the information to local public sources.

Providing Regulatory Incentives for Disclosure

Good regulation involves a mix of "carrots" and "sticks." A number of emerging state and federal environmental programs offer positive incentives like shorter permitting times, one-stop shopping, multimedia permits, fewer inspections, or positive public recognition for companies that substantially exceed compliance with environmental law.

"Beyond compliance" programs generally require participating companies to meet three requirements: 1) an adequate environmental management system; 2) enhanced disclosure of environmental data; and 3) stakeholder consultation. The data disclosure

requirement is generally limited to resource use, emissions, and wastes, and has not to-date included any occupational health or other non-environmental data.

Expanding these programs to cover occupational health and safety or human and labor rights issues would be complex, involving many more agencies, data collection, and sets of incentives, but could be done. Companies that wish to benefit from the additional flexibility of green track programs would likely voluntarily serve as testing grounds.

Protecting Consumers from False Advertising

Positive incentives for increased information production are growing, at least in the environmental area. Less developed are sanctions against incomplete, misleading, and false information.

Both the federal and state governments have long protected consumers against false advertising, as well as fraudulent and illegal business practices. However, the Federal Trade Commission, which is mandated to protect consumer interests, has taken a cautious stance to regulating claims of corporate responsibility.

In a landmark decision, the California Supreme Court in 2002 decided that false advertising and unfair business practices laws extend to a company's misrepresentations about such issues as labor practices. The case alleged that Nike misrepresented its labor practices overseas in public statements, thus misleading consumers.

Some are concerned that this approach will invite a rash of lawsuits and scare off corporations from voluntary reporting before mandatory reporting systems are won, and may make the battle for expanded mandatory reporting more difficult. However, these concerns can be addressed, for example, by providing a short window for companies to self-correct discrepancies that are brought to their attention without penalty.

Designing Verification and Accreditation Standards

A robust, credible system of self-reporting requires external verification of company performance. Currently, third party verifications are undertaken mostly by large accounting firms—the same firms that are now at the center of national controversies. Relying on these firms has had mixed results at best: worker health and safety issues are often missed and the verifiers tend to evidence a pervasive pro-management bias.

Fundamental questions have not been resolved: who's monitoring the monitors? What, precisely, is being verified? What is the appropriate methodology? What are the appropriate qualifications of verifiers?

Currently, there are no rules or standards in the arena of CSR verification. Government policy should create incentives for companies to have their reports verified by third parties that meet specified accreditation criteria. An ideal verification system would combine systems and data verification from internal company sources and regulatory agencies with social and environmental conditions verification from workers and affected communities. Government, or

government-private partnerships, can set out rules for training, areas of expertise, independence, competency, and licensing.

A Role for States? California as Innovator

At this early stage of policy development, pilot projects and regulatory experiments may be more easily and appropriately carried out at the state than the federal level. The results of local or state-level laboratories can feed into developing national and international policy frameworks.

The state of California may be especially well placed to take a leadership role in stimulating public debate and developing policy instruments to increase corporate accountability. California has the world's fifth largest economy and many of its corporations are known as leaders and innovators, including in the high tech industry.

California has long been in the forefront of regulatory strategies, especially on environment. It currently chairs the Multi-State Working Group on environmental management systems, and is designing a "superior track" environmental regulatory program that includes a substantial disclosure component. In many areas of California, state and local authorities are developing regional sustainability plans that involve businesses, regulators, and the public in cooperative goal-setting and monitoring exercises.

Information Disclosure

A policy initiative in California to "raise the bar" on mandatory corporate disclosure could take one of several forms. Mandatory disclosure, such as through enhanced state right-to-know laws, could be both facility and company-based, and designed to feed into local and regional sustainability planning exercises. Such an approach would complement current second generation initiatives and encourage companies to develop internal data collection systems.

Alternatively, disclosure could be modeled after the state's Proposition 65, which requires companies to inform consumers when products contain certain listed chemicals, and which provides for citizen suits to sanction companies for failure to disclose. In this approach, companies would be required not to make changes to how they do business, but to disclose to consumers what they are—or are not—doing. Misleading or untrue statements could be penalized under state law. As discussed above, any disclosure requirement, to be effective, will need a solid information management or data management component to facilitate public awareness.

Leveraging California's Public Pension Funds

A second leg of a California strategy on corporate accountability could leverage the state's huge pension funds, especially the California Public Employees Retirement System, or CalPERS.

With assets of some $150 billion, CalPERs is the third largest pension fund in the world and holds stock in over sixteen hundred companies. In March 1999, CalPERS adopted

the Global Sullivan Principles, which pledge the fund to express support for human rights, protect human health and the environment, and promote sustainable development. They also commit CalPERS to “promote the application of these principles by those with whom we do business.”

CalPERS already sees its role as “moving the herd” in terms of engaging companies on corporate governance such as executive pay and board independence. CalPERS could embrace the social responsibility mantle as part and parcel of good corporate governance. One approach might be to apply a set of mandatory reporting requirements to the corporate portfolio, requiring companies to provide information along a number of axes—environmental, worker health and safety, community improvement, and so on.

California as a Consumer

A third leg of a state-based effort to improve corporate accountability could focus on purchasing decisions. The state currently purchases nearly $3 billion in materials, goods, and services each year. Currently, environmental impacts and product life cycle are not considered in a comprehensive or coordinated approach in the state’s purchasing.

The state’s procurement laws already contain certain socially responsible directives, including .the requirement that contractors with the state develop and implement a nondiscrimination program and not use child labor. These laws could be amended to identify that the state has an interest in procuring goods and services from socially responsible businesses, that is, companies that can demonstrate a wider range of good performance on environmental, labor, and human rights grounds.

Reform of Corporate Law

Corporations are creatures of state law. They exist as legal entities under corporate charters granted in accordance with state law. Another way to enhance corporate accountability is to change state laws on corporate governance.

Every jurisdiction where corporations operate has its own law of corporate governance. In Maine, an ex-corporate lawyer is promoting a Code of Corporate Citizenship, which would be amended to state corporate law. Currently, the Maine law says that directors should discharge their duties with “a view to the interests of the corporation and of the shareholders.” The code would add “but not at the expense of the environment, human rights, the public safety, the communities in which the corporation operates, or the dignity of the employees.”