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Editorial statement

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SPECIAL ISSUE
Voluntary codes of conduct for transnational corporations

This special issue is based on a selected group of three papers that were presented at the 1st International Conference on "Voluntary Codes of Conduct for Multinational Corporations: Promises and Challenges" held at the Zicklin School of Business, Baruch College on 12–15 May 2004. The Conference was organized by the International Center for Corporate Accountability (ICCA), Inc. It was jointly sponsored by Zicklin Center for Business Ethics Research of The Wharton School, University of Pennsylvania, and the World Bank Institute of the World Bank. Additional support was provided by a number of major corporations, academic institutions and non-governmental organizations (NGOs).

The three papers selected for this special issue of *Transnational Corporations* have a unique focus and address the evolving character of voluntary codes of conduct, especially as they pertain to transnational corporations (TNCs). The current wave of globalization has brought about a radical transformation in geopolitical arrangements on the one hand and a shifting locus of economic power and bargaining leverage on the other hand between private economic institutions and regulatory regimes in the political and regulatory authorities.

This wave of globalization has also been accompanied by an expansion of the market economy in which wealth creation and distribution are controlled to a greater extent by private institutions. The result is that, while trade and investment at the country level are influenced by factors endowment and comparative advantage, the distribution of productivity gains does not reflect the relative contribution of different factors of production at the international level. Consequently, labour costs have not moved towards convergence between low-wage and high-wage countries, and capital investment per worker has not increased significantly in low-wage countries to enable them to improve labour skills leading to higher wages.

Another outcome of this state of affairs has been that national governments in developing countries are competing among themselves to attract and maintain foreign direct investment (FDI) undertaken by TNCs, including by making concessions to TNCs in terms of tax and other "give aways", thereby limiting their ability to fashion domestic policies with a better focus on their national interest.

TNCs can exert tremendous influence by creating a new equilibrium in economic and political power. However, they have been unwilling to do so for reasons of self-interest. Unlike in the earlier waves of globalization, where the expansion of TNC power and influence were viewed with distrust, in the current wave of globalization TNCs are viewed as positive instruments of growth and change. Any effort to constrain their conduct is viewed as undesirable.

This situation appears unsustainable. Nature abhors power vacuum and disequilibrium. Recognition of this situation has led TNCs and other societal stakeholders to find interim solutions that would narrow the imbalance between the influence and power of TNCs and those of nation states.

One approach to handling this issue has been the development of voluntary codes of conduct created by TNCs individually, and industry groups collectively. These codes reflect a set of undertakings that their sponsors promise to implement with a view to addressing some of the real or perceived societal concerns associated with or emanating from TNC conduct. This development is still in a nascent stage and the jury is still out as to its viability over the long run. TNCs prefer this approach because it allows them to project and magnify their efforts at a minimum cost and changes in their *modus vivendi*. It is also for these very reasons that TNC critics view them with skepticism.

The three papers presented here provide a composite picture for the reader as to the current state of usage of voluntary codes of conduct. They also point to their internal structurally-oriented strengths and weaknesses and what can be expected of them under the best and worst of circumstances. The authors of the papers recognize that for the foreseeable future voluntary codes of conduct provide the most feasible approach to directing TNC conduct, which would be acceptable to larger elements of society while avoiding imposition of heavy compliance burdens on TNCs that would be economically unjustified or socially undesirable, and would be unlikely to be acceptable to the TNCs. They also point to a number of definitions in the code creation and implementation as currently practiced by TNCs and industry groups. Finally, they indicate certain approaches that would be needed on the part of the codes sponsors so as to make them more effective and socially acceptable.

The paper by Ans Kolk and Rob van Tulder on "Setting global rules? TNCs and codes of conduct" focuses on historical aspects of code development and implementation. The authors suggest that codes of conduct can be seen as an expression of corporate social responsibility, but also as rule-setting behavior – attempts to help fill some of the existing international institutional voids. Their paper examines trends in the adoption and contents of codes of conduct introduced to regulate the behavior of international business. Specific emphasis is placed on the current state of international social responsibility codes, their effectiveness and perspectives for future development.

John Kline's paper on "TNC codes and national sovereignty: deciding when TNCs should engage in political activity" examines the role of TNCs in the formulation and implementation of the political agenda in the countries of production. The author states that when governments decline to intervene in another country's affairs, TNCs can be thrust into the breach between emerging international standards and national political sovereignty, using corporate economic capabilities to influence political change. According to Kline, codes of conduct for TNCs largely ignore the dilemmas presented by increasing pressures on TNCs to engage in political activities that support human rights objectives in foreign countries. The author offers a conceptual "connection continuum" as a taxonomic device to help identify and evaluate key factors that determine the nature and degree of a TNC's responsibility to undertake such political involvement. Ranging from TNCs as proximate causal agents to distantly unaware yet potentially capable actors, the continuum concept provides a way to develop and apply TNC conduct standards that weighs possible corporate complicity in human rights violations with the desire to restrict TNC interference in a country's domestic political affairs.

The third paper by S. Prakash Sethi on "Effectiveness of industry-based codes in serving public interest: the case of the International Council on Mining and Metals (ICMM)" undertakes a detailed analysis of one industry's voluntary code of conduct. The industry in question is the mining industry, which is under heavy pressure for its operational practices that are considered harmful to the environment. There are also issues of questionable practices involving potential human rights abuses. Thus, industry leaders have the most incentive to take effective voluntary measures to forestall further regulation at the national and international level. And yet, as the paper shows, the industry has failed to use this opportunity. The author offers an analytical framework within which to evaluate the relative effectiveness of industry-based principles or codes of conduct. It analyzes the ICMM's Sustainable Development Framework and its adequacy in terms of what the industry group aims to accomplish, and further actions that might be needed to address unresolved issues in order to engender public trust and confidence in the industry's actions and assertions in meeting societal expectations.[1]

The help of Karl P. Sauvant and Joerg Weber in the preparation of this special issue is acknowledged. Also the comments of several anonymous referees proved to be extremely helpful.

S. Prakash Sethi

President, International Center for
Corporate Accountability, Inc., and
University Distinguished Professor, Baruch College, City
University of New York

1 The readers of this special issue should note that ICCA is planning to hold its 2nd International Conference in June 24-28, 2007. The general theme of the conference is "Globalization and the Good Corporation." Readers are invited to contact ICCA with their ideas and suggestions for the conference at 1 Bernard Baruch Way, J1034, New York, NY 10010. Updates on the next conference would be posted on ICCA's website: www.ICCA-CorporateAccountability.org. Email address: oemelianova@ICCA-CorporateAccountability.org.

Setting new global rules? TNCs and codes of conduct

Ans Kolk and Rob van Tulder*

The introduction of codes of conduct can be seen as an expression of corporate social responsibility, but also as rule-setting behaviour – attempts to help fill some of the existing international instutitional voids. To shed light on these aspects and the (potential) effectiveness of codes, this article examines trends in the adoption and contents of codes of conduct introduced to regulate the behaviour of international business. Using the evidence obtained over the years, it presents an overview of the state of current knowledge on international social responsibility codes, and indicates areas for further research, management and policy attention. It also deals with the definition and types of codes, the background and dynamics of the code 'movement', the contents of codes and their compliance likelihood, issues regarding implementation and effectiveness, and 'next steps' that can be taken to obtain further insight.

Key words: TNCs; corporate social responsibility; codes of conduct; NGOs; international organizations; business associations; self-regulation

Introduction

The initiation of codes of conduct can be perceived of as rule-setting behaviour, which contributes to the establishment

* Ans Kolk (corresponding author), Professor, University of Amsterdam Business School, The Netherlands, akolk@uva.nl and Rob van Tulder, Professor, Erasmus University Rotterdam, Department of Business-Society Management, The Netherlands, rtulder@rsm.nl. The comments of the three anonymous referees are gratefully acknowledged.

of new institutions.[1] National governments normally prevail in these codification processes due to their formal position as law-makers. In the international arena, however, rule setting has proven to be more difficult, and considerable international regulatory voids have appeared in the course of the 1990s (Braithwaite and Drahos, 2001). The fact that, in the same period, almost every major transnational corporation (TNC) in the world either drew up and implemented a code of conduct or contemplated to adopt such a document, thus did not develop in isolation.

Codes initiated by TNCs can be interpreted as a corporate attempt to fill in some of the international institutional voids, by introducing informal institutions. But what properties do and will these new institutions have? Company codes of conduct are also an expression of corporate social responsibility. Could that imply that the new institutional setting in the world could trip the balance from properties usually propagated by realist approaches towards an idealist approach of international relations (Gilpin, 2002)? To explore these issues, a more detailed assessment of the trends and nature of codes of conduct is necessary.

Such an analysis could also shed some light on the nature of this corporate code development. Are companies indeed increasingly becoming socially responsible and responsive to societal concerns? Is civil society becoming more effective in pressing for responsible business practices? And are governments correct in putting their hopes on corporate self-regulation? Or does this development merely represent better communication strategies, with codes of conduct as a new form of window dressing? And what can we say about the effectiveness of codes of conduct, from a societal and managerial perspective? Do explicit codes help to tackle major present-day

[1] A definition of "institutions" most often used is the one formulated by Douglas North (1994, p. 360), in which institutions "are made up of formal constraints (e.g., rules, laws, constitutions), informal constraints (e.g., norms of behavior, conventions, self-imposed codes of conduct), and their enforcement characteristics."

world problems, do they set new institutions that operationalize the principles of either a realistic or an idealistic world order? And are they useful instruments to facilitate the multiple dilemmas involved in managing across borders – the difficulties that TNCs face when operating abroad?

Seven years ago we started our research project on TNCs and codes of conduct by posing these broad questions. Using the evidence that has been obtained over the past few years, this article addresses the questions formulated above by presenting an overview of the state of current knowledge with regard to international responsibility codes, and indicating areas for further research, management and policy attention. It subsequently deals with the definition and types of codes, the background and dynamics of the code movement, the contents of codes and their compliance likelihood, issues regarding implementation and effectiveness, and next steps that can be taken to obtain further insight.

Definition and types of codes

International responsibility codes encompass guidelines, recommendations or rules issued by entities within society (adopting body or actor) with the intent to affect the behaviour of (international) business entities (target) within society in order to enhance corporate responsibility. In this definition, the adopting body can be any societal actor, whereas companies are always the target. It should be noted that companies might design codes for other purposes than for the sake of their own ethical behaviour and corporate responsibility. It is highly conceivable that codes adopted by companies are in essence meant to influence other societal actors: regulators, customers, communities, suppliers and contractors, competitors or shareholders. The possibility that codes may serve other purposes than social responsibility as such is relevant when analyzing their properties and substance.

Hence, two types of codes exist. On the one hand, societal, non-profit actors may use codes of conduct to guide and/or restrict companies' behaviour, thus trying to improve corporate social responsibility. Adopting bodies are either governments or international organizations (at the macro level) or social interest groups such as consumer, environmental and minority organizations, trade unions and churches, at the meso level. On the other hand, codes can be drawn up by companies (micro level) or business support groups (meso level) such as industry and trade associations, chambers of commerce, think tanks and business leaders forums. In these cases, codes serve to influence other actors and/or to carry out voluntary or anticipatory self-regulation.

With regard to the effect on other actors, one might think of new market opportunities, risk reduction, increased control over business partners or improvement of the corporate image. Except for control over business partners, whereby codes can potentially become strategic instruments, the other aspects are related to public relations. This could be seen with suspicion, as mere rhetoric (e.g. environmentalists who accuse TNCs of "greenwashing"), but also in a more straightforward, almost existential way, in that companies need a societal license to operate.

Codes can also play a role in the relationship between the public and private sectors. Companies generally resist excessive government laws and regulations that are seen to restrict their freedom of action. The chances of successfully preventing such an command and control approach increase if companies can convincingly show that they can regulate themselves. Self-regulation encompasses voluntary standards adopted by companies or their business support groups in the absence of regulatory requirements, or those that are taken to help compliance or exceed pre-existing regulations (Hemphill, 1992). Thus, codes of conduct are drawn up to anticipate or prevent mandatory regulation.

Waves of codes since the 1970s

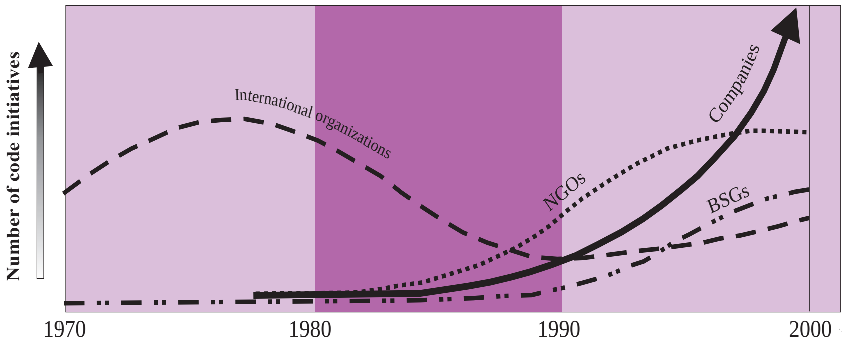
The first attempts to regulate TNCs' behaviour originate in the 1970s, when international organizations such as the

International Labour Organisation (ILO, in 1977), the United Nations Commission on Transnational Corporations (UNCTC, in 1978) and the Organisation for Economic Co-operation and Development (OECD, in 1976) almost simultaneously tried to design codes of conduct. Governments of both developed and developing countries that faced major inroads of TNCs in their economies showed interest in the debate. Critical social interest groups also pushed the discussion further. But the lack of international consensus about the function, wording and potential sanctions against non-compliant companies in particular, moderated the original intention to make the codes mandatory. Instead voluntary codes were agreed, which had only limited effects. The ILO code, for example, was adopted voluntarily by one company, but after trade unions used this code in an industrial dispute with the company's managers, no other company dared to do the same.

In the 1980s, codes of conduct received rather scant attention. The 1970s' draft codes of the ILO (the Tripartite Declaration of Principles concerning Multinational Enterprises) and the OECD (the Guidelines for Multinational Enterprises) performed an exemplary function (Getz, 1990). The boldest initiative to develop a code that stimulated TNCs to maximize their contribution to economic development, was the United Nation's draft code. It never was finalized and adopted, however, and was finally abandoned altogether in 1992, due to differences of interest between developed and developing countries (van Eyk, 1995; WEDO, 1995). In the 1980s, the discussion on corporate codes of conduct was largely confined to business ethics, and was carried on primarily in the United States. A growing number of university centres and specialized journals focused on the study of business ethics. United States companies had traditionally been interested in business ethics for a number of national reasons, particularly related to practices of litigation. The international dimension of the debate, however, remained limited, and attention to business ethics in other than United States companies was rather modest (Langlois and Schlegelmilch, 1990).

In the 1990s, the efforts to formulate (global) standards for corporate conduct re-emerged. Besides international organizations, governments and NGOs, companies and their business associations (business support groups) started to draw up codes in which they voluntarily committed themselves to a particular set of norms and values (figure 1). TNCs, in particular, felt pressured by increasing societal concerns about the negative implications of international production and investment. Leading NGOs, trade unions and churches came up with concrete suggestions for company codes. The challenge for codification was first met by business associations such as the International Chamber of Commerce (ICC) or the Japanese employers' association Keidanren. A growing number of individual companies, such as Nike, Levi Strauss and Shell, also responded by introducing responsibility codes. For Shell, it meant an update of its company code that had already been introduced in the 1970s. For most other companies, the code was their first statement on their (perceived) social responsibility and approach.

Figure 1. Waves of codes of conduct since 1970



Source: the authors.

As a result of these tendencies, at the end of the twentieth century, a plethora of codes and statements of corporate responsibility existed, as shown by different inventories (CEP, 1998; Cragg, 2003; ILO, 1998; Kolk, van Tulder and Welters, 1999; Leipziger, 2003; Nash and Ehrenfeld, 1997; OECD, 1999; UNCTAD, 1996; UNEP, 1998). Particularly the number of private company codes exploded in the past decade of the twentieth century. Measured by sheer numbers, companies have now taken the lead in the voluntary introduction and implementation of codes of conduct. The corporate governance and accounting scandals in the past few years have been a further incentive for the adoption of codes. Although primarily oriented at more internal ethical codes, increased attention to norms and values certainly has an effect in strengthening the code wave as a whole.

A cascade of codes

In the development of codes, business initiatives have interacted with the continued work of international organizations, governments and NGOs, resulting in a veritable cascade of codes. A dynamic development can be observed in which the introduction of a code by one company, frequently in response to stakeholder expectations, very often leads to the adoption of comparable codes by others. This might, in turn, incite additional requests by stakeholders, which again requires a company response, sometimes in the form of an update of the code and a specification of policies. Industries in which this dynamic process has been shown to exist are sporting goods (Van Tulder and Kolk, 2001) and coffee (Kolk, 2005a).

Industries that have received particular attention regarding international responsibility codes are apparel, footwear, soccer balls, carpets, agribusiness, retail, tourism and, most recently, electronics and coffee (CAFOD, 2004; ILO, 2003; Kolk, 2005a; Sajhau, 1997; Van Tulder and Kolk, 2001; World Bank, 2003a). In many cases, this has been linked to labour rights, particularly the issue of child labour (Jenkins, Pearson and Seyfang, 2003; Kolk and Van Tulder, 2002a; United States DOL, 1997; Wolfe and Dickson, 2002). This focus can be explained from the relatively high (child) labour-intensity of these industries, and the fact that they usually sell their products on consumer markets, not on business-to-business markets. These peculiarities strongly increase the vulnerability of companies to societal demands for action, and thus the likelihood of code adoption, both at the company and the industry level.

The country of origin has also been important in this regard. Societal pressure has been stronger in some countries than in others. The dynamics of this interaction between various stakeholders has influenced corporate inclinations to draw up codes of conduct. The domestic stakeholder context has affected United States companies in particular. A study in the late 1980s, which compared the United States and Europe, underlined that the adoption of corporate codes started much earlier and was more widespread in the United States (Langlois and Schlegelmilch, 1990). A more recent study in the garment industry confirmed this tendency (Kolk and Van Tulder, 2002a). It must be noted that with regard to the types of codes adopted, particularly concerning the implementation and compliance mechanisms included (see below), European TNCs tend to adhere to clearer and more specific monitoring systems than United States firms. Japanese TNCs, finally, are least inclined to adopt codes, which seems in line with their general approach to human resource management that stresses informal coordination and control rather than specific contractual relations (van Tulder and Kolk, 2001).

Different corporate governance systems might also play a role in explaining some of the differences in the approach to codes of conduct. In the "outsider" system of the United States with a one-tier board structure, households hold considerable amounts of shares, whereas the role of the CEO is more prominent. At the same time, the share of socially responsible investment (particularly in the hands of institutional investors) is also the highest in the world. Finally, there is a higher propensity for liability and class-action suits. All this has created a particular dynamic that differs from the situation in Europe and Japan. The European and Japanese systems of corporate governance are more "insider systems" where the role of the CEO has been somewhat less prominent so far, and a two-tier board structure exists. Institutional investor interest in social responsibility, and fear for litigation, have lagged behind the United States situation. Codes of conduct under these circumstances play a different role, perhaps more of an internal control (rule-setting) instrument. In European companies formal rules prevail, whereas in Japanese companies informal rules predominate. How recent developments in corporate governance will influence this whole dynamic is an interesting question for further research (see also the final section).

The interaction between companies and their stakeholders has thus been a crucial factor in the development and fine-tuning of international responsibility codes. This has not only had an impact on the number of codes adopted, but also on their contents.

The contents of codes: assessing and comparing compliance likelihood

With growing numbers, the interest in the contents of the responsibility codes has increased as well. The different inventories mentioned above usually include a content analysis, of which the specific components singled out for investigation depend on the approach and objectives of the organization/ researcher in question. However, taken together, these different elements recur in a comprehensive framework developed to analyze and compare codes of conduct (table 1).

This model, first published in 1999 (Kolk, van Tulder and Welters, 1999), aims to assess the so-called "compliance likelihood", which is the probability that companies will conform in practice to codes either proclaimed by themselves or developed by other actors, and that these claims will in fact be translated into responsible behaviour and action. The compliance likelihood is determined by the compliance mechanisms included in codes and the extent to which the claims put forward are measurable. The more specific the codes are, the better can they be measured and, subsequently, monitored. Monitoring is expected to enhance codes' comprehensiveness and compliance likelihood.

The framework has been used to analyze and compare the codes drawn up by a range of companies, international organizations, NGOs and business associations. Examining, at

Table 1. A model to analyze and compare codes of conduct

Criterion			Short elaboration	Classification
SPECIFICITY	ISSUES	1.1 Social	1) employment (employment promotion, equality of opportunity and treatment; security of employment) 2) training 3) working conditions (wages and benefits; conditions of work and life; safety and health) 4) industrial relations (freedom of association; collective bargaining; consultation; examination of grievances; settlement of industrial disputes) 5) force (child labour; forced labour; disciplinary practices)	ranging from: 0 out of 5, to 5 out of 5
		1.2 Environment	1) management policies and systems (subdivided into 4 aspects) 2) input/output inventory (6 aspects) 3) finance (2 aspects) 4) stakeholder relations (7 aspects) 5) sustainable development (3 aspects)	ranging from: 0 out of 5, to 5 out of 5
		1.3 Generic	1) consumer interests (consumer needs; disclosure of information; consumer concerns; marketing practices) 2) community interests (community involvement; disclosure of information; community philanthropy/sponsoring) 3) global development (global issues; socio-political setting; fair and free trade practices; third world development; third world philanthropy/sponsoring) 4) ethics (fundamental human rights and freedoms; fundamental ethical values; bribery and facilitating payments) 5) legal requirements (legal compliance; compliance vis-à-vis business partners	ranging from: 0 out of 5, to 5 out of 5
	FOCUS	2.1 Organizations targeted	general; firms; industries; business partners; internal operations of specific firms	general/firms/ industries/ partners/ internal
		2.2 Geographic scope	global (general); nearly global (frail); general region (moderate); regulatory system (moderate to strong); specific country (strong)	no/general/ frail/moderate/ moderate to strong/strong
		2.3 Nature	general prescription/description (general); predominantly general (frail); general and specific (moderate); predominantly specific (moderate to strong); specific (strong)	no/general/ frail/moderate/ moderate to strong/strong
	MEASURE	3.1 Quantitative standards	% of issues quantified: >90% (predominant); 51%-90% (majority); 25%-50% (medium); 10%-25% (minority); <10% (few) ; none (no)	predominant/ majority/ medium/min-ority/few/no
		3.2 Time horizon	1) quantification % of >90% (predominant); 51%-90% (majority); 25-50% (medium); 10%-25% (minority); <10% (few); none (no) 2) qualitative division into none defined; vague; clear	ibid.; and none/ vague/clear
		3.3 Reference	none defined; home country; host country; international; or combinations	like preceding box
COMPLIANCE	4.1 Monitoring systems and processes		good insight into system and process (clear); reference to some parts, but criteria or time frames are lacking (clear to vague); only general reference to monitoring without details (vague)	clear/clear to vague/vague/ none
	4.2 Position of monitoring actor		firms themselves (1st party); business associations (2nd party); external professionals paid by firms (3rd party); combinations of different actors (4th party); NGOs (5th party); legal authorities (6th party)	ranging from: 1st to 6th party
	4.3 Sanctions		measures have no large implications, e.g. warnings and exclusion of membership (mild); threat to business activities (severe)	none/mild/ severe
	4.4 Sanctions to third parties		measures such as fines, or demands for corrective action (mild); severance of relationship, cancellation of contract (severe)	n.a./none/mild/ severe
	4.5 Financial commitment		classification according to level of fee or relative investment	low/moderate/ high/very high/none
	4.6 Management commitment		no commitment stipulated (none); includes a list of endorsing firms (explicit); or with regard to company codes, when business partners must sign it (explicit); commitment implied (implicit)	none/implicit/ explicit

Source: Van Tulder and Kolk (2001), pp. 273-274.

the time, these four actors' codes with regard to focus, measurability and compliance mechanisms, the codes issued by business associations proved weakest on all scores. This reflects their lowest common denominator principle: many of the meso codes succeed in attracting considerable numbers of subscribing companies because the statements are very vague. This role of a business association in providing so-called "club goods" has been demonstrated more specifically in the case of the Chemical Industry's Responsible Care programme (King and Lenox, 2000; Prakash, 2000).

One might see business associations codes as awareness-raising tools. However, once this function has been fulfilled, they seem to become public relations exercises and alibis for avoiding more drastic steps rather than active means to increase corporate social responsibility. Only better monitoring and especially the imposition of sanctions might prevent adverse selection, in which the least performing companies tend to subscribe most frequently to business associations codes (Lenox and Nash, 2003).

Whereas business associations codes proved weakest as to specificity and compliance, codes developed by NGOs, trade unions and other social interest groups scored higher, also when compared to international organizations and company codes. At the same time, however, the compliance likelihood of these NGO codes was not very high. Measurability – with regard to quantitative standards and time horizons – turned out to be even lower than in some company codes, something that also applied to sanctions and financial commitment. A relatively large number of NGO codes did make references to home-country and international standards, though, and were stricter regarding monitoring systems and monitoring actors. In that sense, they clearly fulfilled the function of putting pressure on other actors.

On average, leaving aside the considerable variety that exists, company codes scored better than business associations codes, especially concerning the organizations targeted, their reference to standards, monitoring systems and position of the monitoring actor. Codes drawn up by international organizations were stricter than company codes on aspects such as their nature and the position of the monitoring actor. It must be noted, however, that the compliance likelihood of international organizations codes was generally not very high (and less than NGO codes). This reveals partly conflict of interests and/or lack of support. Policy competition between national governments often hampers stricter formulations. Taking this into consideration, companies might be better capable of developing cohesive codes that can also be implemented.

Regarding the relatively limited compliance likelihood of international organizations codes, it must also be noted that some of them were never intended to be put into practice, serving mainly as model codes (ILO, 1998). This means that international organizations have had a function in triggering other coalitions and code development. The beginning of an era of multilateral diplomacy can be witnessed in which companies, governments, NGOs and sometimes also business associations bargain over the formulation and implementation of codes of conduct. Examples include the Apparel Industry Partnership (Sethi, 2003) and, more recently, the multi-stakeholder initiative Common Code for the Coffee Community (Kolk, 2005a). In addition to garments and coffee, other sectors have also shown interesting developments – particularly the extractive industries (oil, mining, diamonds) (Sullivan, 2003), and banking. Multi-stakeholder initiatives sometimes interact with corporate initiatives taken by front-runner companies and/or pressurised by NGOs and public opinion.

These are dynamic, in a sense never-ending, processes as codes will continuously be drawn and redrawn on the basis of social bargaining, in which new alliances might be formed. Such an interaction between the different actors has been shown in the sporting goods industry and coffee sector where it led to more sophisticated codes, especially on the part of some companies that were most vulnerable to societal demands, also because of their organizational and strategic peculiarities (Kolk, 2005a; Van Tulder and Kolk, 2001; Kolk and Van Tulder, 2004).

The framework for analysis indicated above (table 1) has proved helpful in delineating and tracing such developments, and can be used in follow-up research on new trends as well (see final section), also to see whether the peculiarities of the different types of codes (international organizations, companies, NGOs, business associations), still holds in the 21st century.

Codes and specific issues: child labour and poverty

In addition to an examination of codes for their specificity and compliance in general, the framework can also be used to focus on particular issues. Especially with regard to child labour, the model has been fine-tuned and elaborated for more detailed analysis, with particular attention to minimum-age requirements, monitoring and sanctions (table 2).

Table 2. A model to analyse and compare corporate codes of conduct on child labour issues

Criteria		Short elaboration	Classification
SPECIFICITY	1.1 Minimum age to employment	Does the code include a minimum age to employment? If so, what age?	yes (age); no
	1.2. Applicability	Is this a universal minimum age or are country-specific exceptions indicated?	n.a.; universal; country-specific
	1.3. Organization targeted	To whom is the code addressed? General, governments; internal operations of specific firms; business partners (suppliers, subcontractors, vendors, manufacturers)	actor category (exact wording)
	1.4. Reference	Is reference made to international standards (ILO, UN), either implicit or explicit, or to home-country or host-country laws?	none; home; host; international (implicit/explicit)
	1.5. Nature of code	Are alternative measures included in the code (such as education for children)? Or does the code only prohibit child labour?	broad; strict
COMPLIANCE	2.1 Monitoring systems and processes	good insight into system and process (clear); reference to some parts, but criteria or time frames are lacking (clear to vague); only general reference to monitoring without details (vague)	clear; clear to vague; vague; none
	2.2 Position of monitoring actor	firms themselves (1st party); BSGs (2nd party); external professionals paid by firms (3rd party); combinations of different actors (4th party); NGOs (5th party); legal authorities (6th party)	ranging from: 1st to 6th party
	2.3 Sanctions and their scope	there are no measures included (none); they apply to company employees (internal); and/or to third parties (respectively all and external)	none; internal; external (actor category); all
	2.4 Type of third-party sanctions	measures such as fines, or demands for corrective action (mild); severance of relationship, cancellation of contract (severe)	n.a.; none; mild; severe

Source: Kolk and Van Tulder (2002b), p. 264.

Codes can also be examined on other social issues in which the role of companies is considered to be important. An example is poverty. In the international discussion on how to combat poverty, the potential contribution of the private sector is frequently mentioned nowadays by a number of international organizations, NGOs and business associations. Company codes can therefore be analyzed to see to what extent they address the different components related to poverty alleviation, as distinguished by international organizations such as the ILO, UNCTAD and OECD. Table 3 contains a model with the policy measures that internationally operating companies can take to diminish poverty (the content issues that relate to equality of opportunity and treatment, conditions of work, and collective bargaining). The second part of the framework, the "context issues" focuses on what companies can contribute to the eradication of poverty and to greater involvement of the poor.

Table 3. A model to evaluate corporate conduct in relation to the eradication of poverty

Criteria		**Short elaboration**	**Classification**
CONTENT ISSUES	Equality of opportunity and treatment	1) Eliminate any discrimination based on race, colour, sex (gender equality), religion, political opinion, national extraction or social origin 2) Respect human rights	Ranging from: 0 out of 2 to 2 out of 2
CONTENT ISSUES	Conditions of work	1) Wages and benefits should be not less favourable than those offered by comparable employers 2) The normal working week should not exceed forty-eight hours plus twelve hours overtime (with overtime being remunerated at higher rates) 3) The minimum age to employment is respected (for light work: 13 years) 4) The highest standards of safety and health are followed	Ranging from: 0 out of 4, to 4 out of 4
CONTENT ISSUES	Collective bargaining	1) Workers have the right to have (and establish) representative organizations of their own choosing which are recognised as partners in collective bargaining 2) The company provides workers' representatives with adequate means and facilities (including information) to conduct meaningful negotiations	Ranging from: 0 out of 2, to 2 out of 2
CONTEXT ISSUES	Address special needs	1) Carry out activities in harmony with development priorities, and social aims and structure of the host country (general policy objectives) 2) Obey national laws and regulations	Ranging from: 0 out of 2, to 2 out of 2
CONTEXT ISSUES	Dynamic comparative advantage	1) Adopt/develop technology to the needs of host countries 2) Invest in high-productivity, high-technology, knowledge-based activities 3) Establish backward linkages with domestic companies 4) Give consideration to conclude contracts with national companies	Ranging from: 0 out of 4, to 4 out of 4
CONTEXT ISSUES	Training	1) Provide training for employees at all levels which develops useful skills and promotes career opportunities 2) Participate in training programmes organised by/together with governments 3) Make services of skilled personnel available to assist in training programmes	Ranging from: 0 out of 3, to 3 out of 3
CONTEXT ISSUES	Monitoring	1) Foster and strengthen local capacities to monitor poverty reduction programmes (participatory methods) 2) Encourage the development of local poverty reduction indicators and targets 3) Design poverty monitoring systems which provide evaluations of anti-poverty programmes	Ranging from: 0 out of 3, to 3 out of 3

Of these two issues mentioned as examples for further elaboration of the content analysis scheme, especially the child labour scheme has been used in different publications. These have shed further light on compliance likelihood and stakeholder interactions. A comparison of child labour codes of the four actors (international organizations, business associations, NGOs, companies) showed that, here as well, those drawn up by NGOs turned out to be most specific, and those developed by business associations the least (Kolk and van Tulder, 2002b). A dynamic interaction could again be noted, resulting in at least some company codes in particular industries that are specific regarding minimum age to employment, monitoring and compliance (Kolk and van Tulder, 2002a). These studies also showed, however, that the imposition of severe sanctions proved to be a complicated issue, pointing at the dilemmas of codes and the underlying discussion about their effectiveness.

On implementation and effectiveness

In the past few years, several studies and NGO campaigns have focused on whether, how and to what extent codes have indeed been implemented by companies, and how monitoring and verification has worked in practice. Some companies and industries have received particular scrutiny. Case study examples include the electronics sector (CAFOD, 2004), apparel (BSR, IRRC and O'Rourke, 2001; Jenkins, Pearson and Seyfang, 2002; Oldenziel, 2001) and sports footwear, especially Nike (e.g. Connor, 2001). They point to the limitations of corporate codes of conduct, particularly of those that are vague and lack clear monitoring mechanisms. Deficiencies include the fact that most codes have so far failed to take a supply chain approach, to reckon with home-based workers and to sufficiently involve employees, both in the formulation of the codes and, most notably, in the audit process. The inability of auditors to monitor adequately (independently) codes and reveal suppliers' disguising practices is mentioned as well.

Concerns about the quality of the audit process and the costs of monitoring were also raised in two other recent studies on code implementation commissioned by international organizations (ILO, 2003; World Bank, 2003b). The ILO (2003) focused on the management systems for such implementation in footwear, apparel and retail. Based on (and citing) anonymous information derived from 329 interviews with managers and workers from TNCs, their suppliers and a limited number of other actors, it concluded that the sports footwear companies were most advanced in the implementation of codes in their operations. TNCs in this industry had drastically reduced the number of suppliers, and delved relatively deeply into the systems of these remaining suppliers. Apparel companies, which work with much more suppliers, were less advanced in the implementation. Retail companies, finally, have usually thousands of suppliers and, also due to the fact that their key activity is to market and sell other brands, seemed to be least focused on code compliance for their own products.

In addition, sports footwear was, comparatively speaking, most advanced in integrating social responsibility in regular management systems, while the other two industries approached it more as an add-on to systems already in place. The report noted that the "research consistently revealed an inadequate, if not poor, level of integration of CSR and Code compliance responsibilities in the internal structure of MNEs and suppliers" (ILO, 2003, p. 246). The sourcing department, crucial in managing the relationship with and imposing requirements on suppliers, was "often the least involved with CSR and Code compliance issues".

The other recent report, published by the World Bank (2003b), summarized the findings of (partly group-wise) interviews of 199 individuals from 164 organizations and companies in apparel and agriculture. It focused particularly on three barriers to improved code implementation, formulated by the World Bank as input for the study. These involved a plethora of codes, the top-down approach and the insufficient understanding of the business case. Especially the first barrier was not really supported by the interviewees. While recognizing the inefficiencies related to the large number of existing codes, they did not see much added value in working towards one harmonized code. Most respondents already observed a convergence of forms and contents, and mentioned to see potential for improvement in taking a more focused (industry-level) approach.

The ILO (2003) study neither found that suppliers experienced great problems because of being confronted with multiple codes from different TNCs, since compliance with the most stringent code satisfies all parties. Moreover, if codes focus on different areas (e.g. one on health and safety, another on working hours), compliance with all of them helps to improve standards across the board. Such overall compliance might be possible, but an important difficulty faced by suppliers is that they usually have to bear the costs for (extra) requirements themselves. It can, therefore, not be ruled out that the multiple codes argument is merely used as a pretext for non-compliance (World Bank, 2003b), hiding more complicated economic issues related to the distribution of costs and benefits (of code compliance) over global supply chains, including the fact the cost savings were the motivation to outsource production in the first place (Kolk and van Tulder, 2002a).

As a greater concern than the mere existence of a multitude of codes, both studies mentioned the inconsistent interpretation and application of provisions (World Bank, 2003b), indicated by the ILO more specifically as the lack of indicators and performance metrics related to labour, social and ethical standards. As part of this problem it was stated that for example labour standards aim at governments, not at companies, which complicates application at the factory level. Like the ILO, the World Bank study referred to the complexity of global supply chains as another barrier to implementation of social responsibility. Even more than apparel, agriculture consists of a number of rather different commodity-driven industries.

This points at the broader, structural economic aspects related to codes of conduct, where contradictory forces exist. With regard to monitoring, for example, it could be argued that TNC cooperation to develop shared schemes might be useful to reduce costs, avoid duplication and facilitate compliance on the part of suppliers. This departs from the assumption that such more operational issues are non-competitive, a view not always shared by TNC headquarters staff who fear that sensitive (factory) information might be disclosed. A common approach also makes the efforts of an individual TNC less visible, which might be undesirable in case this company is specifically targeted by NGOs or consumers and wants to show its own corporate social responsibility profile.

A final issue that needs to be raised is the effectiveness of codes of conduct – in other words, can codes be a useful mechanism for addressing social responsibility? The World Bank (2003b) refers to trade unions' view that law enforcement and collective agreements are much more effective; NGOs have also emphasised that (existing) regulatory standards need to be strengthened and implemented (Jenkins, Pearson and Seyfang, 2002). The debate on the effectiveness of codes of conduct has been addressed in a study that focused on child labour (Kolk and van Tulder, 2002a). It developed a two-by-two matrix to outline the different perspectives that can be taken (figure 2). While applied to child labour in this case, it identifies in general the extent to which a code of conduct can be effective in dealing with a particular social responsibility problem.

Figure 2. Effectiveness matrix of corporate behaviour on social issues

		Effective in dealing with child labour	
Having a corporate code of conduct		YES	NO
	YES	Position 1	Position 2
	NO	Position 3	Position 4

Source: Kolk and van Tulder, 2002a, p. 261.

The positions range from support for the positive impact of corporate codes of conduct (position 1), to emphasis on the unintended negative side-effects of codes, such as, in this case, the impact on children in case of strict sanctions (position 2), to an effective corporate approach by other means that codes (position 3), and, finally, a situation in which it is seen as a public, not a private, responsibility to address social responsibility issues (position 4). Effectiveness was explored by a close examination of the nature of the child labour codes that companies have drawn up, and by a survey among a focus group of companies and stakeholders who were asked for their views. The respondents considered codes to be important, though not the only, instruments for addressing child labour. The study also identified the different managerial and policy dilemmas surrounding corporate codes. These aspects of codes, including the complicated issues surrounding effectiveness and implementation examined in this section, are clearly areas that need further investigation. Below some other steps that could be taken will be mentioned.

Next steps: an agenda for research, policy and management

While codes of conduct might be relatively weak, they are nevertheless part of the new current rules of the game and a vital input for the creation of new international institutions in an era of uncertainty regarding the shape of national and international regulatory regimes (Braithwaite and Drahos, 2001). Especially because many codes are drawn up by large TNCs, their impact goes far beyond the confines of these individual companies. They affect suppliers and other actors within and beyond their value chain, and spill over to other regulatory regimes and rule-setting activities by international organizations.

The actual nature of the international institutions created by companies is still relatively obscure. In the international arena it has always been difficult to enforce agreed-upon rules. The establishment of new rules induced by TNCs certainly adds to filling some of the international regulatory voids. If companies support specific international regulation or model codes (the ILO Declarations, the Universal Declaration on Human Rights, the OECD principles of good governance), this might even be considered as a step towards the further operationalization and implementation of multilateral idealist rules for the global society. This could be the case even if codes of conduct are relatively weakly monitored. In that sense, the proliferation of codes of conduct that contain more and more provisions on social responsibility issues can be interpreted as a move into the direction of more idealist global rules. At the same time, codes of conduct can also be used as means of controlling international supply chains, thus representing a step towards implementing realist global rules, based on the dominance of a few core players (TNCs). It remains vital, therefore, to explore further the dynamics and efficiency of the rule-setting process shaped by corporate codes of conduct. Some future directions will be indicated below.

As mentioned in this article and in the various studies carried out on the contents (compliance likelihood), interaction among the various actors has been an important factor in the development of (more sophisticated) company codes. However, further steps can be taken to improve our understanding of the role and effectiveness of codes. This means first of all that attention needs to shift towards TNCs to investigate how codes (their own codes, but also for example multi-stakeholder initiatives) fit into the strategic choices and dilemmas faced by these companies and their managers. Such a perspective, which examines the management of strategic and ethical trade-offs (Kolk and Van Tulder, 2004), connects strategic peculiarities and imperatives to the organizational purpose to see what room of manoeuvre managers have in dealing with their moral free space (Donaldson, 1996), how they (want to) position themselves and the type of ethical leadership aimed for.

Here the difference between United States, European and Asian TNCs can be further examined. Country/region of origin has been shown to frequently play a role in responsibility and accountability (cf. Kolk, 2005b). This article suggested that countries of origin play an important role. This can be further expanded to the influence of (efficient) stock markets on the adoption of more or less stringent codes. The same applies to the role played by specific investors such as mutual funds, ethical investors or households. Some evidence points at the fact that particularly European TNCs tend to favour more concrete codes with better monitoring procedures, while there are different approaches in the United States and Japan. Does this also imply that codes of conduct originating from European TNCs contribute more to the effectuation of new (or renewed) formal global institutions? And does the more informal approach of Japanese TNCs mean that they will also be least interested in a further formalization of other international institutions? In this regard, it will be interesting to investigate the impact of the strengthening of corporate governance, ethics and reporting guidelines in the different regions (in the aftermath of responsibility crises and regulatory responses such as Sarbanes-Oxley).

Further research on the code formulation and operationalization process in various types of TNCs could also focus at an examination of how foreign affiliates contribute to this process. It could be argued that, if there is a diffusion in innovations and marketing approach between headquarters and affiliates, there could be a similar transfer of best practices in terms of voluntary codes across countries within the same TNC. It seems worthwhile to investigate whether such a process of code decentralization actually takes place and to what extent this is linked to the effectiveness of codes.

Important is also the relative size of companies. Our approach included primarily large TNCs. Smaller TNCs can clearly devote less resources to the adoption and enforcement of codes. They, however, can be more interested in either following the codes pioneered by larger companies or adopt a more informal approach to setting codes of conduct. In the former case this might be part of an attempt to legitimize themselves, in the latter case this would add to the relative institutional chaos in the international arena.

In addition to this management approach, which examines the strategic effectiveness and appropriateness of codes of conduct at the company level, a global commodity or value-chain perspective can be taken (Barrientos, 2002; Gereffi, Humphrey and Sturgeon, 2005), focusing on operational effectiveness as well. This not only helps to map the structure and governance of a global network, but also to trace the impact of codes of conduct in the different parts of the value chain. Moreover, it considers how codes of specific actors interact, what the role of powerful or leading actors is or should be, and where the responsibility (must) lie for the formulation, implementation and enforcement of codes of conduct. The debate on these topics is being waged in with regard to, for example, coffee (Kolk, 2005a), cotton and the extractive industries.

Besides a focus on the *company* (micro level) and the *chain* (meso level), an *issue-specific* perspective seems equally appropriate. Since many companies have drawn up codes that pay particular attention to topics such as child labour, specific issues can be singled out for further analysis in order to assess what role corporate codes of conduct can play in shaping new global institutions. This leads to a more general, macro approach, in which international societal issues (global public goods) are identified, followed by an examination of what companies might do to help solve these problems.

Different from J.F. Rischard (2002) who describes "global problems", we emphasise the fact that issues very often originate from unequal or inappropriate distribution, not so much from want for technological advances, and that they can arise at different levels. While a range of interrelations and interactions exists that should be taken into account, a classification might nevertheless be made, consisting of four categories:

- core social/economic issues that are related to the growth regime of a country, and which are often supposed to be at the heart of any other (re)distribution and wealth problem; this involves particularly income disparity, unemployment and poverty;
- individual rights issues, which cover health, social and human rights (for example, hunger, torture, unequal levels of

vulnerability to diseases and unequal access to medicines and education, freedom, work security);

- group rights issues that relate to the specific rights and problems of groups in society (which refers to discrimination on the basis of for example gender, race and age, and to worker and indigenous rights);
- macro/generic rights issues which are connected to the availability of and access to resources and public goods in general, the right to a safe, peaceful, democratic and clean environment.

This classification of issues can be used to generate ideas about the way in which companies are part of the problem and/or part of the solution. It goes without saying that companies that are part of the problem, by directly or indirectly e.g. employing children, prohibiting freedom of association, paying workers less than subsistence levels, or by adhering strictly to HIV-medicine patents or investing in countries where torture takes place, are also important in helping to solve the problem. That explains the drive to adopt corporate codes of conduct, which many companies have done as a defensive reaction, in order to prevent damage to their reputation. Sometimes, however, other companies (or actors) than the ones (in)directly involved in causing/aggravating the problem can play a role in alleviating the situation or putting pressure on the former group. Examples include companies that provide HIV or other medicines to workers and their families, which proactively adopt a code of conduct on issues that do not (yet) affect them (e.g. Shell's primer on child labour), or which force polluting companies to change policies because future business will be threatened (e.g. insurers, banks and pension funds that require a precautionary policy on climate change before investing in companies).

The identification of global issues and (groups/networks of) companies that are part of the problem and/or the solution seems a promising area for further research and essential to a better understanding of how the effectiveness of codes of conduct and other (self)regulatory instruments can be increased.

An adequate assessment of the specific role of companies as part of the problem and/or solution is also a vital input for negotiations over specific issues at the international level, and for the formation and/or adjustment of international regimes and public/private partnerships.■

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TNC codes and national sovereignty: deciding when TNCs should engage in political activity

John M. Kline*

Codes of conduct for transnational corporations (TNCs) largely ignore the dilemmas presented by increasing pressures on TNCs to engage in political activities that support human rights objectives in foreign countries. Civil society groups often turn to TNCs for action when governments fail to respond effectively to serious, systematic violations of human rights. However, such TNC actions will often contravene traditional standards calling for TNC non-interference in a nation's internal affairs. This article offers a conceptual "connection continuum" as a taxonomic device to help identify and evaluate key factors that determine the nature and degree of a TNC's responsibility to undertake such political involvement. Ranging from TNCs as proximate causal agents to distantly unaware yet potentially capable actors, the continuum concept provides a way to develop and apply TNC conduct standards that weighs possible corporate complicity in human rights violations with the desire to restrict TNC interference in a nation's domestic political affairs.

Key words: codes of conduct; human rights; national sovereignty; TNC political activities; complicity; "sweatshops"; environment; non-governmental organizations (NGOs); supply chain responsibility.

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* Professor of International Business Diplomacy, Walsh School of Foreign Service, Georgetown University, Washington, D.C. The comments of anonymous referees are gratefully acknowledged.

Introduction

A barrier is falling but few people notice. Rather than the proverbial tree that fell in a quiet forest with no one around, this barrier's collapse is being missed by a surrounding world whose sensory perceptions are overloaded by globalization's noisy change. The collapsing barrier is the long-standing admonition by governments against TNC involvement in domestic political affairs. Pressured by civil society activism and social responsibility campaigns, TNCs increasingly engage in political activities related to international human rights, labour rights, and environmental protection standards. The danger lies less in immediate TNC involvement to promote specific goals than in the failure of governments to recognize and set guidelines for such private political actions. The longer governments maintain the illusion that national sovereignty effectively precludes TNC political activities, the greater the likelihood that TNC activities will supplant proper governmental functions. Coherent core principles should inform both public and private sector codes of conduct to guide appropriate TNC political activity.

The growth in TNC political involvements derives from generally laudable objectives. Nation-state governments often prove unable or unwilling to act effectively to address systematic violations of human rights, labour rights and environmental protection standards in countries with unrepresentative or ineffective governments. Expanded cooperation among civil society groups internationally, coupled with the more effective use of media and market pressures, draw proximate and/or capable TNCs into activities that can influence political change in these countries. This type of TNC involvement differs in orientation, magnitude and impact from traditional corporate actions to promote national policies that benefit local operations. Newer TNC political activities are connected to strategies that require cultivating the corporation's reputation and image in an interconnected global marketplace rather than nurturing disassociated corporate citizenships in separate host countries.

The path to progress does not lie in rebuilding the national sovereignty barrier against outside influences. Unrepresentative national governments abusive of their own citizen's rights should be subject to international sanction, including actions by private sector entities responsive to global community values. This approach will provoke conflicts between international codes and some host government policies, but such clashes are inevitable in an emerging global community where international norms begin to take precedence over assertions of inviolate national sovereignty. The important concern should be how codes will develop to guide TNC actions. New international principles are required to inform guidelines or processes that shape the appropriate role for TNC involvement in political activities.

This article explores how normative concepts and principles might be used to evaluate when and why TNCs should become involved in a host country's internal affairs, focusing particularly on issues related to human rights. A proposed "connection continuum" offers a taxonomic instrument to help organize factors linking TNCs to human rights abuses, suggesting how to assess the relative responsibility among various TNCs to take actions with clear political impacts. The continuum's potential use is illustrated through the discussion of contemporary issues that have generated pressure for increased TNC political involvements. The article aims to promote renewed discussion on the topic of TNC political action, offering an initial proposal on how TNC codes and procedures might address such activities.

The context and the challenge

Political involvements by TNCs in the 1960s-1970s, headlined by ITT's support for the military coup overthrowing President Salvador Allende in Chile, stirred debate about limiting the expanding influence of these new private actors on the international stage. In the academic community, the debate helped spark emerging studies of international business-government relations that crossed traditional disciplinary lines, integrating elements drawn from international politics, economics and business (Boddewyn, 2004). These analyses focused largely on the interactions of TNCs with host and home countries, examining how TNCs might alter traditional international affairs theory dominated by nation-state relations. Internationally coordinated and boundary-spanning TNCs appeared able to exploit "gaps" between territorially-bounded national laws and the minimalist coverage provided by international agreements. Within countries, foreign affiliates linked to foreign control and resources appeared to challenge and perhaps threaten national government sovereignty, at least for many smaller developing countries.

Governments responded by reasserting the inviolability of national sovereignty, with political authorities in both host and home countries endorsing the principle of TNC non-interference in domestic political affairs. Occasionally, strong home countries attempted to extend their political influence extraterritorially through TNC channels, such as United States assertions of extraterritorial export controls over foreign affiliates, but such cases did not envision TNCs acting on their own, absent home government direction. By contrast, unanticipated pressures emerged from non-governmental organizations (NGOs) that sought increased TNC involvement in domestic political affairs, exemplified by calls for TNCs to oppose and help dismantle the apartheid regime in South Africa. This development set up a dynamic tension between governments and NGOs, with TNCs often caught in the middle (Gladwin and Walter, 1980, pp. 130-257).

Voluntary codes of conduct emerged principally as "soft law" alternatives to the continued inability of governments to achieve sufficient consensus for binding international law standards. As detailed in a prior article (Kline, 2003), most intergovernmental codes embraced the political non-interference principle embodied within broader enumerated guidelines for "good corporate citizenship". Individual company and industry codes of conduct also generally endorsed non-interference standards, proclaiming corporate "neutrality" on political issues.

By contrast, a growing number of NGOs, coalescing into a broad civil society movement, developed more nuanced positions. Few NGOs would endorse abandoning the general principle of TNC non-interference, but an examination of NGO positions nevertheless finds strong advocacy for selective TNC actions that would clearly constitute involvement in a host country's internal affairs. Under this bifurcated approach, NGOs encourage TNCs to cross the "bright line" standard proscribing political activities when such actions advance important favoured objectives, particularly the promotion of human rights (*ibid*).

Many codes of conduct, including some adopted by individual TNCs, call for companies to "respect" and sometimes to "support" or even "promote" human rights, generally making reference to the United Nations Universal Declaration of Human Rights. This formulation offers little practical guidance while providing fertile ground for case-by-case disagreements over whether the standard has been met. Actions urged on TNCs as part of a commitment to human rights have included defiance of local law, intervention in judicial and legislative processes, breach of contract, and coercive denial of sales and service. Related goals involved the overthrow of national governments, promotion of political movements, damage to a country's economy, and the alteration of domestic policy and regulations (*ibid*). Such goals and actions address core political issues that lie too far outside a TNC's basic societal role to represent desirable corporate conduct unless undertaken within more explicit, politically-sanctioned international guidelines.

Ideally, public institutions should lead rather than lag issues raised by the global community's expanding economic and social integration. The preferred, first choice option remains for governments to meet their own role responsibilities by addressing important global problems, devising international law and accompanying political arrangements to enforce agreed norms. However, the practical application of international legal documents, such as the United Nations Universal Declaration of Human Rights, exceeds the international community's current ability to interpret and enforce global standards through a sanctioned political authority.

If responsible national and international public sector actors fail to address serious, systematic violations of basic human rights, a response by non-governmental actors, including TNCs, may be ethically justified and perhaps morally required as a second- or third-best option. However, the challenge lies in developing agreed principles in advance that can guide such business conduct within reasonable boundaries. Without soundly reasoned principles, urgent pressures from specific cases will bring *ad hoc* responses where neither the justification nor potential impacts of TNC political involvements are clear or assured.

Delimiting the core issues

Before exploring potential code of conduct guidelines for TNC political involvement, two assertions will help simplify and focus the examination. The first assertion posits that legally chartered foreign affiliates normally should possess both responsibilities and rights to participate in a nation's political processes, as governed primarily by that nation's laws. Ethical theory links rights and responsibilities; TNCs cannot be held responsible for political outcomes but denied rights associated with political participation. The second assertion favours the establishment of general guidelines while allowing the possibility for unusual exceptions if a clear burden-of-proof standard is met. This position focuses on proactively guiding TNC conduct rather than waiting for individual case judgments. These assertions help avoid digression into either debate that denies any TNC rights to political involvement or raises anecdotal objections to general guidelines.

The primary issue examined in this article relates to possible TNC political involvements in cases where host country governments engage in serious and systematic violations of human rights. The analysis considers various normative principles and concepts that could help determine the nature of a TNC's responsibility in such cases as well as guide appropriate responsive actions. After exploring possible code guidelines for these cases, the article then briefly assesses how such guidelines might apply on three other types of issues where NGOs seek increased TNC actions to address: (1) unjust allocations of revenue from national resources due to governmental corruption or discrimination against minority groups; (2) "sweatshop" labour conditions where national law standards are low and/or unenforced; and (3) environmental degradation where national law standards are low and/or unenforced. These four types of cases do not cover all politically-relevant issues, but they do address a range of important high-profile examples from which basic code guidelines might be derived.

In cases in which host country governments systematically violate their citizens' human rights, a beginning proposition holds that the principal responsibility for action should fall on other governments, acting individually or (preferably) collectively through international organizations. This locus of responsibility designates peer public sector actors with comparable powers and roles to address an issue of governmental misconduct that will inherently challenge the principle of national political sovereignty. Serious violations of world community norms could cost a national government the political legitimacy from which sovereignty claims are derived and/or justify interventions that override national sovereignty, but such determinations are best made by public sector authorities.

International legal documents also place some duties regarding human rights on non-governmental actors, including TNCs. The United Nations Universal Declaration of Human Rights proclaims generally that "every individual and every organ of society" should respect and help promote human rights (United Nations, 1948). The Guidelines for Multinational Enterprises, adopted in 1976 by the Organisation for Economic Co-operation and Development (OECD), was amended in 2000 to add a provision calling on TNCs to respect human rights (OECD, 2002). More recently, the "Draft norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights", being developed and debated in the United Nations Economic and Social Council's Commission on Human Rights, seeks to elabourate TNC responsibilities with much greater specificity (ECOSOC, 2003). However, such international instruments lack effective legal enforcement; even advocates of greater TNC responsibilities in this area generally acknowledge that States bear the primary responsibility for human rights (van der Putten, Crijns and Hummels, 2003, pp. 82-91; Sullivan, 2003, pp. 286-287).

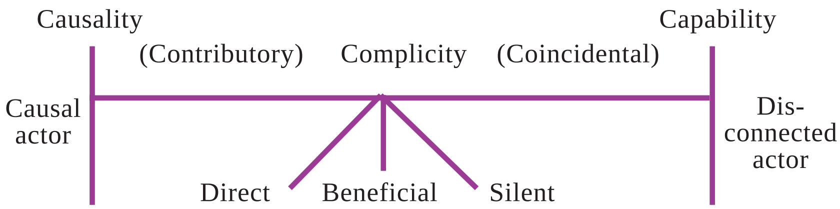
Nevertheless, when national governments and intergovernmental institutions fail to act effectively, and serious, systematic human rights violations continue, other organizations and individuals, including TNCs, hold some degree of responsibility to act. One step, of course, could involve increased advocacy for more effective government actions, but failing a satisfactory and timely response, other alternatives may also be considered. The global reach and substantial resources controlled by TNCs offer the potential for influence within other countries. TNC actions can arise from a self-recognized sense of voluntary corporate responsibility. More often, civil society groups, stymied in the public arena, turn towards TNCs in search of more responsive, effective leverage. TNC political involvements generally arise in such cases when NGOs organize campaigns to target particular companies for media and marketplace pressures (Kline, 2005).

In such circumstances, and where governmental directives are absent, should TNCs respond by engaging in activities that will inherently constitute involvement in the domestic political affairs of host countries? If so, what principles or responsibility standards could guide proper TNC conduct?

Devising a connection continuum

A conceptual connection continuum provides one way to consider possible justifications for TNC political involvements. As illustrated in figure 1, the continuum establishes an array of rationales for TNC action based on the nature of a corporation's connection to the human rights violation. The continuum could apply to any form of long-term foreign direct investment (FDI), covering equity as well as low or non-equity forms ranging from fully-owned subsidiaries through joint ventures, strategic alliances or even significant subcontracting or licensing arrangements (UNCTAD, 2003). The two essential tests for the continuum's relevance to any particular case are that (1) a TNC's identity can be associated with a corporate entity or business function linked to a human rights abuse; and (2) the TNC possesses some degree of control over the business entity or function, creating a capacity to influence actors or outcomes related to the abuse. Identifiable FDI linkages and some capability to act therefore constitute prerequisite conditions before the connection continuum can be used to assess the nature and degree of a TNC's responsibilities related to potential political involvements.

Figure 1. Connection continuum



Source: author.

At the extreme left of the continuum, a TNC is causally linked to human rights violations, perhaps provoking or urging host government actions. Possible examples might involve TNCs collabourating with a politically repressive government to plan and execute projects involving forced relocations, seizure of property and violent suppression of dissent. In such cases, the TNC's actions already constitute political involvement and create a direct causal connection to the harm.

These types of causal activities epitomize a type of TNC political involvement that simply should never be undertaken.

Corporations bear a *prima facie* responsibility to assess and avoid such involvements prior to initiating business relationships. If recognized after the fact, responsible TNC conduct would demand cessation of the activity coupled with maximal efforts towards restitution for the victims.

The notion of complicity rests at the centre of the continuum. Drawing on a distinction suggested by the United Nations Global Compact, complicity might be further differentiated between direct, beneficial and silent complicity (United Nations, 2003). Direct complicity suggests TNC actions towards the left on the continuum that support or contribute to government human rights violations. For example, TNC activities that could be termed contributory might range from close collabouration by supplying armaments, training or support sites for repressive military actions, to providing more general products or financial support that contributes significantly to the government's ability to maintain power and carry out repressive actions. While perhaps not intentionally causal in nature, these contributory activities still involve TNCs in the human rights violations. Once aware of direct complicity, TNCs should sever or at least minimize the contributory linkage in line with the directness and significance of their involvement.

Beneficial complicity suggests less TNC involvement, intentional or unintentional, in a host government's human rights violations, but asserts that the TNC will benefit from the results of the government's actions. For example, political repression may enforce a degree of stability that enhances immediate commercial prospects for at least a short-term investor. The TNC is not responsible for the government's violations but its indirect beneficial connection could create a rationale for responsive corporate behaviour. TNC steps might include passively refusing the potential benefit or more actively redirecting beneficial resources to the victims and/or using the resources to oppose government violations.

Silent complicity ranges to the right of the continuum's centre point as a TNC's relationship to human rights violations becomes more distant, ambiguous and primarily coincidental.

This concept's basic notion implies the TNC is at least aware and perhaps knowledgeable about the violations but has no substantial linkage to the action or the results. For example, a TNC may simply be aware of a host country's government violations connected to a project completely unrelated to the TNC's own sphere of operations. At greatest distance, the TNC may not even conduct business in the country. TNC action in line with such a coincidental connection might still indicate some responsibility to inform relevant appropriate actors regarding the violations and perhaps to encourage a response.

Capability anchors the right side of the continuum. At this extreme, disconnected TNCs may have no substantive ties to the human rights violations, perhaps lacking knowledge or even awareness regarding the actions. For example, TNCs may be uninformed regarding such matters in countries where they maintain no equity investments or significant trading interests. However, these TNCs could still possess resources giving them potential influence to help protect or assist the victims, directly or indirectly. If unintentionally unaware, such TNCs have no responsibility to act. However, if informed about both the situation and their potential capability to act, these TNCs may incur some degree of responsibility, albeit at the far end of the continuum arranged by the nature of causal or complicit connections to the human rights violations.

Developing TNC code guidelines

The concept of a connection continuum, anchored at the two extremes by causality and capability, calls attention to crucial determinative elements for evaluating TNC involvement in a host country's domestic political affairs. For example, the continuum can help distinguish between cases involving TNC acts of commission and omission. When TNCs are linked to host country government violations of human rights on the left side of the continuum through causal or significant contributory connections, the involvements constitute acts of commission and TNCs face a *prima facie* duty to undertake corrective and restorative actions. TNC connections that fall on the right side of the continuum describe potential rather than actual involvement, where decisions and judgments must weigh trade-offs between proactively initiating political involvement and opting for an act of omission. Generally TNCs face a clearer and stronger moral imperative when connected to a problem by an act of commission versus omission, although responsibility may still attach to the latter in cases marked by both critical need and the failure of other parties to respond effectively.

Considerations of proximity, tied to the principle of subsidiarity, can also be used to evaluate relative degrees of TNC responsibility along the continuum (UNCTAD, 1994, pp. 314-315). The actors most proximate to a problem normally bear the greatest responsibility to respond, which corresponds to the TNCs linked to host government human rights violations through causal and contributory connections on the left side of the continuum. The subsidiarity principle, which favours action at the lowest level closest to a problem, presumes that the most proximate actors are best positioned to understand the situation and select the most effective response. However, if the proximate actors lack either the capability or willingness to respond, then responsibility passes to the next most proximate, capable and willing actor. Hence, responsibility for action may travel along the continuum towards the right side, encountering progressively more distant but capable TNCs that then confront decisions about whether to become involved in the country's political affairs in order to respond to human rights violations to which the company has neither a causal nor contributory connection.

The task of developing TNC code guidelines might begin on the extreme left with strong negative injunctions against TNC activities that establish direct causal connections to a government's human right violations. This level of involvement implies acts of intentional commission that should attract broad international reprobation, not due to national sovereignty concerns but because such actions breach minimum "do no harm" standards. As factual circumstances move to the right away from direct causality through progressively less significant contributory connections, the strict negative injunction against

TNC involvements might be relaxed in favour of assessments of cost/benefit ratios.

Weighing the cost/benefit ratios of TNC impacts suggests a type of modified "Sullivan Principles" approach.[1] If TNC operations conform to good conduct standards that help prevent or off-set harm from human rights violations, some minimal level of firm contribution to a repressive host country regime might be acceptable, such as legally-required payment of taxes. However, a difficult question embedded in this approach requires deciding whether to measure TNC impacts at the micro or macro level. In essence, this issue led Rev. Leon Sullivan to disavow his own Principles in South Africa after concluding that ending racial discrimination in individual companies did not achieve sufficient progress in overthrowing the apartheid system in the country. Case circumstances may dictate whether TNC cost/benefit impacts on human rights violations should be measured only within the immediate micro sphere of corporate operations or judged more broadly as linked to political conditions in the host country.

Once across the continuum's centre point, arguments for TNC involvement in a host country's domestic political affairs become more problematic, even in cases of serious human rights violations. When TNC connections are coincidental or assertions of responsibility arise from estimates of some potential TNC capability to exert influence, the burden of proof rests heavily on the advocates of TNC action. Factors supporting the subsidiarity principle now work in reverse. Actions undertaken by TNCs with limited knowledge and understanding of local circumstances face diminished chances for success while increasing the potential for unanticipated, counterproductive side effects. In short, assigning responsibility to TNCs based on capability factors without proximate connections may reduce confidence in assessments of the likely impacts and outcomes of TNC actions.

[1] The Sullivan Principles enumerated business conduct standards for TNCs operating in South Africa during the apartheid era, essentially endorsing an approach where the benefits created for the black population were thought to outweigh harm caused by the continued TNC presence.

Use of the continuum draws attention to the various types of connections that could link TNCs to a host government's human rights violations. TNCs may avoid risky connections by identifying and evaluating in advance the potential implications of a project's ties to the government. For example, entering into joint venture arrangements with government enterprises establishes a clear and close partnership connection that constitutes collabourative if not direct causal ties to related government violations. Product use or project benefits that significantly support the government also connect TNCs to potential abuses of governmental power. The more that a product relates directly to abusive use, or that projects confer benefits difficult for host governments to otherwise obtain (such as scarce hard currency), the more closely the TNCs are connected to governmental misdeeds.

Recognition of these critical elements can help TNCs take steps to structure and implement code mechanisms to avoid or manage governmental connections that might render them directly complicit in human rights violations. One preventive step would be to adopt an explicit ethical human rights risk assessment for any new investment or other significant business operation in a country, particularly if a project involves close connections with the government and/or human rights violations have been reported in the country. TNCs conduct political risk assessments, incorporating them into normal business risk evaluations. Ethical human rights risk assessments merit at least an equal commitment of time, attention and resources to devise and employ measures that evaluate a project's relationship to potential human rights violations (Frankental and House, 2000, pp. 30-36; Sullivan and Seppala, pp. 102-112).

Risk assessments must be gauged against some standard, so TNCs also require a code of conduct that clearly establishes the company's position regarding the relationship between business projects and potential human rights violations. Rather than issuing endorsements of broad principles, TNCs should develop more practical self-identity codes that link standards to business operations in a manner that can serve both as a meaningful internal guide to conduct and a transparent external expression of corporate values (Kline, 1985, pp. 100-101). Transparency should also govern relations between TNCs and host governments. In dealings with public authorities, TNCs should maximize public access to information so that external groups can ascertain if a TNC's conduct conforms to its own code standards as well as evaluate the host government's stewardship of its public interest obligations.

The Voluntary Principles on Security and Human Rights illustrate many elements of this approach (United States, Department of State, 2000; Freeman and Hernandez Uriz, 2003, pp. 241-259). The Principles set forth standards designed to guide natural resource TNCs in investment projects where operations may require special security arrangements. Informed by past events during which TNCs faced charges of collabouration or contributory involvement in human rights violations by security personnel, including government forces, these principles address TNC responsibilities in selecting and monitoring security personnel as well as reporting possible human rights violations. The Principles were drafted cooperatively and endorsed by the Governments of the United States and the United Kingdom, many large natural resource TNCs and several NGOs. In defining practical TNC responsibilities, the Principles outline limitations on both collabourative TNC involvements with host country government forces as well as TNC obligations for proactive responses in cases of possible violations. The Principles' precedent is limited by the narrow scope of issues addressed, sectors encompassed and governments involved, but at least this exercise demonstrated a willingness to tackle standards for TNC conduct that can involve matters closely linked to a country's internal political affairs.

Guidelines for other political involvements

The connection continuum may provide conceptual guidance for TNC codes of conduct on other types of involvements in domestic political affairs. This section briefly considers how the continuum might apply to three other issues on which NGOs commonly call for TNC actions that would involve political activities. One such topic relates to a host country government's allocation of revenue derived from TNC activities. This issue generally arises in the context of large natural resource projects where an unrepresentative and/or corrupt central government misappropriates public funds and, in particular, returns little revenue to people (often indigenous minorities) located in regions from which the resources are extracted. The allocation of central government revenue indisputably constitutes a central political function of governmental authority, so TNC activity to alter the distribution certainly constitutes involvement in the country's domestic political affairs.

Cases linking TNCs to issues of government revenue allocation typically find these firms in close contractual relationships with the government, often including joint ventures with State enterprises. Negotiations over the allocation of project revenues between joint venture partners is expected business practice, but a TNC attempting to influence how a government chooses to spend its own share of project revenue steps far beyond business practice and into the arena of domestic politics. If a TNC somehow becomes causally linked to government misappropriations, such as engaging in bribery, corrective and restorative action is required. More generally, causal or contributory connections should simply be avoided through advance ethical risk assessments.

Transparency provides another mechanism that can help avoid or minimize contributory connections to governmental misappropriation of project revenue. Whether or not TNCs hold equity ownership or maintain effective control over project operations, a minimal condition for venture participation could require a transparent public accounting of revenue generation and distribution from the project. Although some traditionally confidential business information with potential competitive implications could be disclosed under such procedures, such a precautionary step would be valuable and competitive impacts could be minimized if widely adopted as a standard in TNC codes of conduct. The "Extractive Industries Transparency Initiative" reflects this type of approach (Woolfson and Beck, 2003, pp. 123-124). TNCs might also participate in revenue allocation arrangements negotiated through joint government, business, NGO and international organization schemes such as the unusual agreement forged for an oil project in Chad (Useem, 2002, pp. 102-114; Wax, 2004, p. A16), but this venture is too new to assess its relative success or its possible replication elsewhere.

Sometimes NGO advocates urge TNCs to compensate directly disadvantaged populations, in effect providing revenue or socioeconomic benefits that should come from an effective and representative government. TNCs can certainly provide community support as a philanthropic activity; however, this type of discretionary action should be dealt with separately and not confused with operational code of conduct standards that carry normative obligations. In fact, pressuring TNCs to substitute for governments in providing needed community resources invests TNCs with public responsibilities that might legitimately require corollary rights (such as deciding fair distribution questions) that go beyond a business role and risks granting private enterprises inappropriate public powers.[2]

TNCs connected to revenue misallocation through beneficial complicity could refuse or redirect unwarranted gains, although active reallocation steps again bring TNCs close to making public policy decisions regarding the disposal of what should be public revenues. The farther TNCs fall to the right on the connection continuum, the less knowledgeable and capable the companies will be to evaluate and determine appropriate allocation decisions regarding public revenues. If a TNC at least maintains a legally incorporated presence in the host country, open advocacy within local political processes might be pursued as part of a general corporate citizenship role. Lacking such a substantive connection, other TNC political

[2] An illustration of TNCs confronting such public sector tasks can be found in descriptions of Shell's role in Nigeria. See Farah, 2001, p. A22; White, 2004, p. 5).

involvement would probably reflect instances in which foreign governments or NGOs are simply using TNCs as a tool to influence a host country's policies.

Labour issues present another challenge for evaluating responsible TNC activities that could lead to involvement in a country's internal political affairs. Causal connections clearly exist when TNCs own a majority stake in factories with "sweatshop" conditions. A TNC's code of conduct should set and implement practical standards to improve labour conditions, operating above local legal and industry practices when necessary. Contributory connections also exist across a range of activities, from TNCs functioning as minority partners to contractual purchase agreements if an unrelated TNC knowingly sets terms that will likely necessitate labour abuses under competitive conditions. If purchase contracts provide local suppliers with sufficient profit margins that "sweatshop" conditions are not required, the TNC shifts to the right side of the connection continuum, probably beyond the point of beneficial complicity.

TNCs on the continuum's right side may still possess capability to influence labour conditions at supplier factories, leading NGOs to target large retail firms connected to foreign labour abuses only through subcontractors in a sometimes long international supply chain. Although capability fosters a temptation to use TNC influence, the distant relationship to the "sweatshop" site can also present a conundrum. Without proximity, retailers at the end of a subcontractor supply chain likely lack knowledge and understanding of local conditions, with equally limited aptitude for follow-up actions. External monitors and assessment agents could be hired to manage implementation activities, but such a step simply underscores that the targeted TNC's only real involvement arises from its capability to fund the actions of others.

If a remote retailer's capability provides the best hope to address foreign labour abuses, serious failures must be occurring among the many potential intervening public and private sector actors arrayed along the supply chain. The critical need barrier should be high for case exceptions where the capability factor alone connects a TNC to foreign abuses, particularly if the firm bears no causal, contributory or perhaps even beneficial complicity link to the abuses. Not only would corporate action involve resource expenditures, but the firm's involvement would imply new social responsibility for resulting impacts that may lie beyond the TNC's capacity to reasonably predict or control.

For example, a retailer's decision to terminate supply contracts with a foreign "sweatshop" factory, or even to impose minimum employee age requirements higher than local standards, could cost current factory employees their jobs. The retailer's action now establishes a major contributory if not a causal connection to the workers' job loss, increasing the firm's responsibility to assess and perhaps help ameliorate resultant harm, despite little local knowledge, understanding or proximate capacity for action.

The issue of political involvement on labour issues can arise through both direct and indirect actions. TNC activities could promote labour rights that conflict with national standards, particularly on issues involving unions and collective bargaining procedures. Relatively clear International Labour Organisation (ILO) principles can help guide normative decisions in this area, but many governments have not adopted all ILO conventions and local law and practice may differ from international standards in substance and/or enforcement. TNC activities that support union activities different from national standards, such as the creation of unions independent from government unions or control, could easily involve companies in the dynamics of domestic politics because unions often constitute important political as well as economic actors. The potential role of unions in domestic political change is illustrated historically in the fight against apartheid in South Africa as well as in more contemporary cases ranging from Chile to China.

The growth in TNC supply-chain involvement on labour issues injects particular sensitivities into the political dynamic. In these cases, the TNC may lack local equity investments that establish a legal national citizenship tie to the host country. Yet such non-citizen corporations are urged to require local citizens to act in ways that may be contrary to their national law, policies or practices. The point here is not whether such national standards should change but whether foreign TNCs, lacking even domestic legal incorporation, should serve as the capable mechanism to change local practice through private commercial requirements. Such intentional use of TNC influence arguably constitutes involvement in a host country's internal affairs regarding the effective implementation of the national government's laws and policies.

More broadly, TNC actions can also affect the achievement of priorities chosen by national governments where trade-offs may exist between relative improvements in labour conditions and other economic growth objectives. The more TNCs impose detailed labour requirements through supply chain contracts, the more those standards will influence the level and distribution of economic benefits resulting from a country's comparative advantage factors. TNC requirements that simply adhere to broadly accepted minimum international norms may still conflict with a national government's policy choices. Where agreed international norms are absent, or TNC requirements stand significantly above internationally-accepted minimums, TNC actions will play a more independent role in shaping a country's effective standards. This impact raises basic questions about who should determine policy-related trade-offs within each country, and whether certain types of supply chain influence may effectively involve TNCs in such domestic political choices.

Environmental issues pose similar risks of TNC involvement in domestic political affairs. TNC connections to disputed environmental practices can range from directly causal to implicitly capable of potential influence. The relationship to a country's internal affairs depends primarily on whether national law and practice differ substantially from non-national standards that TNCs might seek to require in local business operations. As with labour issues, TNC supply chain pressures can affect national policy choices and outcomes even where a TNC lacks local legal incorporation. In such cases, the TNC may be serving essentially as an instrument to advance the normative preferences of another government or a foreign NGO. Without broad international agreement on applied environmental principles and practices, along with clear guidelines for TNC conduct where national priorities may differ, TNC actions to promote particular environmental standards may interject the firm into a nation's internal affairs.

Conclusions

A new dimension has opened in the evolving study of international business-government relations where TNC actions derive from motivations and objectives distinct from the pursuit of traditional corporate interests. In the twenty-first century, TNCs are called upon to withdraw from countries to undermine abusive governments or to work actively for political reforms within undemocratic host countries. If a country's labour laws are deemed insufficient or ineffective, global retailers employ supply-chain leverage to impose labour standards on factories in countries where the firms lack even a local legal presence. TNCs face pressures to use the highest environmental standards in all global locations, however a host government views trade-offs between current economic development and longer-term environmental protection.

These TNC actions exert influence on national political processes and outcomes and often constitute involvement in a nation's domestic political affairs. Home country governments seldom require such TNC activities, but those governments can support, acquiesce, regulate or prohibit such involvement. Generally, the determination of a governmental response occurs reactively case-by-case, directed by the prevailing winds of political expediency rather than any enunciated principle or established process that could serve prospectively to guide proper TNC conduct. This article suggests the possible use of a conceptual connection continuum to help evaluate TNC responsibilities where actions could bring involvement in a nation's internal affairs. Rather than promoting the continuum concept as a finished product, the intention is to draw renewed attention to these issues and stimulate discussion on developing more systematic code guidelines for determining the normative rationale and appropriate response options for responsible TNC activities.

As presently formulated, the connection continuum offers a potential aid to the difficult challenge of formulating and applying TNC codes. The central concept posits ways to differentiate among TNCs by determining relative levels of responsibility along a sliding scale that considers key factors shaping a firm's relationship to human rights abuses or other serious problems. Perhaps in a future design, the construct might become multidimensional, better reflecting different types and degrees of TNC capability to influence outcomes in diverse countries, or even the potential for collective action among business actors. The composition of potential cost-benefit trade-offs from TNC political involvements might also be measured along the array, although these assessments would depend critically on which actors are making such evaluations. For now, the continuum presents a rather simple taxonomic tool to identify and organize important factors that can help evaluate potential TNC actions where social responsibility may lead to political involvement in a nation's internal affairs.

Political cooperation among the world's nation states has failed to keep pace with the burgeoning global web of economic and social interactions occurring among private sector entities. When governments decline to intervene in another nation's affairs, TNCs can be thrust into the breach between emerging international standards and national political sovereignty, using corporate economic capabilities to influence political change. This approach has been pragmatic rather than principled, succeeding primarily against relatively small and weak nation states located in the developing world. This disparity often advances the perspectives and priorities of advanced industrialized nations, home to the vast majority of TNCs, rather than reflecting broadly agreed values of an emerging global society.

Current international codes are being shaped principally by private sector entities based in developed countries that represent a privileged minority of the world's population.

Greater leadership must emerge from public authorities, acting through globally inclusive institutions, to provide more fully representative leadership and legitimacy to the international code process. Proper governmental leadership is especially crucial during the unfolding tentative transition from a world system dominated by isolated nation-state sovereignty towards a global community linked by shared values and normative principles of action.

Initiatives such as the United Nations Global Compact represent positive steps towards the identification and elabouration of core global standards and TNC "best practice" responses. Nevertheless, the issue of TNC involvement in domestic political affairs remains the ignored giant amidst the crowd of TNC code issues. Whether encountered directly on human rights violations or indirectly on policies dealing with revenue allocations, labour conditions or environmental standards, TNC involvement in political activities merits a reexamination of guidelines for TNC conduct relative to national sovereignty principles. ■

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The effectiveness of industry-based codes in serving public interest: the case of the International Council on Mining and Metals

S. Prakash Sethi*

Companies in the mining industry have lately faced extensive criticism for their operational practices and their impact on the environment. Additionally, many of their operations in poorer developing countries have had a deleterious effect on indigenous peoples and raised issues of human rights abuses. The mining industry has responded to these concerns by initiating various reform measures, including a cooperative, industry-based initiative that would provide a framework for establishing standards of conduct for member companies. This article briefly describes these initiatives. In particular, it discusses a major industry initiative, the Sustainable Development Framework, created under the aegis of the International Council on Mining and Metals. Next, the article offers an analytical framework within which to evaluate the relative effectiveness of industry-based principles or codes of conduct. Finally, it analyzes the Council's Sustainable Development Framework and its adequacy in terms of what the industry group aims to accomplish, and further actions that might be needed to address unresolved issues in order to engender public trust and confidence in the industry's actions and assertions in meeting societal expectations.

Key words: transparency, accountability, compliance verification, independent external monitoring, extractive industries, mining and minerals, industry or group-based codes of conduct, International Council on Mining and Metals, ICMM, principles or codes of conduct.

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* University Distinguished Professor, Zicklin School of Business, Baruch College, The City University of New York, and President, International Center for Corporate Accountability, Inc. (ICCA). Research assistance in the preparation of this article was provided by Olga Emelianova, Director for Project Services, ICCA, Inc., and is gratefully acknowledged. The author is grateful to two anonymous referees for their comments on an earlier draft of this article.

Introduction: mining industry operations in a hostile public environment

The mining industry has long been the subject of extensive public criticism for the harmful impact of its operations on the planet's physical environment and also for the long-term deleterious impact on many aspects of people's quality of life. Societal attitudes toward mining have always been somewhat ambivalent. Modern economic growth and rising living standards would not have been possible without the minerals and fossil fuels provided by the industry. It is also an unavoidable fact of life that mining activity leaves a large and often irretrievable footprint on the environment in ways that are increasingly unacceptable to society in general, and the impacted communities in particular. This condition has been further aggravated with the increasing demand for minerals and fossil fuels from the growing economies of countries like China and India.

To some extent, public antagonism toward the mining industry has risen from greater awareness of environmental issues, e.g. global warming, sustainable development and environmental degradation. The mining industry is viewed by many as economically too powerful. In addition, it is alleged that the industry has used its economic leverage to gain political influence and to thwart meaningful reforms of its *modus operandi*.[1] There are also other issues of concern, which relate especially to the poorer developing countries in remote parts of the world. They include human rights abuses through the use of excessive police and military forces,[2] harm to local communities and indigenous populations,[3] forced labour and involuntary servitude,[4] and bribery and corruption,[5] to name a few.

[1] See, for example, Bream and Reed 2005; Salinero 2005; Steeman 2004; Chakrabarty 2005; Oxfam America 2005; and Treadgold 2005.

[2] See, for example, *The Economist* 2002; and Tam and Lifsher 2003.

[3] See, for example, *The Economist* 2005; Abrash 2001; and Kapelus 2002.

[4] See, for example, Collingsworth 2002; and *Oil & Gas Journal* 2000.

[5] See, for example, Cockburn 2003; Simpson 2005; and Matlack, Smith and Edmondson 2004.

The mining industry – and its leadership – has been cognizant of the rising public hostility and has undertaken a variety of initiatives to respond to public criticism. Major mining companies have initiated specific principles or codes of conduct, which outline their commitment to operating in an environmentally friendly manner.[6] Companies have been publishing sustainability reports to provide greater transparency about their activities pertaining to environmental protection and sustainability.[7] They have been cooperating with private and public lending agencies to create uniform standards for project evaluation and reporting (Treanor 2003; Balls 2004). And, finally, they have been responding to the concerns of NGOs through dialogue and consultations in dealing with these issues.[8]

The jury is still out as to the impact of various initiatives undertaken by the mining industry. However, one thing is certain. All industries and large companies – especially transnational corporations (TNCs) – must respond to societal concerns if they wish to maintain their social franchise, i.e. their license to do business in a politically and socially harmonious environment. Therefore, the activities of the mining industry must be evaluated in terms of meeting an acceptable level of societal expectations with regard to changes in the industry's practices, meaningful transparency in public disclosure, and the steps taken by the industry to engender public trust through independent external verification of the industry's claims.

I. Scope of the article

The primary focus of this article is on a specific initiative undertaken by the mining industry, the Sustainable Development Framework (SDF). It was created under the aegis of the

[6] For examples of specific corporate codes and environmental policies, see Newmont Mining's Environmental Policy (www.newmont.com); Rio Tinto's Environmental Policy (www.riotinto.com); and Shell's Environmental Minimum Standards (www.shell.com).

[7] Examples of sustainability reports are "Alcoa 2004 Sustainability Report" (www.alcoa.com), "BP Sustainability Report 2004" (www.bp.com), and "Freeport 2001 Economic, Social and Environmental Report: Working towards Sustainable Development" (www.fcx.com).

[8] See, for example, Connor 2004; Forsyth 1999; and Hamann 2003.

International Council on Mining and Metals (ICMM), an organization established by some of the largest mining companies in the world.[9] My rationale for focusing on the ICMM initiative is threefold:

- ICMM's SDF is a major cooperative effort undertaken by the mining industry and includes most of the largest companies in the industry. It has the personal involvement of top management at these companies. The sponsoring companies have committed enough financial resources to ensure that ICMM would not be hindered from accomplishing its mission for lack of funding.
- In the process of developing this initiative, the mining industry actively undertook a systematic, extensive and highly visible process of involving diverse groups of public interest organizations representing various constituencies impacted by the mining industry. ICMM also commissioned numerous studies by experts to generate meaningful information on the issues affecting the industry from the perspective of its critics.
- The success of this initiative would be a major step forward in demonstrating the viability of industry-based codes where similar efforts in other industries have had limited success. Furthermore, to the extent that the process of creating and implementing this initiative identifies other areas of concern, it would serve as a laboratory for trying out new approaches towards narrowing the gap between societal expectations and company-industry performance.

The first section of the article is devoted to a detailed description of the mining industry's response to the public criticism of its operational practices. It includes a description of the ICMM's SDF, its consultative process and its principles and how they are to be operationalized. I also analyze the measures by which ICMM's code process intends to evaluate and monitor the performance of individual members and of the entire group.

[9] For a detailed history of the development of the ICMM project, see the ICMM Web Site at www.ICMM.com.

This article is not limited to a case study of ICMM's SDF, however. The SDF belongs to a genre of codes that are group-based, i.e. they are developed jointly by a group of companies or organizations that share common characteristics or face similar external challenges and where it is felt that the combined efforts of the group are likely to be more effective in responding to external challenges than individual companies and institutions acting alone.

I create an analytical framework within which to evaluate the relative effectiveness of industry or group-based voluntary codes of conduct. This framework delineates the necessary preconditions that must be met if an industry or group-based code of conduct is to fulfill its intended objectives. I also draw comparisons with other industry-based codes to gain a better understanding of their dynamics and the lessons that could be usefully applied to the mining industry. Finally, I analyze the ICMM's SDF as to its adequacy in terms of what the industry group aims to accomplish. This includes an examination of the SDF with regard to its governance structure, operational policies, baseline standards and benchmarks, performance evaluation, accountability, and measures of transparency and public disclosure.

II. Institutional pressures for reforms in the mining industry

In addition to general public criticism and NGO hostility, mining companies have also been pressured for reform by some of the world's major public and private lending institutions to improve their performance in the area enumerated in the previous section. The most notable of these are The Extractive Industry Review, The Extractive Industry Transparency Initiative and The Equator Principles.

The Extractive Industries Review (EIR) – a project launched by the World Bank Group in 2001 – is intended to assess the World Bank's involvement in the extractive industries and its role in poverty alleviation through sustainable development. The EIR Final Report released in December 2004 provides industry analysis by civil society, governments and industry representatives, and recommendations for the World Bank's future role in the industry.[10] The Extractive Industries Transparency Initiative (EITI) was announced by the United Kingdom's Prime Minister Tony Blair at the World Summit on Sustainable Development in Johannesburg in September 2002. The EITI process advocates a multi-stakeholder approach to increase transparency over payments by companies to governments and government-linked entities, as well as transparency over revenues by those host country governments.[11] The Equator Principles, launched in October 2002, is a voluntary set of guidelines developed and agreed to by some of the world's largest private financial institutions.[12] The Equator Principles are based on the policies and guidelines of the World Bank and International Finance Corporation. Although all these initiatives emanate from different sources and address different issues, their ultimate goal has been to pressure all or different segments of the mining industry to modify their conduct in ways that is protective of the environment and respects the rights of the communities that are adversely impacted by their operations.

III. The mining industry's response

There has been growing recognition on the part of mining companies that the *status quo* has become untenable. In response, companies in the mining industry have vastly expanded their communication and public information effort through the publication of corporate sustainability reports.[13]

[10] For details, see www.eireview.org.

[11] For details, see www.eitransparency.org.

[12] The founding signatories of the Equator Principles are: ABN AMRO Bank, Banco Bradesco, Banco do Brasil, Banco Itaú, Banco Itaú BBA, Bank of America, Barclays plc, BBVA, Calyon, CIBC, Citigroup Inc., Credit Suisse Group, Dexia Group, Dresdner Bank, EKF, HSBC Group, HVB Group, ING Group, JPMorgan Chase, KBC, Manulife, MCC, Mizuho Corporate Bank, Rabobank Group, Royal Bank of Canada, Scotiabank, Standard Chartered Bank, The Royal Bank of Scotland, Unibanco, WestLB AG, Westpac Banking Corporation. For details, see www.equator-principles.com.

[13] See Annandale, Morrison-Saunders and Bouma 2004; Kolk 2003 and 1999; Peck and Sinding 2003; and Marshall and Brown 2003.

Furthermore, to gain credence with the various stakeholders of the industry, companies in the industry have created individual or group-based guiding principles or codes of conduct outlining the industry's commitments to changes in its operating practices.[14]

A more comprehensive and far-reaching effort in this direction has been the SDF.[15] This initiative is the primary vehicle through which the mining industry has channeled most of its resources to demonstrate its commitment to meeting societal expectations. The intent of the SDF is to create a uniform set of principles that individual companies would adapt to their own situations either by following the SDF as it currently stands, or by creating their own codes of conduct to respond to their specific concerns within the SDF. Therefore, the success or failure of this initiative would likely have a significant impact as to whether this effort would be emulated by other industries, and whether or not it would engender enough public trust and credibility to merit long-term commitment on the part of the industry.

IV. Antecedents to the ICMM's SDF: the MMSD project

In the late 1990s, rising public concern over environmental and social harm attributed to the mining industry induced top executives of the leading mining companies to launch a new effort. Called the "Global Mining Initiative" (GMI),[16] it led to the creation of the Mining, Minerals and Sustainable Development (MMSD) project. From its very inception, the

[14] See, for example, the Kimberley Process. Launched in May 2000, it combines efforts of governments, the international diamond industry and civil society representatives to stem the flow of conflict diamonds (see www.kimberleyprocess.com). For examples of other group-based codes in the mining and materials industries, see Montreal Protocol, Responsible Care, UNEP Gold Industry Voluntary Code Initiative, and UN Strategic Approach to International Chemicals Management. See also Paton 2000; Howard, Nash and Ehrenfeld 1999; and Tapper 1997.

[15] See details at the ICMM Web Site (www.icmm.com).

[16] For details on the Global Mining Initiative, see www.icmm.com/gmi.php.

GMI effort was spearheaded by three of the world's largest mining companies, namely Rio Tinto, Western Mining Corporation and Phelps Dodge Corporation.[17] Start-up funds of approximately $4 million were provided by 28 companies, each one contributing at least $150,000. By the time the project's initial report was completed, its cost had escalated to over $7 million.[18]

Launched in July 1999, MMSD was conceived as a wide-ranging research and consultation project. Its objective was to examine and understand the conditions that would "maximize the contribution of the mining and mineral sector to sustainable development at the global, national, regional and local levels" (Walker and Howard, 2003, p. xi). The report recognized that prior efforts by the industry to accomplish similar goals had not succeeded because of critical bottlenecks such as "lack of trust among companies, governments and civil society, and the absence of necessary skills, resources, and institutional capacity" (ibid.).

In one sense, the MMSD project was a model of deliberate planning, inclusive participation by all major stakeholders, open dialogue, transparency in external communications and public disclosure.[19] Although it was funded by the mining industry, it was organized as an independent collaborative effort and managed by three organizations, Environmental Resources Management (ERM), International Institute for Environment and Development (IIED) and World Business Council for Sustainable Development (WBCSD).[20] According to project

[17] The CEOs of the three companies, Sir Robert Wilson, Hugh Morgan and Douglas Yearley, played a leadership role in creating the project.

[18] For details on MMSD's governance and organization structure see http://www.iied.org/mmsd/governance.html.

[19] For details see the "Stakeholder Engagement" page of the MMSD project at http://www.iied.org/mmsd/activities/ global_information_dialogue.html. For NGO engagement in Mining Initiatives see Hamann 2003.

[20] *Environmental Resources Management (ERM)* is one of the world's leading providers of environmental and sustainability services. It has over 100 offices in 35 countries and employs more than 2,300 staff. ERM delivers solutions for leading business and government clients, assisting them to manage their environmental, social and related risks. ERM's mining clients include Rio Tinto PLC, Anglo American, Newmont, and BHP Billiton.

documents, it involved over 5,000 participants from various stakeholder groups from all over the world. MMSD's initial report was an attempt to provide in-depth analysis of societal issues faced by the extractive industry and offer recommendations for improving corporate performance compatible with sustainable development.[21]

MMSD's report identified six major issues that would guide the industry's efforts towards the creation of a viable set of *voluntary principles*. These were: (a) that voluntary approaches alone are not sufficient when there was compelling social priority but no business case to justify the additional expenditure required; (b) lack of critical integration in the industry would be an obstacle, which could only be overcome through greater collaboration within the industry; (c) local issues should be solved locally as local endowments and priorities differ; (d) best practices should be defined by decentralized and iterative process, not by a fixed set of parameters that could be "read out of a manual"; (e) collective action must include companies of all sizes in order to produce positive results; and (f) existing organizations should be encouraged to continue facilitating collective action (Walker and Howard 2003, pp. 4-5).

The pioneering work undertaken by MMSD led to two initiatives. The first one was the creation of a set of voluntary principles by the International Council on Mining Metals

The International Institute for Environment and Development (IIED) is an independent, non-profit research institute working in the field of sustainable development. IIED aims to provide expertise and leadership in researching and achieving sustainable development at local, national, regional, and global levels. In alliance with others, it seeks to help shape a future that ends global poverty and delivers and sustains efficient and equitable management of the world's natural resources.

The World Business Council for Sustainable Development is a coalition of 160 international companies united by shared commitment to sustainable development via the three pillars of economic growth, ecological balance and social progress. The members are drawn from more than 30 countries and 20 major industrial sectors. It also benefits from a Global Network of 35 national and regional business councils and partner organizations involving some 1,000 business leaders globally.

[21] For details on MMSD's Working Papers see http://www.iied.org/mmsd/wp/index.html

(ICMM) in May 2003 that would guide the conduct of companies in the mining industry along the guidelines set by MMSD's initial report (ibid, p. 6). The second initiative was the creation of a partnership with the World Wildlife Foundation of Australia and several Asia-Pacific mining companies to create a pilot certification programme (ibid). This activity has not yet come to fruition, and in any case, is not part of this article, which focuses only on the activities of ICMM and the creation of voluntary principles.

V. Public reaction to the MMSD report

The critics of the industry were not impressed. They argued that the process was stage-managed to stretch over a long period of time so as to avoid the necessity of substantive action by way of changing mining practices.[22] The industry was also accused of selecting many NGOs that were friendly to its perspective and who may otherwise be relatively uninformed about the environmental sustainability issues pertaining to the industry.[23] Critics considered the consultative process to be so biased that it led to a boycott by a large number of mining-related environmental and human rights non-government organizations (Corpuz and Kennedy 2001).

Many critics view the MMSD initiative as primarily a media campaign to "educate" the public. As evidence, they point to a statement by Sir Robert Wilson, Executive Chairperson of Rio Tinto, saying: "Despite the efforts of companies and industry associations, the mining, metals, and minerals industry has fallen into increasing public disfavor. It is seen, at best, as a necessary evil. It has become accepted thinking that the industry is incompatible with sustainable development" (ibid.). MMSD is seen as a public relations offensive to bridge the "gulf between the industry's self-perception and how it is seen by others" (ibid.). In terms of substance, MMSD was criticized for not being adequately consultative and participative, and for its failure to respond to the real issues of environment, sustainability and the rights of indigenous peoples, among others. To wit:

[22] See, for example, Raja 2002 and Nostromo Research 2002.
[23] See JATAM 2005 and Baue 2002.

- No process is independent that relies on $5 million or more from the very companies whose activities it is trying to analyze. This is the ultimate case of co-optation for those trying to tackle the industry meaningfully.
- No analysis is participatory that tries to encompass issues created by the mining industry – and as defined by the mining industry – without considering the case of many of the world's most mine-impacted communities.
- The space for indigenous participation on various levels of the multimillion-dollar bureaucracy created by the IIED has been tokenistic at best and ignorant and insulting at worst (ibid.).

In a statement signed by NGO representatives from different parts of the world, the group challenged the integrity of the process and credibility of its sponsors. "Mining will continue to be a part of the global economy for the foreseeable future. We may be willing to work with the mining industry to reduce the damage that mining does to communities and the environment. But the where, when, and how of mining should be decided by those most affected" (Project Underground 2005). Accordingly, the industry's efforts at consultative process were critized as a thinly disguised attempt to ratify the industry view of sustainability. Consequently, "we reject the Global Mining Initiative's efforts in the lead up to Rio +10, and also the process known as Mining, Minerals and Sustainable Development, which aim to co-opt the very notion of sustainability" (ibid.).

In another broadside against the mining industry, the MMSD initiative was criticized for allegedly promoting dialogue and sustainability, "as long as mining companies get to continue their destructive practices" (Friends of the Earth 2002). Friends of the Earth, a major international environmental NGO, was one of the several groups that formally rejected the MMSD report as lacking in substance and deficient in process. "One of the other big problems is that MMSD has not talked to enough people in developing countries in the southern hemisphere where some of the worst problems exist" (Jones 2002).

VI. ICMM's structure and modus operandi

ICMM was created in May 2001, through the transformation of another industry organization, the International Council on Metals and the Environment (ICME), a global, multi-metal representative organization, which agreed to broaden the group's mandate and transform itself into the ICMM. ICMM is governed by its members, which currently include six major companies and three commodity and regional trade and industry associations.[24] These include, among others, Anglo American, Rio Tinto, BHP Billiton, Alcoa, Noranda, Sumitomo, Mitsubishi, Nippon, Newmont Mining, Freeport McMoRan, and Placer Dome. The trade associations are a group of intra-country industry groups and national and multinational organizations.

The governance structure is entirely controlled by the mining industry. The first Chairperson of the ICMM Council was Douglas Yearley, the retired Chairperson and Chief Executive Officer (CEO) of Phelps Dodge Corporation. He was succeeded by Rio Tinto's CEO, Sir Robert Wilson, who in turn was replaced by the former Executive Chairperson of Noranda, Inc, David Kerr. The current ICMM Council Chairperson is Wayne Murdy, CEO of Newmont Mining Corporation.[25] As currently constituted, ICMM has no governance level input from non-industry groups. ICMM's Executive Committee is exclusively comprised of the CEOs of eight corporate members of the Council.[26] The Association members are represented by the Association's Coordination Group.

[24] See appendix for details.

[25] For details on ICMM's Governance and Organizational Structure, visit ICMM's website (www.icmm.com).

[26] The eight members of the Executive Committee are: A. J. (Tony) Trahar, Chief Executive Officer, Anglo American plc.; Bobby Godsell, Chief Executive Officer, AngloGold Ashanti; Charles (Chip) Goodyear, Chief Executive Officer, BHP Billiton; Wayne Murdy, President & Chief Executive Officer, Newmont Mining Corporation; Kazuo Oki, President and Representative Director, Nippon Mining and Metals; Andrew Michelmore, Chief Executive Officer, WMC Limited; and Leigh Clifford, Chief Executive, Rio Tinto plc.

ICMM's 2004 report reaffirms the notion of an industry-controlled organization. It states: "ICMM is a CEO-led organization comprising many of the world's leading mining and metals companies as well as regional, national, and commodity associations" (ICMM 2004, p. i.). It later also says: "ICMM members believe that by acting collectively they can best ensure their continued access to land, capital and markets, as well as build trust and respect amongst key stakeholders." The report claims that member companies have been working toward advancing the sustainable development agenda for almost ten years and that members are committed to improving their sustainable development performance and to producing responsibly the mineral and metal resources society needs.

The report further states: "Clear targets and accountability are essential to improve performance and build trust. Our sustainable development principles give us a context to achieve this. They were adopted in May 2003 and our corporate members have committed to report on their performance against them. Our work programme is designed to put our principles into practice" (ibid p. i.).

VII. ICMM's core principles and their amplifications

During the first two years of its existence (May 2001 – May 2003), ICMM initiated a wide variety of programmes and activities that focused on setting standards for the industry's performance, creating international policy and collaborative networks, and catalyzing change for sector-wide action. In May 2003, ICMM announced the result of this effort in the form of "Sustainable Development Framework" that would henceforth guide the actions of the mining industry. The SDF outlined ten principles against which ICMM's members would measure their sustainable development performance (table 1).

ICMM has further amplified the ten principles into 46 explanatory statements. These are designed to add meaning to the more generalized aspirations that constitute the main principles (an illustration of the amplifications of some principles is provided in table 2).[27]

Table 1. The ICMM SDF: main principles

Corporate Governance
Principle 1: Implement and maintain ethical business practices and sound systems of corporate governance.

Corporate Decision-Making
Principle 2: Integrate sustainable development considerations within the corporate decision-making process.

Human Rights
Principle 3: Uphold fundamental human rights and respect cultures, customs and values in dealings with employees and others who are affected by our activities.

Risk Management
Principle 4: Implement risk management strategies based on valid data and sound science.

Health and Safety
Principle 5: Seek continual improvement of our health and safety performance.

Environment
Principle 6: Seek continual improvement of our environmental performance.

Biodiversity
Principle 7: Contribute to conservation of biodiversity and integrated approaches to land use planning.

Material Stewardship
Principle 8: Facilitate and encourage responsible product design, use, re-use, recycling and disposal of our products.

Community Development
Principle 9: Contribute to the social, economic and institutional development of the communities in which we operate.

Independent Verification
Principle 10: Implement effective and transparent engagement, communication and independently verified reporting arrangements with our stakeholders.

Source: International Council on Mining and Metals, www.icmm.com.

[27] For the complete list of amplifications of the ICMM SD Framework principles, see www.icmm.com.

Table 2. Explanatory statements of two ICMM principles

Corporate Governance Principle 1: Implement and maintain ethical business practices and sound systems of corporate governance.	Develop and implement company statements of ethical business principles, and practices that management is committed to enforcing. Implement policies and practices that seek to prevent bribery and corruption. Comply with or exceed the requirements of host-country laws and regulations. Work with governments, industry and other stakeholders to achieve appropriate and effective public policy, laws, regulations and procedures that facilitate the mining, minerals and metals sector's contribution to sustainable development within national sustainable development strategies.
Corporate Decision-Making Principle 2: Integrate sustainable development considerations within the corporate decision-making process.	Integrate sustainable development principles into company policies and practices. Plan, design, operate and close operations in a manner that enhances sustainable development. Implement good practice and innovate to improve social, environmental and economic performance while enhancing shareholder value. Encourage customers, business partners and suppliers of goods and services to adopt principles and practices that are comparable to our own. Provide sustainable development training to ensure adequate competency at all levels among our own employees and those of contractors. Support public policies and practices that foster open and competitive markets.

Source: International Council on Mining and Metals, www.icmm.com.

VIII. Current status of ICMM activities and reported progress

ICMM's 2004 report provides details of various activities undertaken by the industry and its member companies, how they relate to various principles, and the industry's agenda for the year 2005, as follows:

"1. Sustainable Development Framework (Principles: All)
Key achievements and activities in 2004: Development of the Mining and Metals Sector Supplement to the GRI 2002 Guidelines followed, in early 2005, by a commitment to report in accordance with GRI framework, launch of the good practice website and translation of ICMM Principles into four languages.
Goals for 2005: Developing a verification element for the framework
2. Environmental Stewardship (Principles: 6, 7)
Key achievements and activities in 2004 – Initiatives to improve members' environmental performance: Continued IUCN-ICMM Dialogue, publication of case studies on mining and biodiversity conservation, fulfillment of the pledge not to explore or mine in World Heritage sites, a survey of financial assurance practices for mine closure and agreement to develop a tailings management reference guide.
Goals for 2005: Publication of good practice guidance on mining and biodiversity conservation, online reference guide of good practices in tailings management, approaches to integrated land-use planning, discussion paper on biodiversity offsets and advocacy paper on financial assurance.
3. Socio-Economic Development (Principles: 3, 9)
Key achievements and activities in 2004 – Increasing our understanding of how mining contributes to social and economic development: Launch of resource endowment study, indigenous peoples' issues review and tools for local community development.

Goals for 2005: Outputs of resource endowment study, publication of case study examples to enhance the socio-economic development of host communities and dissemination of community development tools.

4. Health and Safety (Principles: 5)

Key achievements and activities in 2004 – Improved health and safety performance through: Indicators of health and safety performance, scoping of a database of safety statistics for benchmarking of members' operations, agreement with the Chinese Government and our partners on a programme to improve mine safety in China, work with UNEP on awareness and preparedness for emergencies at local level, or APELL.

Goals for 2005: A report on a harmonized approach for setting and reviewing workplace exposure limits, launch of health and safety database and publication of case studies on APELL in mining.

5. Materials Stewardship (Principles: 4, 8)

Key achievements and activities in 2004: Steps towards a policy framework on material stewardship, the "Apeldoorn Declaration" agreeing on the need for a metals specific method for assessing ecotoxicity impacts and input to PrepCom2 for the UN's Strategic Approach to International Chemicals Management (SAICM)

Goals for 2005: Guidance document on materials stewardship, eco-efficiency tools and case studies, publication on metals recycling and continued involvement in SAICM.

6. Science-Based Regulations (Principles: 4)

Key achievements and activities in 2004 – Recognizing that sustainable development policies need to be based on valid data and sound science, ICMM participated in various policy forums throughout 2004: Europe's draft new chemicals policy (REACH), Metals Environmental Risk Assessment Guidance, Human Health Risk Assessment Guidance and IFC policies and performance standards.

Goals for 2005: Continued participation in policy debates and developing technical input based on sound science with various partners, such as the Ecotoxicity Technical Advisory Panel.

7. Participation in International Forums (Principles: 1, 4, 7, 9, 10)
Key achievements and activities in 2004 – Bringing our members' perspective to: The World Bank's Extractive Industries Review, the Extractive Industries Transparency Initiative, World Conservation Forum and Global Dialogue of Governments
Goals for 2005: Continued participation in these and other forums to ensure ICMM's mission and position are broadly understood.
8. Collaborative Approach
Key achievements and activities in 2004: Worked collaboratively with 34 organizations, participation in 27 international events, maintaining two websites, three newsletters and 13 FYI e-letters.
Goals for 2005: Stronger partnerships and continued collaborations, increased attendance in international forums, improvements to our websites, four newsletters and ongoing communication with our members.
9. Membership and Governance
Key achievements and activities in 2004: A new corporate member, Lonmin, joined in October, a strategic meeting in May, ICMM annual meeting in October and forum for CEOs.
Goals for 2005: Continue to work strategically with our members to meet ICMM's objectives and continue to uphold high standards of transparency in how we work."
(ICMM 2004)

IX. Analytical framework: voluntary codes of conduct

A. Proliferation of voluntary codes of conduct

The past two decades witnessed an enormous growth on the part of individual companies and industry groups to create some type of statement of principles or conduct that would establish the sponsoring organization's *bona fides* as a socially responsible company or industry. Available data, although not comprehensive, suggests that these codes have become *de* *rigueur* among corporations and industry groups all over the world. Almost 60% of the corporations, among the *Fortune 500* corporations, and a smaller number of the 500 largest international corporations have corporate codes of conduct (Webley and Le Jeune 2004). Even a cursory examination of the websites of major corporations and industry groups would provide ample evidence to the reader of the pervasiveness of this phenomenon.

Unfortunately, the widespread creation of codes by corporations and industry groups has not gone beyond the rhetoric stage.[28] Sponsoring organizations, in general, have failed to take adequate steps to implement their codes and to make their efforts transparent. Nor do business organizations as yet view them as a means of building public trust. Business organizations cite a variety of difficulties in creating industry or sector-wide operating principles or standards of conduct. It is argued that business rationale against creating and implementing meaningful standards of conduct in such areas as pollution, sustainability and human rights, is not tenable on economic and socio-political grounds. This situation makes it necessary, and at the same time quite difficult, that there be maximum participation by industry members.

The inevitable result of this state of affairs has been that these principles or codes of conduct are treated with disdain and largely dismissed by both the knowledgeable and the influential opinion leaders among various stakeholder groups, the news media and even the public-at-large. Instead of gaining public trust and credibility for their efforts, the sponsoring organizations suffer from adverse public relations effects and potential damage to their institutional reputation.[29]

Industry groups are an integral part of the economic landscape in most market-based economies. There is a large body of academic and professional literature tracing their

[28] See Kaptein 2004.

[29] See Sethi 2003a, 2003b and 2002; Sethi and Sama 1998; Jenkins 2005.

historical evolution and growth. Governments all over the world have created legal and regulatory frameworks to promote collective and cooperative efforts as the part of business entities while ensuring that these efforts do not lead to collusion and anti-competitive behaviour.[30]

B. Traditional industry-based codes of conduct

The economic case for voluntary cooperation among business enterprises is clear and compelling. Business organizations develop voluntary arrangements to standardize technical and quality standards for products, procedures, contracts, and other arrangements that create economies of scale, reduce transaction costs, provide rules of fair competition among companies and engender confidence among customers. Cooperative efforts also play an important role under conditions of imperfect markets (so-called “market failures”)[31] that provide companies with above normal profits (so-called “economic rents”). Companies may also cooperate among themselves to advance their economic interests in the political arena in creating laws and regulations that enhance their vital interests. They may also benefit when their collective action contributes to lax regulatory regimes on the part of the governments, called non-market failures or regulatory failures.[32]

A third dimension of the benefit of industry coalitions is to protect companies from paying the cost of negative externalities.[33] Examples of such externalities may be air pollution, untreated wastewater, etc. and the impact of these negative externalities on the individuals and communities involved. Typically these negative externalities are handled by

[30] See, for example, Boadway 1997; Barnett, Mischke and Ocasio 2000; Gupta, Hofstetter and Buss 1997.

[31] See Harris and Carmen 1983; Wolf 1979; Spulber 2002.

[32] Harris and Carmen 1983; Wolf 1979; Garner 1996. Also see Boadway 1997; Barnett, Mischke and Ocasio 2000; Clark 1998.

[33] See Sethi 1979; Jenkins, Maguire and Morgan 2004; Murty and Russell 2005; Bhat and Bhatta 2004; Thomassin and Cloutier 2004; Alfaro and Rodriguez-Clare 2004; Herve 1990; Dybvig and Spatt 1983; Nason 1989; Quiggin and Chambers 1998.

local or regional authorities at lower costs by generating economies of scale. However, to the extent that individual companies or industries may avoid paying their fair share, the additional cost burden falls on the community. Industry groups can mobilize greater resources through collective action and thereby minimize their cost burden for such externalities since the benefits of collective action are apparent to all members. The cost burden for the community, however, is quite diffused. Impacted individuals and communities are dispersed and less able to organize in order to protect their vital interests.

Voluntary business groupings, however, must contend with two problems, namely the free rider problem and the problem of adverse selection, whose magnitude and severity would adversely impact their collective operation. Free rider problems accrue from a situation in which some type of pressure and coercion is necessary to ensure that member organizations, which benefit from the collective effort, also share the cost of maintaining such effort in proportion to the benefits derived by them.[34] Adverse selection occurs when companies joining the group are likely to exploit the benefits accruing from their participation in the group without any consideration of the harm that their actions might cause other members of the group.[35] There are, however, some fundamental differences between the conventional form of industry-based organizations and their principles or codes of conduct, and the CSR related principles or codes of conduct. These distinctions have the potential to limit the scope of cooperation among companies and exacerbating the problems associated with industry-based groups.

C. CSR-related industry or group-based codes of conduct

Voluntary principles or codes of conduct, dealing with societal issues, share a similar intellectual heritage and economic rationale with other more general principles mentioned above.

[34] Andreoni and McGuire 1993; Conlon and Pecorino 2002.

[35] Crocker and Snow 1992; Inderst 2005; Fabel and Lehmann 2000; Wilson 1980.

Generally described under the rubric of principles or codes of corporate social responsibility (CSR), they are established by industry or group-based organizations that protect and advance the groups' shared interests. These groups also create principles to which all members should aspire and establish standards and procedures, which would guide the conduct of group members.

The business case or the economic justification for CSR-related principles or codes of conduct is infinitely more complex than that for the conventional business-groups and their codes of conduct. In direct contrast to the conventional principles or codes, CSR-related codes call for the industry or group members to assume voluntarily the costs of some of the industry's negative externalities.

For purposes of this article, the term "code of conduct" has been used in a broader, more generic sense. It includes all types of initiatives launched by individual companies and industries. These initiatives may be variously called guiding principles, ethical principles, codes of ethics or codes of conduct. The objective of these principles and codes may include the demonstration of a company's philosophy, ethical or value-based principles; the description of a company's or industry's activities and modus operandi which have been of concern to various segments of the community; and an expression of commitment as to how a company would modify its operations or management practices to address these issues. And, finally, these principles or codes may describe the business entity's perspective as a responsible corporate citizen.

A widening gap between societal expectations and corporate performance creates a legitimacy gap, which is worsened by lack of credibility for corporate actions and pronouncements on the part of influential stakeholders (Sethi 2003b). Therefore, corporations and industry groups must take necessary actions to bridge this gap or risk greater public scrutiny and regulation of the industry's activities and performance. Industry-based groups, however, face some major challenges in transforming this need "to do something" into actionable strategies. The difficulties faced by these groups arise from conflicts among member companies within the industry, and hostility and a lack of trust in the industry's external socio-political environment. Specifically:

- Many companies are philosophically opposed to creating voluntary codes that they view as a give-in to the industry's critics and a coerced response to meeting extra-legal demands imposed by the industry's critics.
- There is the inherent difficulty of finding common ground among member companies who otherwise compete vigorously against each other.
- Another set of difficulties emanates from individual companies' operational constraints, financial concerns and, above all, corporate culture and management orientation toward responding to social and environmental challenges.[36]
- The long-term benefits of industry-wide cooperative effort, nevertheless, carry short-term costs that must be compensated through improved productivity, which takes time and requires structural and organizational changes that are not always easy to accomplish. Otherwise, they would reduce short-term corporate earnings and adversely impact the company's stock price.
- The prevailing nature of competitive markets, shareholder expectations, incentives of the financial middleperson and management reward system (i.e. agency costs) overwhelmingly emphasize the short-term character of earnings.[37] There is a strong incentive to underestimate long term risks since a recognition of these risks would lower the expected earnings of a company when compared with its competitors who choose to ignore them. This situation is further aggravated by the lack of adequate research and reliable data in quantifying long term risk given the short-term oriented nature of incentives (Sethi 2005).

[36] See Herrmann 2004; Sethi 1994; Sethi and Williams 2000.

[37] See Eisenhardt 1989; Jensen and Meckling 1976; Moh'd, Perry and Rimbey 1995; Cho 1992; Wright, Mukherji and Kroll 2001; Wright and Mukherji 1999; Bruhl 2003; Van Marrewijk 2003; Williamson 1985.

D. Necessary elements of group-based CSR-related codes of conduct

The above discussion is not intended to suggest that CSR-related industry-wide codes are unlikely to be viable under any set of circumstances. Instead, it is suggested that industry-wide codes can serve an important industry goal, i.e. narrowing the gap between societal expectation and industry performance in a manner that is economically efficient, technologically feasible and minimizes the need for additional governmental regulations in an environment of public trust in corporate actions and assertions of corporate performance.

Industry-based CSR codes serve an important business and social purpose. From the business viewpoint, such codes provide industry members with a voluntary and more flexible approach to addressing some societal concerns about how an industry operates. It creates a mechanism whereby an industry may develop solutions that are focused, take cognizance of the industry's special needs and public concerns and are economically efficient. They engender public trust through a "reputation effect" while avoiding being tainted for the actions by other companies.

From the public's perspective, voluntary codes also serve an important purpose. They avoid the need of further governmental regulation with the prospect of imposing onerous regulatory conditions. They also allow the moderate elements among the affected groups to seek reasonable solutions to the issues involved.

An industry-based code of conduct is in the nature of a "private law" or a "promise voluntarily made" whereby an institution makes a public commitment to certain standards of conduct. The nature of "voluntariness", and, by implication, the flexibility afforded to companies, depends on the basic premise that the sponsoring organizations and their critics share a common interest in improving the underlying conditions of the affected groups and regions, and that it is in the interest of all parties to resolve the underlying issues within the realistic constraints of the available financial resources and competitive conditions.[38]

The "private law" character of voluntary codes of conduct gives the sponsoring organization a large measure of discretionary action. It also imposes a heavy burden to create independent systems of performance evaluation, monitoring and verification, and public disclosure. This is a proactive stance and perhaps the best of all possible worlds. It provides scope for experimentation and building consensus, and facilitates the enactment of public law. The success of this system, however, depends on the industry's ability to create and sustain a high level of public credibility. The private law character of the code does not reduce the obligations of the companies or industries – it increases their burden to ensure that its skeptical critics and the public-at-large believe in the industry's responses and performance claims.

E. Current approaches to creating industry-based CSR-related codes

Industry-based code initiatives fall along a spectrum where one end of the spectrum comprises of codes, which are broad principles or statements of good intent. They lack specificity in terms of performance expectations and thus require low-level commitment on the part of the member companies. The second end of the spectrum consists of codes with greater specificity. They require independent external monitoring of company compliance against well-defined, objective, quantifiable and outcome-oriented measures of performance.

An overwhelmingly large number of current industry-based CSR-related codes fall in this category of broad principles, or lean heavily towards them. Industry groups feel that, to be successful, an industry-wide or group-based approach must include the largest possible number of companies in the collective effort. The consensus approach is intended to create

[38] Sethi 2003b; Melrose 2004.

solutions that are amenable to most members and thus facilitate industry-wide effort in brining about desired changes.

It may seem counter-intuitive, but this approach yields exactly the opposite result from the one publicly claimed by the codes' sponsors. Industry-wide CSR-related codes that depend on voluntary compliance and rarely incorporate enforcement measures, greatly suffer from the problems of free rider and adverse selection. The need to keep the largest number of companies in the group pushes performance standards to the lowest common denominator, if at all. Companies with the weakest records can force standards down to what they are willing to live with. This situation suits the poorly performing and recalcitrant companies, i.e. adverse selection, that stand to gain from enhanced public approval – at no or little cost to themselves – as a result of the time and resources expended by the best-performing companies. At the same time, the best-performing companies suffer from the taint caused by the actions of recalcitrant companies.

A more serious, albeit negative, outcome of this approach lies in its successive loss of credibility with the industry's external stakeholders. Most current industry-based codes, which fall in the category of "principles", suffer from a low level of customer (societal) satisfaction. Most industry groups offering codes make similar claims as to performance and yet are unable and unwilling to satisfy customers (society) with credible performance measures. The codes generate little value to either the companies or society. The phenomena is generally described in the economic literature as a problem of asymmetric information and is best illustrated by the example of selling used cars, as discussed by the Nobel laureate economist George Akerlof.[39] Just as in the case of used cars (pejoratively called "lemons"), industry–groups find it difficult to persuade their external and even internal stakeholders that they are telling the truth with regard to their code elements and performance standards. As in the case of used cars, each seller knows the

[39] See Akerlof 1970; Johnson and Waldman 2003; Levin 2001; Kim 1985; Boyan 1982.

quality of his/her offerings. Since the products are not similar, the customer must have sufficient and believable information about the claims made by each seller. The sellers, however, are unwilling or unable to provide verifiable or trustworthy information. At the same time, each seller immediately matches the claims of every other seller. Since the buyer has no means to compare the truthfulness of competing claims, he/she treats each seller's information as equally false and thereby debases the quality claims of all sellers.

This situation creates disincentives for the companies that are willing to offer greater compliance of a code's broader principles because they cannot get improved believability from the public. It is, therefore, not surprising that most industry-based codes and their performance claims are disbelieved by the public. At the same time, the enhanced reputation effect arising from the efforts of the forward looking companies would be shared equally by the recalcitrant companies in the same group who would benefit at the formers' expense. Conversely, any public reprobation of the recalcitrant companies would also taint the reputation of the forward-looking companies because they belong to the same group.

Another perverse outcome of this approach is that it may lead a code effort to be captured by the companies with the least amount of commitment to code compliance. This situation is akin to the capture theory of regulation where the regulators are co-opted by the regulates and thus lose their legitimacy as regulators.[40] This also leads to a situation wherein the better performing companies remain quiet or, worse still, opt-out of the system and thus allow the members with worse compliance intentions to set the de facto industry standard and thereby make the public repudiation of the code effort a self-fulfilling prophecy.

An examination of a wide variety of industry-based codes indicates that certain pre-condition must be met for those codes to become viable.

[40] Posner 1974; Quirk 1981; Thompson 2003; Fields 1998; Becker 1986.

In the early stages of the evaluation of a social issue – e.g. environmental protection, sustainable development and human rights abuses – a small group of forward looking companies and their leaders must be willing to take the lead in changing the industry direction. The small size of the group minimizes the free rider problem since all participants have *a priori* agreed to adapt certain standards of conduct. It also eliminates the adverse selection issue since membership-by-invitation-only precludes the companies with the worst reputations from joining the group.

The founding group has first mover's advantages, creating standards that are (a) substantial and yet cost effective, and (b) meaningful to gain credence with the industry's critics and the public-at-large. The small size of the group allows for greater opportunities for intensive dialogue with the NGO community and creates more open and inclusive governance systems. The group size can be gradually expanded as other companies see the benefits of joining the group and also find the cost effort manageable.

A code must cover issues demanded by the public and not merely those preferred by industry. Performance verification must be done through mechanisms accepted by the public and not merely those considered convenient by the sponsoring group. A code effort succeeds only when its sponsors have demonstrated the sincerity of their commitments in a manner that is substantial, verifiable and engenders public trust. And last but not least, the industry's leadership must demonstrate a philosophical commitment to the common good, whereby industry leaders become active participants in shaping the public agenda and not merely defending entrenched industry interests.

X. ICMM's SDF: analysis and evaluation

ICMM's efforts and achievements, epitomizing the activities of the mining industry and its member companies, are analyzed at two levels. I first examine the broad framework and intellectual underpinnings of group-based codes of conduct, their strengths and shortcomings, and how these issues have been addressed by the ICMM's SDF in its governance structure, operational procedures, performance evaluation and transparency. These concerns are endemic to all group-based codes of conduct and must be addressed as an integral part of creating and managing the organism. The second part of the evaluation focuses on the performance of the SDF against the organization's self-proclaimed objectives, time frame, achievement targets, accountability and transparency.

A. Governance structure

The starting point for our analysis is the governance structure adopted by ICMM. The MMSD report had called for a new governance structure that would foster industry involvement but would not be dominated by it. ICMM's governance structure, however, has failed to meet even the minimal standards outlined in the MMSD report. The board structure is totally controlled and led by the leadership of the major mining companies that comprise the core support of ICMM. As presently constituted, ICMM is an industry-directed and industry-controlled organization. There is no formal process to incorporate external, non-industry based input in the governance structure.

ICMM's current governance structure is closer to that of industry-based trade associations, which are formed to protect industry members' interests in their traditional business activities. As such, it runs counter to the governance formats that are increasingly being adopted by other industry groups in natural resources, manufacturing and internationally oriented industry-trade associations, which seek to involve non-industry stakeholders at the governance and consultative levels.[41]

The strength of this structure lies in the fact that all deliberations of the group are protected from outside scrutiny.

[41] For examples of industry-based CSR-related codes of conduct involving NGOs and other external stakeholders, see Fair Labour Organizations (www.fairlabour.org), The Forest Stewardship Council (www.fscus.org) and Rainforest Alliance (www.rainforest-alliance.org).

The group disseminates only information that it considers appropriate for public consumption. The group may have been formed to address societal concerns; but the fact remains that its governance structure and *modus operandi* cause it to formulate those issues solely from the industry's perspective and, to the extent external views are considered, they are addressed through the industry's prism and viewpoint.

ICMM's governance structure enables the group to control the problems of free rider and adverse selection by establishing criteria for participation that would presumably exclude those who did not wish to subscribe to the group's principles and standards of conduct. However, it also imposes a heavy burden of proof on the group to demonstrate industry compliance with this SDF.

An analysis of ICMM's activities, described in the next section, suggests that ICMM has to date failed to deliver on any of its goals as outlined in the MMSD report and incorporated in the ICMM's SDF. Moreover, a review of the ICMM's 2004 report, which describes the organization's progress through 2004 and outlines its goals for 2005, is equally disappointing. The main conclusion that one draws from the report is that it would be unrealistic to expect any meaningful and measurable progress from ICMM in meeting its goals in the foreseeable future.

B. Principles and operating procedure

A careful reading of the principles (table 1) suggests that they are primarily inspirational in character, with heavy emphasis on "intent" and call for "commitment" on the part of member companies to improve their performance along indicated dimensions. In this sense, they are similar to scores of other such codes that emphasize "aspirational content" and "good intent" but fall short on delivering specific actions and desired outcomes. As such, they could have been written by any knowledgeable expert, or a good public relations person, in a relatively short period of time. There is little evidence to suggest that these principles benefited in any meaningful manner from the $7 million MMSD effort in intensive group participation and publication of voluminous reports.

A major flaw of these principles lies in their lack of specificity. For example, the first principle states its goal to "implement and maintain ethical business practices and sound systems of corporate governance". However, there is no discussion of what constitutes "ethical business practices", or "sound systems of corporate governance". While we may all agree with the spirit of these principles, we may be far apart as to their transformation in actual business practices. As discussed earlier, the system of corporate governance as outlined in the MMSD report and incorporated in the ICMM structure fails to meet the spirit of these principles.

To take another example, consider principle 6, which calls for "continual improvement of our environmental performance". Unfortunately, such a statement begs the question rather than answers it. To be specific, what is a company's current level of environmental performance and what would constitute acceptable levels of improvement? Even at a conceptual level, the principle could have been more specific. For example, there could be a minimum level of performance-specific environmental practices to which all industry members would be expected to adhere. From this standard, one could measure "improvement" in two ways: (a) the capacity of a company to improve vs. its actual performance, and (b) narrowing the gap between a company's performance and societal expectations. Unfortunately, the principle is silent on this issue. The current approach provides a safe harbour for companies that are lagging in meeting the minimal standards of performance simply because the minimum level has not been specified. Under these conditions, "continual improvement" is a meaningless standard and may end-up misleading the public as to a company's performance on this issue.

Principle 10 calls for effective and transparent engagement with stakeholders, including "independently verified reporting arrangements". However, the ICMM does not provide information as to how company performance would be independently verified and results reported to the public. Equally important, the ICMM does not suggest any approaches as to what the industry would do in the event that a member company's verification procedures lack independence. Nor does it indicate what the industry might do in the event that a member company declines to make public its findings with regard to its compliance with the ICMM Framework. When viewed in the context of the analytical framework presented earlier in this article, it becomes apparent that the ICMM's process of code formulation, and issues covered in the code and rules of governance fall within the purview of what I consider to be drawbacks of group-based code formulation. The overwhelming dominance of industry interests has been pervasive in every aspect of ICMM's deliberations.

It should be noted here that a number of similar efforts in other industries have suffered similar disappointments in terms of gaining public credibility.[42] Code formulation, when there are no prior established standards, must be largely independent (but not hostile) to an industry's interests in order to have realistic inputs from other segments of society that are adversely impacted by an industry's current practices.

Given the ICMM's governing structure, control of the organization by some of the largest mining companies in the industry, and the personal involvement of the top management of these companies, one would expect that the industry would move aggressively to instigate changes in the industry's practices and have a more proactive response to society's concerns, which the industry itself has acknowledged. Instead, this state of affairs has yielded quite the opposite results. It would seem that the industry leaders have retarded, if not completely stalled, the reform progress through their control of the organization. This situation recalls similar results where industry-based trade associations succeed in capturing and co-opting relevant regulatory agencies and moving them away from regulation to the role of protectors of the industry.[43]

[42] O'Rourke 2003; Kapstein 2001.
[43] See footnote 39.

The next step in the ICMM's effort was to amplify the ten principles into 46 explanatory statements so as to give these principles further meaning and substance (table 2). Unfortunately, these explanatory statements also suffer from the same flaws as the principles they are intended to clarify. The amplificatory standards are quite broad and non-specific. They are also quite vague – which would allow significant variations from the core values of the SDF and still qualify a company as meeting code standards. Rather than alleviating the problem of overly generalized principles, the amplifications have further exacerbated the problem by overly simplistic explanations. Neither the principles nor their amplifications provide any standards with regard to the following:

- What is the "absolute minimum" and is it stated in a manner that is quantitatively defined and objectively measured? Is there anything that the industry asks its member companies to do or refrain from doing which leaves no wiggle room? Are there any issues and standards that are considered to be of "zero tolerance" and where less than full compliance is not an option?

- Why is it that no amplification indicators call for "outcome-oriented" standards of performance? Why can there not be minimum quantitative standards with regard to toxic waste, waste water treatment, disposal of mine waste, to name a few?

- How does the industry define fair remuneration and working conditions? What if the local government's minimum wages and working conditions are considered grossly inadequate and widely violated? What if the companies themselves have played an important role in encouraging local governments to keep these wages deliberately low and impose working conditions that border on involuntary servitude? And where does the notion of "living wage" fit in this equation?

- How does the industry plan to protect the property rights and cultural heritage of indigenous peoples under conditions in which local tribes are unable to protect their interests in the face of overwhelming economic power of the mining companies? Quite often, these groups consider their land as sacred land that cannot be sold or bartered. It has also been known that mining companies, often acting in concert with host country governments, forcibly acquire tribal land by paying nominal amounts of money as compensation.

It is important that these and similar concerns are adequately addressed before an industry-based framework can provide guidance to member companies that would be viable and credible to the industry's external constituencies. What is being suggested here is that any such framework must explicitly recognize the need for outcome-oriented standards and establish different levels of tolerance – from zero to good faith effort – towards achieving these goals.

The ICMM's initial report had indicated that it was essential to have "clear targets and accountability". The ICMM's implementation procedures currently envisaged fails to recognize the inherent flaws in industry-based codes, which were discussed in the previous section.

The ICMM's current guidelines indicate that independent monitoring and public reporting are to be voluntary and at the discretion of individual companies. The SDF has no provision as to how the industry will monitor member companies' compliance with principles and how it would persuade recalcitrant members to improve their compliance. Unfortunately, given its current governance structure, it is unlikely that the ICMM would be able to address such questions. We are left with the conclusion that the SDF as currently formulated is like a placebo wrapped in an authentic-looking package. Its acceptance, and claims of performance, would depend not on facts but on our perception of facts as presented by the ICMM and its member companies.

A review of the ICMM's plans for the future suggests that, even if all of the proposals currently under review are implemented, they are unlikely to improve the quality of code implementation in terms of delivering results that are meaningful, have a direct relation to societal expectations, accurately and objectively measure individual company performance (which is independently monitored and verified), and provide for maximum transparency in public disclosure.

The ICMM's initial report had recognized that most individual mining companies operating in different parts of the world would be facing different types of environmental and sociological challenges, both as to scope and intensity, and would require different and, quite often, highly situation-specific approaches to meeting these challenges. This suggests that, although individual companies would use different approaches, the end result of their efforts must be to meet the objectives of the ICMM's principles and their amplifications.

However, a review of member companies' most recently published sustainability reports further points to the large gap that currently exists between the ICMM's principles and standards and their implementation by the member companies. None of the reports provide a link to the company's activities and how they relate to the implementation of the ICMM's principles and amplifications. Nor do these reports provide any information as to how, when and to what extend those companies would integrate the SDF in their operations, independently monitor their compliance and make their findings public.[44]

XL. Recommendations and guidelines for the future

The aforementioned discussion and analysis leads one to conclude that the ICMM's SDF, and its operationalization as currently envisaged, falls short of meeting the minimum level

[44] These comments are based on my analysis of the most recent sustainability reports from the following ICMM member companies: Rio Tinto, BHP Billiton, Umicore, Placer Dome, Newmont, Alcoa, Anglo American, Lonmin Plc., and Freeport McMoRan Copper & Gold. Inc.

of commitment that must be met if the industry is to gain public acceptance and credibility. However, this need not be the case for the future. Through the ICMM, the extractive industry has recognized the problems that it must confront. It has also established general guidelines to address those issues. Now, the companies that helped to establish those guidelines must be willing to take the next and more difficult step, i.e. to put the ICMM SDF into real operational form, company-by-company and site-by-site.

The SDF offers one of the most significant opportunities to demonstrate the effectiveness of an industry-based framework for sustainable development. It has far-reaching consequences for the industry's economic and financial health. It can also help in making real progress in protecting the environment and making the planet a more livable habitat. Its potential success has the ingredients of making significant progress in addressing other problems of global magnitude, i.e. oppressive regimes, widespread corruption, the waste of national resources, ethnic violence, forced labour and a plundering of mineral wealth.

However, the voluntary nature of the SDF means that members of the ICMM must press forward and transform the current general and essentially aspirational character into a functionally specific SDF. This would include general standards that are universally applicable and country-site specific standards applicable to individual locations and countries. Without such an amplification of the SDF, the efforts of the ICMM and its members will not only be unproductive, but also will further hurt the reputation of the industry.

To conclude: for the ICMM to be the voice of the mining industry, and in particular its member companies which are amongst the largest and most successful mining companies in the world, it must take steps towards a more meaningful implementation of the SDF:

- Establish clear-cut standards of conduct that would be the most attainable and best possible standards at the current state of technology and societal expectations. Furthermore, these standards should not be limited to environmental issues, but must encompass, among others, issues of bribery and corruption, human rights abuses, rights of indigenous people, and transparency in its dealings with local governments and especially the army and police in a host country. A starting point in this direction would be the "Voluntary Principles on Security and Human Rights", jointly promulgated by the governments of the United States and the United Kingdom on 19 December 2000.[45]

- Establish "minimum" standards of conduct in the above-mentioned areas that would be considered inviolate under any conditions and make member companies pledge never to violate them.

- Review the current policies and practices of member companies to ensure their total compliance with the inviolate minimum standards of conduct.

- Require member companies to develop their own codes of conduct. They would comply with the broad principles enumerated in the SDF but would also take cognizance of unique conditions prevalent in different countries of mining operations.

- Establish criteria for creating standards for performance evaluation and independent external monitoring systems for compliance verification. Any monitoring system must be an integral part of code compliance on a regular basis.

- Ensure maximum transparency in public disclosure of member companies' performance with its code compliance.

* * *

[45] See United States Department of State Web Site for Voluntary Principles on Security and Human Rights (http://www.state.gov/g/drl/rls/2931.htm).

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Appendix. ICMM members and associated members

List of industry members

Anglo-American Plc.
Mitsubishi Materials Corporation
Alcoa
WMC Limited
AngloGold Ashanti
BHP Biliton
Noranda Inc.
Zinifex Limited
Freeport/McMoRan Copper & Gold, Inc.
Placer Dome Inc.
Rio Tinto Plc
Umicore
Newmont Mining Corporation
Sumitomo Metal Mining
Nippon Mining and Metals
Lonmin Plc.

List of associated members

Chamber of Mines of South Africa
Prospectors and Developers Association of Canada
International Lead Zinc Research Organization
Camara Minera de Mexico
Sociedad Nacional de Mineria (SONAM)
Japan Mining Industry Association
World Coal Institute
Internacional Zinc Association
Mining Industries Associations of Southern Africa
Federation of Indian Mineral Industries
Euromines
Nickel Producers Environmental Research Association (NIPERA)
Consejo Minero de Chile A.G.
International Wrought Copper Council
Nickel Institute
Instituto Brasiliero de Mineracao
International Aluminium Institute
International Copper Association (ICA)
Sociedad Nacional de Minera y Petroleo
Eurometaux
Minerals Council of Australia
The Cobalt Development Institute
Indonesian Mining Association

Source: International Council on Mining and Metals, www.icmm.com.

RESEARCH NOTE

World Investment Report 2005: Transnational Corporations and the Internationalization of R&D Overview

United Nations Conference on Trade and Development*

END OF THE DOWNTURN

Led by developing countries, global FDI flows resumed growth in 2004 …

On account of a strong increase in foreign direct investment (FDI) flows to developing countries, 2004 saw a slight rebound in global FDI after three years of declining flows. At $648 billion, world FDI *inflows* were 2% higher in 2004 than in 2003. Inflows to developing countries surged by 40%, to $233 billion, but developed countries as a group experienced a 14% drop in their inward FDI. As a result, the share of developing countries in world FDI inflows was 36% (table 1), the highest level since 1997. The United States retained its position as the number one recipient of FDI, followed by the United Kingdom and China (figure 1).

Many factors help to explain why the growth of FDI was particularly pronounced in developing countries in 2004. Intense

* The *World Investment Report 2005* (*WIR05*) was prepared under the overall guidance of Karl P. Sauvant by a team led by Anne Miroux and comprising Diana Barrowclough, Harnik Deol, Persephone Economou, Torbjörn Fredriksson, Masataka Fujita, Masayo Ishikawa, Kálmán Kalotay, Dong Jae Lee, Guoyong Liang, Padma Mallampally, Nicole Moussa, Abraham Negash, Hilary Nwokeabia, Shin Ohinata, Jean-François Outreville and James Xiaoning Zhan. Specific inputs were prepared by Victoria Aranda, Americo Beviglia Zampetti, Kumi Endo, Hamed El-Kady, Anna Joubin-Bret, Victor Konde, Michael Lim, Helge Müller, Thomas Pollan, Prasada Reddy, Christoph Spennemann, Joerg Weber and Kee Hwee Wee. This is a reprint of pages 1-34 of the *World Investment Report 2005. Overview* (New York and Geneva: United Nations), UNCTAD/WIR/2005(Overview).

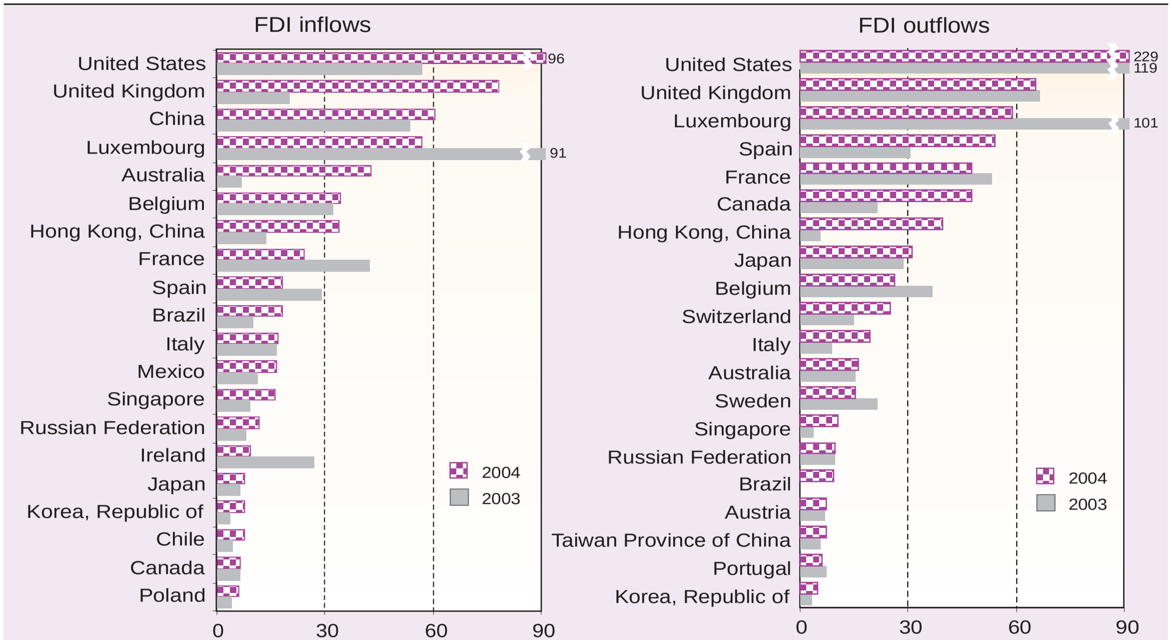
Table 1. FDI flows, by region and selected countries, 1993-2004

(Billions of dollars and per cent)

Region/country	FDI inflows							FDI outflows						
	1993-1998 (Annual average)	1999	2000	2001	2002	2003	2004	1993-1998 (Annual average)	1999	2000	2001	2002	2003	2004
Developed economies	256.2	849.1	1 134.3	596.3	547.8	442.2	380.0	353.3	1 014.1	1 092.7	662.2	599.9	577.3	637.4
Europe 147.3	520.4	722.8	393.9	427.6	359.4	223.4	218.1	763.5	866.1	451.3	396.9	390.0	309.5	
European Union	140.3	501.5	696.3	382.6	420.4	338.7	216.4	200.8	724.6	813.4	433.9	384.5	372.4	279.8
United States	86.1	283.4	314.0	159.5	71.3	56.8	95.9	92.3	209.4	142.6	124.9	134.9	119.4	229.3
Japan	1.3	12.7	8.3	6.2	9.2	6.3	7.8	21.4	22.7	31.6	38.3	32.3	28.8	31.0
Other developed countries	21.5	32.5	89.2	36.7	39.6	19.6	52.9	21.5	18.5	52.5	47.7	35.8	39.1	67.6
Developing economies	138.9	232.5	253.2	217.8	155.5	166.3	233.2	56.6	88.2	143.2	78.6	47.8	29.0	83.2
Africa 7.1	11.9	9.6	20.0	13.0	18.0	18.1	2.3	2.5	1.6	- 2.6	0.4	1.2	2.8	
Latin America and the Caribbean	47.9	108.6	97.5	89.1	50.5	46.9	67.5	12.7	44.7	60.6	29.1	11.4	10.6	10.9
Asia and Oceania	83.9	112.0	146.0	108.7	92.0	101.4	147.6	41.6	41.0	81.1	52.0	36.0	17.2	69.4
Asia	83.4	111.6	145.7	108.6	92.0	101.3	147.5	41.6	41.1	81.1	52.0	36.0	17.2	69.4
West Asia	3.5	1.9	3.8	7.1	5.7	6.5	9.8	0.2	1.6	1.4	1.1	0.9	- 4.0	0.0
East Asia	51.6	77.3	116.2	78.7	67.3	72.1	105.0	31.7	29.8	72.0	26.1	27.6	14.4	53.5
China	38.5	40.3	40.7	46.9	52.7	53.5	60.6	2.6	1.8	0.9	6.9	2.5	- 0.2	1.8
South Asia	2.9	3.1	3.1	4.1	4.5	5.3	7.0	0.1	0.1	0.5	1.4	1.1	1.0	2.3
South-East Asia	25.3	29.3	22.6	18.8	14.5	17.4	25.7	9.6	9.6	7.2	23.3	6.4	5.8	13.6
Oceania	0.4	0.4	0.3	0.1	0.0	0.1	0.1	0.0	- 0.1	0.0	0.1	0.0	0.0	0.0
South-East Europe and the CIS	6.6	10.5	9.1	11.8	12.8	24.1	34.9	1.3	2.6	3.2	2.7	4.5	10.6	9.7
South-East Europe	1.6	3.7	3.6	4.5	3.8	8.4	10.8	0.1	0.1	0.0	0.2	0.6	0.1	0.2
CIS	5.0	6.8	5.5	7.3	9.0	15.7	24.1	1.3	2.5	3.2	2.5	3.9	10.4	9.5
World 401.7	1 092.1	1 396.5	825.9	716.1	632.6	648.1	411.2	1 104.9	1 239.1	743.5	652.2	616.9	730.3	
Memorandum: share in world FDI flows														
Developed economies	63.8	77.7	81.2	72.2	76.5	69.9	58.6	85.9	91.8	88.2	89.1	92.0	93.6	87.3
Developing economies	34.6	21.3	18.1	26.4	21.7	26.3	36.0	13.8	8.0	11.6	10.6	7.3	4.7	11.4
South-East Europe and the CIS	1.6	1.0	0.6	1.4	1.8	3.8	5.4	0.3	0.2	0.3	0.4	0.7	1.7	1.3

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, annex table B.1.

Figure 1. Global FDI flows, top 20 economies,[a] 2003, 2004
(Billions of dollars)



Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, annex table B.1.

[a] Ranked on the basis of the magnitude of 2004 FDI flows.

competitive pressures in many industries are leading firms to explore new ways of improving their competitiveness. Some of these ways are by expanding operations in the fast-growing markets of emerging economies to boost sales, and by rationalizing production activities with a view to reaping economies of scale and lowering production costs. Higher prices for many commodities have further stimulated FDI to countries that are rich in natural resources such as oil and minerals. In some developed as well as developing countries, increased inflows in 2004 were linked to an upturn in cross-border merger and acquisition (M&A) activity. Greenfield FDI continued to rise for the third consecutive year in 2004. Provided economic growth is maintained, the prospects for a further increase in global FDI flows in 2005 are promising.

FDI *outflows* increased in 2004 by 18%, to $730 billion, with firms based in developed countries accounting for the bulk ($637 billion). In fact, almost half of all outward FDI originated from three sources: the United States, the United Kingdom and Luxembourg in that order (figure 1). Developed countries as a group remained significant net capital exporters through FDI; net outflows exceeded net inflows by $260 billion. While FDI outflows from the European Union (EU) declined by 25%, to $280 billion (a seven-year low), most other developed countries increased their investment abroad. In the case of the United States, outflows increased by over 90%, to $229 billion, a record high.

The stock of FDI in 2004 is estimated at $9 trillion. It is attributed to some 70,000 transnational corporations (TNCs) and their 690,000 affiliates abroad, with total sales by foreign affiliates amounting to almost $19 trillion (table 2). Ranked by foreign assets, General Electric (United States) remained the largest non-financial TNC worldwide, followed by Vodafone (United Kingdom) and Ford Motor (United States) (table 3). Among the top 100 TNCs worldwide, four companies, led by Hutchison Whampoa (Hong Kong, China), are based in developing economies (table 4).

Table 2. Selected indicators of FDI and international production, 1982-2004

(Billions of dollars and per cent)

Item	Value at current prices (Billions of dollars)				Annual growth rate (Per cent)						
	1982	1990	2003	2004	1986-1990	1991-1995	1996-2000	2001	2002	2003	2004
FDI inflows	59	208	633	648	22.8	21.2	39.7	-40.9	-13.3	-11.7	2.5
FDI outflows	27	239	617	730	25.4	16.4	36.3	-40.0	-12.3	-5.4	18.4
FDI inward stock	628	1 769	7 987	8 902	16.9	9.5	17.3	7.1	8.2	19.1	11.5
FDI outward stock	601	1 785	8 731	9 732	18.0	9.1	17.4	6.8	11.0	19.8	11.5
Cross-border M&As [a]	..	151	297	381	25.9 [b]	24.0	51.5	-48.1	-37.8	-19.6	28.2
Sales of foreign affiliates	2 765	5 727	16 963 [c]	18 677 [c]	15.9	10.6	8.7	-3.0	14.6	18.8 [c]	10.1 [c]
Gross product of foreign affiliates	647	1 476	3 573 [d]	3 911 [d]	17.4	5.3	7.7	-7.1	5.7 [d]	28.4 [d]	9.5
Total assets of foreign affiliates	2 113	5 937	32 186 [e]	36 008 [e]	18.1	12.2	19.4	-5.7	41.1 [e]	3.0 [e]	11.9 [e]
Exports of foreign affiliates	730	1 498	3 073 [f]	3 690 [f]	22.1	7.1	4.8	-3.3 [f]	4.9 [f]	16.1 [f]	20.1 [f]
Employment of foreign affiliates (thousands)	19 579	24 471	53 196 [g]	57 394 [g]	5.4	2.3	9.4	-3.1	10.8 [g]	11.1 [g]	7.9 [g]
GDP (in current prices) [h]	11 758	22 610	36 327	40 671	10.1	5.2	1.3	-0.8	3.9	12.1	12.0
Gross fixed capital formation	2 398	4 905	7 853	8 869	12.6	5.6	1.6	-3.0	0.5	12.9	12.9
Royalties and licence fee receipts	9	30	93	98	21.2	14.3	8.0	-2.9	7.5	12.4	5.0
Exports of goods and non-factor services [h]	2 247	4 261	9 216	11 069	12.7	8.7	3.6	-3.3	4.9	16.1	20.1

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, table I.3.

a Data are only available from 1987 onward.
b 1987-1990 only.
c Based on the following regression result of sales against FDI inward stock (in millions of dollars) for the period 1980-2002: Sales=2 003.858+1.87288*FDI inward stock.
d Based on the following regression result of gross product against FDI inward stock (in millions of dollars) for the period 1982-2002: Gross product=622.0177+0.369482*FDI inward stock.
e Based on the following regression result of assets against FDI inward stock (in millions of dollars) for the period 1980-2002: Assets= -1 179.838+4.177434*FDI inward stock.
f For 1995-1998, based on the regression result of exports of foreign affiliates against FDI inward stock (in millions dollars) for the period 1982-1994: Exports=357.6124+0.558331*FDI inward stock. For 1999-2004, the share of exports of foreign affiliates in world exports in 1998 (33.3 per cent) was applied to obtain the values.
g Based on the following regression result of employment (in thousands) against FDI inward stock (in millions of dollars) for the period 1980-2002: Employment=16 552.15+4.587846*FDI inward stock.
h Based on data from the International Monetary Fund, *World Economic Outlook*, April 2005.

Table 3. The world's top 25 non-financial TNCs, ranked by foreign assets, 2003 [a]

(Millions of dollars and number of employees)

Ranking by:						Assets		Sales		Employment		TNI [b]	No. of affiliates		
Foreign assets	TNI[b]	II[c]	Corporation	Home economy	Industry	Foreign	Total	Foreign	Total	Foreign	Total	(Per cent)	Foreign	Total	II[c]
1	77	37	General Electric	United States	Electrical & electronic equip.	258 900	647 483	54 086	134 187	150 000	305 000	43.2	1068	1398	76.39
2	7	95	Vodafone Group Plc	United Kingdom	Telecommunications	243 839	262 581	50 070	59 893	47 473	60 109	85.1	71	201	35.32
3	72	12	Ford Motor Company	United States	Motor vehicles	173 882	304 594	60 761	164 196	138 663	327 531	45.5	524	623	84.11
4	90	65	General Motors	United States	Motor vehicles	15 4466	448 507	51 627	185 524	104 000	294 000	32.5	177	297	59.60
5	10	78	British Petroleum Co. Plc	United Kingdom	Petroleum expl./ref./distr.	141 551	177 572	192 875	232 571	86 650	103 700	82.1	60	117	51.28
6	31	41	ExxonMobil Corp.	United States	Petroleum expl./ref./distr.	116 853	174 278	166 926	237 054	53 748	88 300	66.1	218	294	74.15
7	22	80	Royal Dutch/Shell Group	United Kingdom/ Netherlands	Petroleum expl./ref./distr.	112 587	168 091	129 864	201 728	100 000	119 000	71.8	454	929	48.87
8	68	94	Toyota Motor Corp.	Japan	Motor vehicles	94 164	189 503	87 353	149 179	89 314	264 410	47.3	124	330	37.58
9	16	48	Total	France	Petroleum expl./ref./distr.	87 840	100 989	94 710	118 117	60 931	110 783	74.1	419	602	69.60
10	62	69	France Telecom	France	Telecommunications	81 370	126 083	21 574	52 202	88 626	218 523	48.8	118	211	55.92
11	14	58	Suez	France	Electricity, gas and water	74 147	88 343	33 715	44 720	111 445	172 291	74.7	605	947	63.89
12	89	34	Electricite De France	France	Electricity, gas and water	67 069	185 527	16 062	50 699	51 847	167 309	32.9	204	264	77.27
13	80	63	E.On	Germany	Electricity, gas and water	64 033	141 260	18 659	52 330	29 651	69 383	41.2	478	790	60.51
14	85	74	Deutsche Telekom AG	Germany	Telecommunications	62 624	146 601	23 868	63 023	75 241	248 519	37.0	97	178	54.49
15	59	67	RWE Group	Germany	Electricity, gas and water	60 345	98 592	23 729	49 061	53 554	127 028	50.6	377	650	58.00
16	23	23	Hutchison Whampoa Ltd	Hong Kong, China	Diversified	59 141	80 340	10 800	18 699	104 529	126 250	71.4	1900	2350	80.85
17	32	40	Siemens AG	Germany	Electrical & electronic equip.	58 463	98 011	64 484	83 784	247 000	417 000	65.3	753	1011	74.48
18	53	46	Volkswagen Group	Germany	Motor vehicles	57 853	150 462	71 190	98 367	160 299	334 873	52.9	203	283	71.73
19	21	35	Honda Motor Co Ltd	Japan	Motor vehicles	53 113	77 766	54 199	70 408	93 006	131 600	72.0	102	133	76.69
20	34	89	Vivendi Universal	France	Diversified	52 421	69 360	15 764	28 761	32 348	49 617	65.2	106	238	44.54
21	42	83	ChevronTexaco Corp.	United States	Petroleum expl./ref./distr.	50 806	81 470	72 227	120 032	33 843	61 533	59.2	93	201	46.27
22	3	30	News Corporation	Australia	Media	50 803	55 317	17 772	19 086	35 604	38 500	92.5	213	269	79.18
23	65	29	Pfizer Inc	United States	Pharmaceuticals	48 960	116 775	18 344	45 188	73 200	122 000	47.5	73	92	79.35
24	93	85	Telecom Italia Spa	Italy	Telecommunications	46 047	101 172	6 816	34 819	14 910	93 187	27.0	33	73	45.21
25	50	18	BMW AG	Germany	Motor vehicles	44 948	71 958	35 014	47 000	26 086	104 342	54.0	129	157	82.17

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, annex table A.I.9.

[a] All data are based on the companies' annual reports unless otherwise stated.
[b] Ranking among top 100 TNCs worldwide. TNI, the abbreviation for Transnationality Index, is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.
[c] Ranking among top 100 TNCs worldwide. II, the abbreviation for Internationalization Index, is calculated as the number of foreign affiliates divided by the number of all affiliates.

Note: Affiliates counted in this table refer to only majority-owned affiliates.

Table 4. The top 25 non-financial TNCs from developing economies, ranked by foreign assets, 2003[a]

(Millions of dollars, number of employees)

Ranking by:						Assets		Sales		Employment		TNI[b]	No. of affiliates		
Foreign assets	TNI[b]	II[c]	Corporation	Home economy	Industry	Foreign	Total	Foreign	Total	Foreign	Total	(Per cent)	Foreign	Total	II[c]
1	7	41	Hutchison Whampoa Limited	Hong Kong, China	Diversified	59 141	80 340	10 800	18 699	104 529	126 250	71.4	1900	2350	80.85
2	27	39	Singtel Ltd.	Singapore	Telecommunications	17 911	21 668	4 672	68 848	8 642	21 716	43.1	23	30	76.67
3	42	35	Petronas - Petroliam Nasional Bhd	Malaysia	Petroleum expl./ref./distr.	16 114	53 457	8 981	25 661	3 625	30 634	25.7	167	234	71.37
4	26	48	Samsung Electronics Co., Ltd.	Republic of Korea	Electrical & electronic equip.	2 387	56 524	41 362	54 349	19 026	55 397	44.1	80	89	89.89
5	12	36	Cemex S.A.	Mexico	Construction Materials	11 054	16 021	5 189	7 167	17 051	25 965	69.0	35	48	72.92
6	23	37	América Móvil	Mexico	Telecommunications	8 676	13 348	3 107	7 649	8 403	18 471	50.4	12	16	75.00
7	31	24	China Ocean Shipping (Group) Co.	China	Transport and storage	8 457	18 007	6 076	9 163	4 600	64 586	40.1	22	56	39.29
8	46	7	Petroleo Brasileiro S.A. - Petrobras	Brazil	Petroleum expl./ref./distr.	7 827	53 612	8 665	42 690	5 810	48 798	15.6	13	79	16.46
9	25	47	LG Electronics Inc.	Republic of Korea	Electrical & electronic equip.	7 118	20 173	14 443	29 846	36 268	63 951	46.8	134	151	88.74
10	16	34	Jardine Matheson Holdings Ltd	Hong Kong, China	Diversified	6 159	8 949	5 540	8 477	57 895	110 000	62.3	16	23	69.57
11	10	14	Sappi Limited	South Africa	Paper	4 887	6 203	3 287	4 299	9 454	16 939	70.4	115	456	25.22
12	33	45	Sasol Limited	South Africa	Industrial chemicals	4 226	10 536	5 033	9 722	5 643	31 150	36.7	21	25	84.00
13	50	30	China National Petroleum Corp.	China	Petroleum expl./ref./distr.	4 060	97 653	5 218	57 423	22 000	1 167 129	5.0	119	204	58.33
14	22	2	Capitaland Limited	Singapore	Real estate	3 936	10 316	1 449	2 252	5 033	10 175	50.7	2	61	3.28
15	8	43	City Developments Limited	Singapore	Hotels	3 879	7 329	703	930	11 549	13 703	70.9	228	275	82.91
16	4	49	Shangri-La Asia Limited	Hong Kong, China	Hotels and motels	3 672	4 743	436	542	12 619	16 300	78.4	29	31	93.55
17	15	33	Citic Pacific Ltd.	Hong Kong, China	Diversified	3 574	7 167	2 409	3 372	8 045	12 174	62.5	2	3	66.67
18	45	16	CLP Holdings	Hong Kong, China	Electricity, gas and water	3 564	9 780	298	3 639	488	4 705	18.3	3	11	27.27
19	41	21	China State Construction Engineering Corp.	China	Construction	3 417	9 677	2 716	9 134	17 051	121 549	26.4	28	75	37.33
20	24	22	MTN Group Limited	South Africa	Telecommunications	3 374	4 819	1 308	3 595	2 601	6 063	49.8	6	16	37.50
21	2	26	Asia Food & Properties	Singapore	Food & beverages	3 331	3 537	1 232	1 273	32 295	41 800	89.4	2	4	50.00
22	11	46	Flextronics International Ltd.	Singapore	Electrical & electronic equip.	3 206	5 634	4 674	8 340	80 091	82 000	70.2	92	106	86.79
23	30	17	Companhia Vale do Rio Doce	Brazil	Mining & quarrying	3 155	11 434	6 513	7 001	224	29 632	40.5	16	55	29.09
24	29	10	YTL Corp. Berhad	Malaysia	Utilities	2 878	6 248	489	1 060	1 518	4 895	41.1	24	115	20.87
25	20	38	Hon Hai Precision Industries	Taiwan Province of China	Electrical & electronic equip.	2 597	6 032	4 038	10 793	78 575	93 109	54.9	25	33	75.76

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, annex table A.I.10.

[a] All data are based on the companies' annual reports unless otherwise stated.
[b] Ranking among top 50 TNCs based in developing countries. TNI, the abbreviation for Transnationality Index, is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.
[c] Ranking among top 50 TNCs based in developing countries. II, the abbreviation for Internationalization Index, is calculated as the number of foreign affiliates divided by the number of all affiliates.

Note: Affiliates counted in this table refer to only majority-owned affiliates.

The pace at which the top 100 TNCs are expanding internationally appears to have slowed down. Although their sales, employment and assets abroad all rose in absolute terms in 2003, their relative importance declined somewhat as activities in the home countries expanded faster. Japanese and United States TNCs are generally less transnationalized than their European counterparts. The top 50 TNCs based in developing economies (table 4), with a shorter history of outward expansion, are even less transnationalized, but the gap between TNCs from developed and developing countries is shrinking in this respect.

International investment in services, particularly financial services, continued to grow steadily, accounting for the bulk of the world FDI stock. The services sector accounted for 63% of the total value of cross-border M&As in 2004, with financial services responsible for one-third of the value of cross-border M&As in this sector. For the first time, this year's *WIR* ranks the top 50 financial TNCs. Large TNCs dominate world financial services, not only in terms of total assets but also in terms of the number of countries in which they operate. Citigroup (United States) tops the list, followed by UBS (Switzerland) and Allianz (Germany). Financial TNCs from France, Germany, Japan, the United Kingdom and the United States accounted for 74% of the total assets of the top 50 financial TNCs in 2003.

Low interest rates, higher profits and the recovery of asset prices, principally in developed countries, contributed to an upturn in M&As, including cross-border M&As; their value shot up by 28% to $381 billion. These transactions played an important part in the continued restructuring and consolidation process of many industries, especially in the developed world. The largest M&A deal in 2004 was the acquisition of Abbey National (United Kingdom) by Santander Central Hispano (Spain), valued at $16 billion. In developing countries, cross-border M&As accounted for a more modest share of overall FDI activity, although firms from these countries were increasingly involved in M&As, including some high-profile cases. The upswing in FDI flows to developing countries was mainly associated with greenfield investments notably in Asia.

China and India together accounted for about a half of all new registered greenfield (and expansion) projects in developing countries in 2004.

In terms of the three main forms of FDI financing, equity investment dominates at the global level. During the past decade, it has accounted for about two-thirds of total FDI flows. The shares of the other two forms of FDI – intra-company loans and reinvested earnings – were on average 23% and 12% respectively. These two forms fluctuate widely, reflecting yearly variations in profit and dividend repatriations or the need for loan repayment. There are notable differences in the pattern of FDI financing between developed and developing countries; reinvested earnings are consistently more important in the latter.

FDI continues to surpass other private capital flows to developing countries as well as flows of official development assistance (ODA). In 2004, it accounted for more than half of all resource flows to developing countries and was considerably larger than ODA. However, FDI is concentrated in a handful of developing countries, while ODA remains the most important source of finance in a number of other developing countries. This is particularly the case for most least developed countries (LDCs) even though FDI flows have surpassed ODA for individual countries in that group.

Countries continue to adopt new laws and regulations with a view to making their investment environments more investor friendly. Out of 271 such changes pertaining to FDI introduced in 2004, 235 involved steps to open up new areas to FDI along with new promotional measures (table 5). In addition, more than 20 countries lowered their corporate income taxes in their bid to attract more FDI. In Latin America and Africa, however, a number of policy changes tended to make regulations less favourable to foreign investment, especially in the area of natural resources.

At the international level, the number of bilateral investment treaties (BITs) and double taxation treaties (DTTs) reached 2,392 and 2,559 respectively in 2004, with developing

Table 5. National regulatory changes, 1991-2004

Item	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65	76	60	63	69	71	70	82	102
Number of regulatory changes	82	79	102	110	112	114	151	145	140	150	208	248	244	271
of which:														
More favourable to FDI [a]	80	79	101	108	106	98	135	136	131	147	194	236	220	235
Less favourable to FDI [b]	2	-	1	2	6	16	16	9	9	3	14	12	24	36

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, table I.14.

[a] Includes liberalizing changes or changes aimed at strengthening market functioning, as well as increased incentives.

[b] Includes changes aimed at increasing control, as well as reducing incentives.

countries concluding more such treaties with other developing countries. More international investment agreements were also concluded at the regional and global level, potentially contributing to greater openness towards FDI. The various international agreements are generally becoming more and more sophisticated and complex in content, and investment-related provisions are increasingly introduced into agreements encompassing a broader range of issues. There is also a rise in investor-State disputes, paralleling the proliferation of international investment agreements.

…with the Asia and Oceania region the largest recipient as well as source of FDI among developing countries.

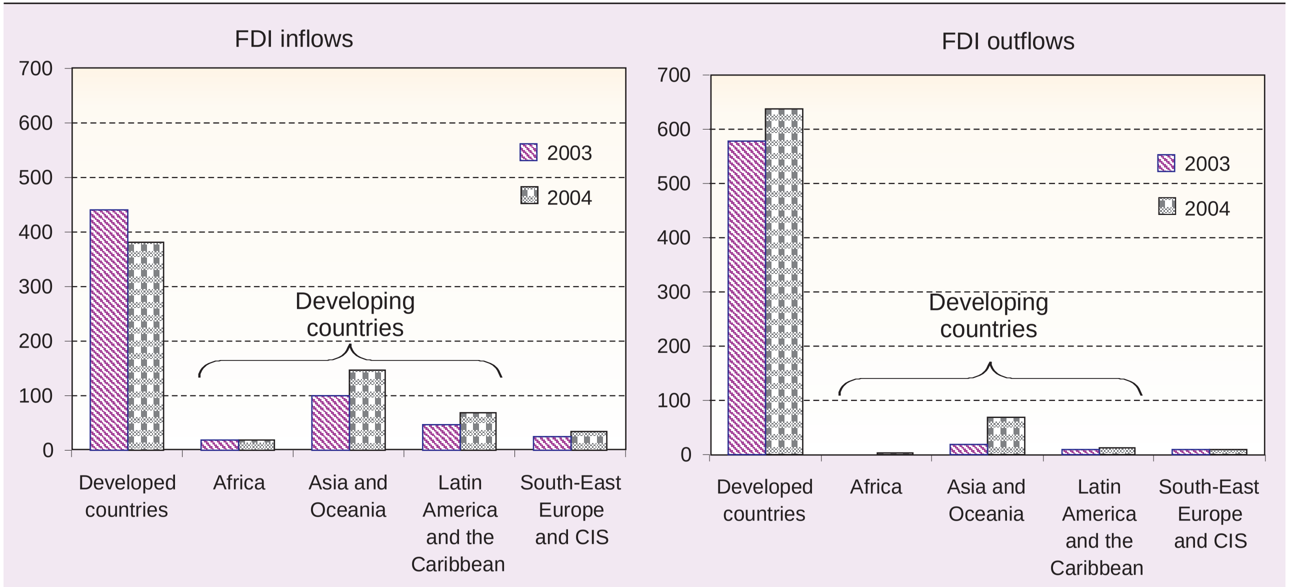
The upturn in global FDI was marked by significant differences between countries and regions (figure 2 and table 1). *Asia and Oceania* (for definition, see box 1) was again the top destination of FDI flows to developing regions. It attracted $148 billion of FDI, $46 billion more than in 2003, marking the

Box 1. Changes in geographical groupings used in *WIR05*

Major changes in the classification of groups of economies have been introduced by the United Nations Statistical Division. The EU now has 25 members, including the 10 countries that became new members on 1 May 2004. Eight countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia) have been reclassified from Central and Eastern Europe (CEE) to EU, and Cyprus from West Asia to EU. Malta has now been reclassified from "other developed countries" to EU. These ten countries are now included among the "developed countries". After the reclassification of the eight EU-accession countries from CEE as developed countries, the remaining CEE countries, along with countries formerly in the group Central Asia (under developing countries) are now classified under South-East Europe in a new grouping comprising South-East Europe and the Commonwealth of Independent States (CIS). CIS includes all of the former republics that were part of the former USSR except the Baltic States. In addition to the reclassifications mentioned above, the nomenclature used for the developing Pacific Island countries classified in previous *WIRs* under the Pacific subregion of the Asia-Pacific region is changed to "Oceania".

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, box I.2.

Figure 2. FDI flows by region, 2003, 2004
(Billions of dollars)



Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, figure II.1.

largest increase ever. East Asia saw a 46% increase in inflows, to reach $105 billion, driven largely by a significant increase in flows to Hong Kong (China). In South-East Asia, FDI surged by 48% to $26 billion, while South Asia, with India at the forefront, received $7 billion, corresponding to a 30% rise. FDI inflows to West Asia grew even more, rising from $6.5 billion to $9.8 billion, of which more than half was concentrated in Saudi Arabia, the Syrian Arab Republic and Turkey. China continued to be the largest developing-country recipient with $61 billion in FDI inflows.

The Asia and Oceania region is also emerging as an important source of FDI. In 2004 the region's outward flows quadrupled to $69 billion, due mainly to dramatic growth in FDI from Hong Kong (China) but also to increased investments by TNCs from other parts of East Asia and South-East Asia. Most of these investments are intraregional, taking place especially among the economies of East and South-East Asia. However, interregional investment from Asian economies also increased. For example, a key driver of Chinese outward FDI was the growing demand for natural resources. This has led to significant investment projects in Latin America. Indian TNCs also invested large amounts in natural resources in other regions, primarily in African countries and the Russian Federation. Asian investment in developed countries is on the rise as well: the past year in particular has seen a few sizeable acquisitions of United States and EU firms by Chinese and Indian TNCs – such as the acquisition by Lenovo (China) of the personal computers division of IBM (United States).

The growth of both inward and outward FDI flows in Asia and Oceania is being facilitated by various policy changes at the national and regional levels. For example, the Association of Southeast Asian Nations (ASEAN) and China signed an agreement to establish a free trade area by 2010, and several Asian countries signed free trade agreements with the United States.

FDI rebounded in Latin America following four years of decline...

Following four years of continuous decline, FDI flows to Latin America and the Caribbean registered a significant upsurge in 2004, reaching $68 billion – 44% above the level attained in 2003. Economic recovery in the region, stronger growth in the world economy and higher commodity prices were contributing factors. Brazil and Mexico were the largest recipients, with inflows of $18 billion and $17 billion respectively. Together with Chile and Argentina they accounted for two-thirds of all FDI flows into the region in 2004. However, FDI inflows did not increase in all the countries of Latin America. There were notable declines in Bolivia and Venezuela, mainly linked to uncertainty regarding legislation related to oil and gas production. In Ecuador the completion of the crude oil pipeline construction explained the decrease in FDI inflows. A number of countries modified their legislation and tax regimes to increase the State's share in revenues from non-renewable natural resources. It is still too early to assess the impact of these changes on the volume of FDI. Significant projects remain under development and additional ones were announced during 2004.

The sectoral composition of inward FDI to parts of Latin America and the Caribbean appears to be changing. For several countries of the region, natural resource and manufacturing industries became more popular FDI destinations than services in 2004. In Argentina, Brazil and Mexico, manufacturing attracted more FDI than services. FDI in Mexico's *maquiladora* industry surged by 26% in response to growing demand in the United States after three consecutive years of decline. The completion of most privatization programmes, coupled with financial difficulties facing foreign investors in the aftermath of the recent financial crisis and the ensuing economic stagnation in some countries, reduced the attractiveness of the services sector for FDI in Latin America. Firms in that sector suffered the most from the impact of the economic crisis, facing serious problems in reducing their large foreign-currency liabilities while at the same time being unable (owing to the non-tradability of their activities) to shift towards export-oriented production. In Central America and the Caribbean, however, renewed privatization activity made services the largest FDI recipient sector. In the Andean Community, high oil and mineral prices sustained the position of the primary sector as the main recipient of FDI flows.

... remained stable in Africa …

FDI flows to Africa remained at almost the same level – $18 billion – as in 2003. FDI in natural resources was particularly strong, reflecting the high prices of minerals and oil and the increased profitability of investment in the primary sector. High and rising prices of petroleum, metals and minerals induced TNCs to maintain relatively high levels of investment in new exploration projects or to escalate existing production. Several large cross-border M&As were concluded in the mining industry last year. Despite these developments Africa's share in FDI flows worldwide remains low, at 3%.

Angola, Equatorial Guinea, Nigeria, Sudan (all rich in natural resources) and Egypt were the top recipients, accounting for a little less than half of all inflows to Africa. While FDI inflows to the last three rose, those to South Africa, another important FDI recipient, fell. LDCs in Africa received small amounts: around $9 billion in total in 2004. Most investment in Africa originated from Europe, led by investors from France, the Netherlands and the United Kingdom, and from South Africa and the United States; together these countries accounted for more than half of the region's inflows. FDI outflows from Africa more than doubled in 2004, to $2.8 billion.

A renewed wave of FDI-friendly measures and initiatives at national and international levels has sought to facilitate and attract more FDI to the African continent. At the national level, many measures focused on liberalizing legal frameworks and improving the overall environment for FDI. However, failure to move rapidly on economic and social policies important for attracting and retaining FDI, and a weak emphasis on capacity building, have hampered the ability of many countries in the region to attract FDI, in particular in manufacturing. Thus far, international market-access measures and initiatives targeting African countries (such as the United States' African Growth and Opportunity Act) overall have not been very successful in increasing FDI. In order to realize the potential for increased FDI and to derive greater benefits from it, African countries generally need to develop stronger industrial and technological capabilities.

The need for international support to Africa's development has been stressed in several recent initiatives. For example, the Commission for Africa (established by the United Kingdom) released a report in March 2005 recommending a substantial increase in aid to Africa: an additional $25 billion per year to be implemented by 2010. It also proposed several measures that could help the continent attract more FDI and enhance its benefits for development. Specifically the report called for donors to double their funding for infrastructure, adopt a 100% external debt cancellation, support an Investment Climate Facility for Africa under the New Economic Partnership for Africa's Development (NEPAD) initiative, and create a fund that would provide insurance to foreign investors in post-conflict countries in Africa.

… and increased in South-East Europe and the CIS for the fourth consecutive year.

FDI inflows to South-East Europe and the CIS, a new group of conomies under the United Nations reclassification (box 1), recorded a fourth year of growth in 2004, reaching an all-time high of $35 billion. This was the only region to escape the three-year decline (2001-2003) in world FDI flows, and it maintained robust growth in inward FDI in 2004 (more than 40%). Trends in inward FDI to the two subregions have differed somewhat, however, reflecting the influence of various factors. In South-East Europe, FDI inflows started to grow only in 2003. Led by large privatization deals, these inflows nearly tripled, to

$11 billion in 2004. In the CIS, inflows grew from $5 billion in 2000 to $24 billion in 2004, benefiting largely from the high prices of petroleum and natural gas. The Russian Federation is the largest recipient of FDI inflows in the region.

By contrast, FDI inflows to developed countries continued to decline.

FDI flows into developed countries, which now include the 10 new EU members (see box 1), fell to $380 billion in 2004. The decline was less sharp than in 2003, possibly suggesting a bottoming out of the downward trend that started in 2001. The decline pertained to many major host countries in the developed world. However, there were some significant exceptions; the United States and the United Kingdom recorded substantial increases in inflows mainly as a result of cross-border M&As. Meanwhile, investment outflows from developed countries turned upwards again in 2004 to reach $637 billion.

FDI flows into the EU as a whole fell to $216 billion – the lowest level since 1998. However, the performance of individual EU members varied, with Denmark, Germany, the Netherlands and Sweden registering the most significant declines. To some extent the persistence of the downward FDI trend in the EU reflected large repayments of intra-company loans and repatriation of earnings in a few members. At the same time, FDI inflows into all the 10 new EU countries increased, attracted by high rates of economic growth, the availability of skilled human resources at competitive costs and reduced uncertainty with regard to the regulatory framework for FDI following EU accession. Flows into Japan surged by 24% to $8 billion, while those to other developed countries (Israel, New Zealand, Norway and Switzerland) declined.

Further increases in FDI are expected.

Prospects for FDI worldwide appear to be favourable for 2005. For 2006, global FDI flows can be expected to rise further if economic growth is consolidated and becomes more widespread, corporate restructuring takes hold, profit growth persists and the pursuit of new markets continues. The continued need of firms to improve their competitiveness by expanding into new markets, reducing costs and accessing natural resources and strategic assets abroad provides strong incentives for further FDI in developing countries in particular. Also, the improved profitability of TNCs is likely to trigger greater M&A activity, which should also push up the levels of FDI in developed countries.

Surveys of TNCs, experts and investment promotion agencies (IPAs) undertaken by UNCTAD corroborate this relatively optimistic picture, as do the findings of other recent surveys. In the UNCTAD surveys, more than half of the responding TNCs as well as experts and four-fifths of the IPAs expected short-term (2005-2006) growth in FDI flows; very few predicted a decline of FDI in the near future. The competitive pressure on firms, continued offshoring of services, ongoing liberalization and the growth of TNCs from emerging markets were identified as factors that should lead to more FDI.

At the same time, there are grounds for caution in forecasting FDI flows. The slowdown of growth in some developed countries, along with structural weaknesses and financial and corporate vulnerabilities in some regions, continue to hinder a strong recovery of FDI growth. Continuing external imbalances in many countries and sharp exchange-rate fluctuations, as well as high and volatile commodity prices, pose risks that may hinder global FDI flows.

There is some variation in the FDI prospects of individual regions. In view of the improved economic situation in Asia and Oceania, its important role as a global production centre, its improved policy environment and significant regional integration efforts, the prospects for FDI flows to that region are strongly positive. According to the TNCs, experts and IPAs surveyed by UNCTAD, the region's outlook for FDI is bright. FDI inflows to Latin America and the Caribbean are expected to increase in 2005-2006 as most of the driving forces behind

FDI growth in 2004 are set to continue. Prospects are also positive for Africa, partly as a result of higher commodity prices and Africa's natural resource potential. One out of four TNC respondents expected that inflows to Africa would increase in 2005-2006, suggesting more cautious optimism vis-à-vis this region.

FDI inflows into South-East Europe and the CIS are expected to grow further in the near future, based on the expectation that their competitive wages, in particular in South-East Europe, could attract an increasing number of efficiency-seeking or export-oriented projects, while the natural-resource-rich CIS countries could benefit from continued high oil and gas prices.

Despite the decline in 2004, prospects for renewed growth in both inward and outward FDI flows for developed countries in 2005 remain positive, underpinned by forecasts of moderate economic growth and a strong pick-up in corporate profits. Already, during the first six months of 2005, cross border M&As in developed countries increased significantly. For the largest recipient country – the United States – prospects for FDI are good, although the inflows may not reach the high levels recorded in 2004.

R&D INTERNATIONALIZATION AND DEVELOPMENT

TNCs are internationalizing R&D, including in developing countries …

WIR05 focuses on the internationalization of research and development (R&D) by TNCs. This is not a new phenomenon. When expanding internationally, firms have always needed to adapt technologies locally to sell successfully in host countries. In many cases, some internationalization of R&D has been necessary to accomplish this. However, it was traditionally the case that R&D was reserved for the home countries of the TNCs. By contrast, now a number of new features are emerging in the internationalization process. In particular, for the first time, TNCs are setting up R&D facilities outside developed countries that go beyond adaptation for local markets; increasingly, in some developing and South-East European and CIS countries, TNCs' R&D is targeting global markets and is integrated into the core innovation efforts of TNCs.

Consider the following illustrations. Since 1993 when Motorola established the first foreign-owned R&D lab in China, the number of foreign R&D units in that country has reached some 700. The Indian R&D activities of General Electric – the largest TNC in the world – employ 2,400 people in areas as diverse as aircraft engines, consumer durables and medical equipment. Pharmaceutical companies such as Astra-Zeneca, Eli Lilly, GlaxoSmithKline, Novartis, Pfizer and Sanofi-Aventis all run clinical research activities in India. From practically nothing in the mid-1990s, the contribution by South-East and East Asia to global semiconductor design reached almost 30% in 2002. STMicroelectronics has some of its semiconductor design done in Rabat, Morocco. General Motors (GM) in Brazil competes with other GM affiliates in the United States, Europe and Asia for the right to design and build new vehicles and carry out other core activities for the global company. There are many such examples.

In theory, the internationalization of R&D into developing countries is both expected and unexpected. It is expected for two reasons. First, as TNCs increase their production in developing countries, some R&D (of the adaptive kind) can be expected to follow. Second, R&D is a form of service activity and like other services, it is "fragmenting", with certain segments being located where they can be performed most efficiently. Indeed, according to a survey of Europe's largest firms conducted in 2004 by UNCTAD and Roland Berger, all service functions – including R&D – are now candidates for offshoring. It is unexpected in that R&D is a service activity with very demanding skill, knowledge and support needs, traditionally met only in developed countries with strong national innovation systems. Moreover, R&D is taken to be the least "fragmentable" of economic activities because it involves knowledge that is strategic to firms, and because it often requires dense knowledge exchange (much of it tacit) between users and producers within localized clusters.

It is clear that, to date, only a small number of developing countries and economies in transition are participating in the process of R&D internationalization. However, the fact that some are now perceived as attractive locations for highly complex R&D indicates that it is possible for countries to develop the capabilities that are needed to connect with the global R&D systems of TNCs. From a host-country perspective, R&D internationalization opens the door not only for the transfer of technology created elsewhere, but also for the technology creation process itself. This may enable some host countries to strengthen their technological and innovation capabilities. But it may also widen the gap with those that fail to connect with the global innovation network.

…with important implications for innovation and development.

Innovative activity is essential for economic growth and development. Moreover, sustainable economic development requires more than simply "opening up" and waiting for new technologies to flow in. It demands continuous technological effort by domestic enterprises, along with supportive government policies. With the increasing knowledge-intensity of production, the need to develop technological capabilities is growing. Greater openness to trade and capital flows does not reduce the imperative of local technological effort. On the contrary, liberalization, and the open market environment associated with it, have made it necessary for firms – be they large or small, in developed or developing countries – to acquire the technological and innovative capabilities needed to become or stay competitive.

R&D is only one source of innovation, but it is an important one. It takes various forms: basic research, applied research and product and process development. While basic research is mainly undertaken by the public sector, the other two forms are central to the competitiveness of many firms. In the early stages of technological activity enterprises do not need formal R&D departments. As they mature, however, they find it increasingly important to monitor, import and implement new technologies. The role of formal R&D grows as a firm attempts significant technological improvements and tackles product or process innovation. For complex and fast-moving technologies it is an essential part of the technological learning process.

But the process of acquiring technological capabilities is slow and costly. Technical change and advanced science-based technologies in many industries call for more high-level skills and intense technical effort. These require better infrastructure, not least in information and communication technologies (ICTs). They also require strong supporting institutions, as well as stable and efficient legal and governance systems. Finally, they require access to the international knowledge base, combined with a strategy to leverage this access for the benefit of local innovation systems. The cumulative forces that are increasing the gap between countries with respect to innovation make the role of policy increasingly important at both the national and international levels.

There are large differences in countries' capabilities to innovate and benefit from the R&D internationalization process. According to a new measure of national innovation capabilities – the UNCTAD Innovation Capability Index – the differences appear to be growing over time (table 6). Developed countries fall into the high capability group, as do Taiwan Province of China, the Republic of Korea and Singapore, along with some of the economies of South-East Europe and the CIS. The medium

Table 6. Regional unweighted averages for the UNCTAD Innovation Capability Index

Region	1995	2001
Developed countries (excl. the new EU members)	0.876	0.869
The new EU members	0.665	0.707
South-East Europe and CIS	0.602	0.584
South-East and East Asia	0.492	0.518
West Asia and North Africa	0.348	0.361
Latin America and the Caribbean	0.375	0.360
South Asia	0.223	0.215
Sub-Saharan Africa	0.157	0.160

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D,* table III.6.

capability group comprises the remaining economies in transition, most of the resource-rich and newly industrializing economies and two sub-Saharan African economies (Mauritius and South Africa). The low capability group contains most of the sub-Saharan African countries as well as several countries in North Africa, West Asia and Latin America. Among developing countries, South-East and East Asia are the leaders in innovation capability, while the position of Latin America and the Caribbean has deteriorated over time and has been overtaken by North Africa and West Asia.

The innovative capabilities of a country are directly relevant to its attractiveness as a host country for R&D by TNCs, as well as to its ability to benefit from such R&D. The quality of R&D performed abroad depends on local capabilities of the host country. The same applies to the resulting externalities in terms of how much local firms and institutions are able to absorb and learn from exposure to best practice R&D techniques and skills. Whether or not R&D deepens over time, and how far it spreads over different activities, are the result of an interactive process between the TNCs and local actors in the host economy, and this process is in turn affected by the institutional framework and government policies of the host country.

TNCs are the drivers of global R&D.

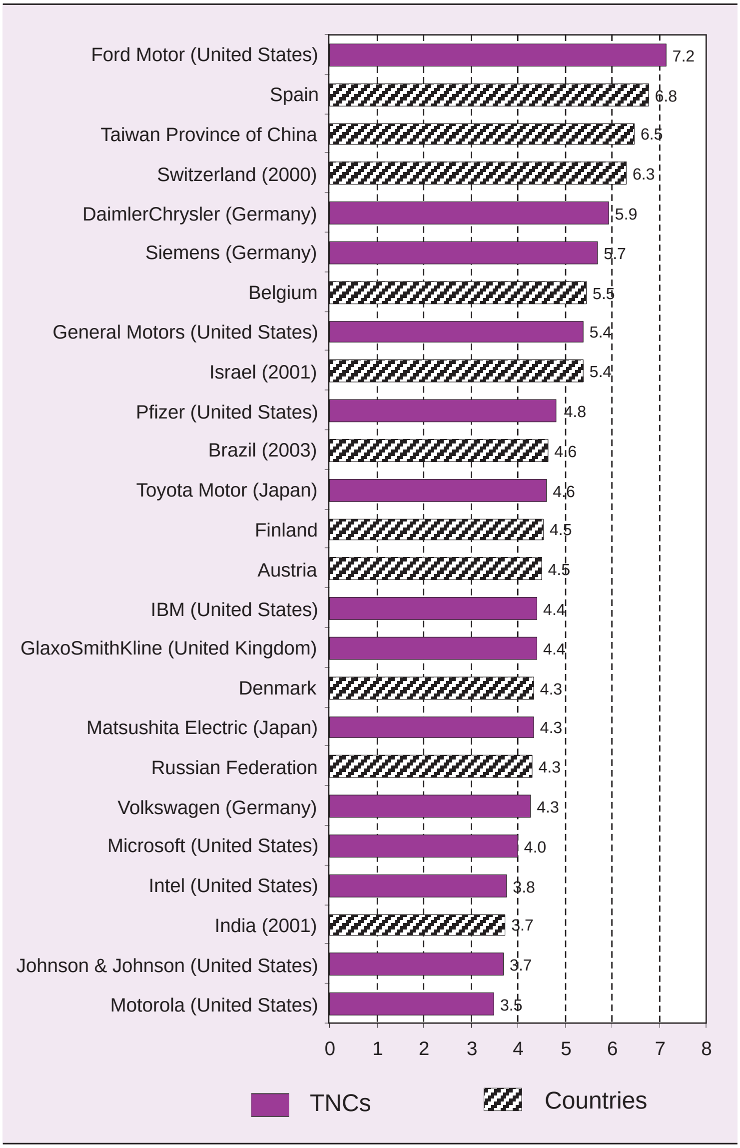
Global R&D expenditure has grown rapidly over the past decade to reach some $677 billion in 2002. It is highly concentrated. The top ten countries by such expenditure, led by the United States, account for more than four-fifths of the world total. Only two developing countries (China and the Republic of Korea) feature among the top ten. However, the share of developed countries fell from 97% in 1991 to 91% in 2002, while that of developing Asia rose from 2% to 6%. Similarly, there has been a rise in innovation outputs (as measured by the number of patents issued). For example, between the two time periods of 1991-1993 and 2001-2003, the share of foreign patent applications from developing countries, South-East Europe and the CIS to the United States Patent and Trademark Office, jumped from 7% to 17%.

TNCs are key players in this process. A conservative estimate is that they account for close to half of global R&D expenditures, and at least two-thirds of business R&D expenditures (estimated at $450 billion). These shares are considerably higher in a number of individual economies. In fact, the R&D spending of some large TNCs is higher than that of many countries (figure 3). Six TNCs (Ford, Pfizer, DaimlerChrysler, Siemens, Toyota and General Motors) spent more than $5 billion on R&D in 2003. In comparison, among the developing economies, total R&D spending came close to, or exceeded, $5 billion only in Brazil, China, the Republic of Korea and Taiwan Province of China. The world's largest R&D spenders are concentrated in a few industries, notably IT hardware, the automotive industry, pharmaceuticals and biotechnology.

The R&D activities of TNCs are becoming increasingly internationalized. This trend is apparent for all home countries, but starts from different levels. In the case of United States TNCs, the share of R&D of their majority-owned foreign affiliates in their total R&D rose from 11% in 1994 to 13% in 2002. German TNCs set up more foreign R&D units in the 1990s than they had done in the preceding 50 years. The share of foreign to total R&D in Swedish TNCs shot up from 22% to 43% between 1995 and 2003.

Reflecting the increased internationalization of R&D, foreign affiliates are assuming more important roles in many host countries' R&D activities. Between 1993 and 2002 the R&D expenditure of foreign affiliates worldwide climbed from an estimated $30 billion to $67 billion (or from 10% to 16% of global business R&D). Whereas the rise was relatively modest in developed host countries, it was quite significant in developing countries: the share of foreign affiliates in business R&D in the developing world increased from 2% to 18% between 1996 and 2002. The share of R&D by foreign affiliates in different countries varies considerably. In 2003 foreign affiliates accounted for more than half of all business R&D in Ireland, Hungary and Singapore and about 40% in Australia, Brazil, the Czech Republic, Sweden and the United Kingdom.

Figure 3. R&D expenditure by selected TNCs and economies, 2002
(Billions of dollars)



Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, figure IV.1.

Conversely, it remained under 10% in Chile, Greece, India, Japan and the Republic of Korea (figure 4). Other indicators, such as the rising number of R&D alliances and growing patenting activity, similarly confirm the increased internationalization of R&D activities in developing countries.

Their R&D is growing particularly fast, though unevenly, in developing countries …

The share of host developing countries in the global R&D systems of TNCs is rising, but unevenly. Only a few economies have attracted the bulk of the R&D activity. Developing Asia is the most dynamic recipient. In the case of R&D expenditures by majority-owned foreign affiliates of United States TNCs, for example, the share of developing Asia soared from 3% in 1994 to 10% in 2002. The increase was particularly noticeable for China, Singapore, Hong Kong (China) and Malaysia. In the foreign R&D activities of Swedish TNCs the share of countries outside the Triad more than doubled, from 2.5% in 1995 to 7% in 2003. Survey findings and other data for Germany and Japan support the growing importance of developing countries and some economies in transition as locations for TNCs' R&D.

Official statistics generally suffer from time lags, and may not fully capture the pace of R&D internationalization. More recent data on FDI projects indicate that the expansion of R&D to new locations is gaining momentum. Of 1,773 FDI projects involving R&D worldwide during the period 2002-2004 for which information was available, the majority (1,095) was in fact undertaken in developing countries or in South-East Europe and the CIS. Developing Asia and Oceania alone accounted for close to half of the world total (861 projects). A survey of the world's largest R&D spenders conducted by UNCTAD during 2004-2005 also shows the growing importance of new R&D locations. More than half of the TNCs surveyed already have an R&D presence in China, India or Singapore. In South-East Europe and the CIS, the Russian Federation was the only significant target economy mentioned by the responding firms as hosting R&D activities (figure 5).

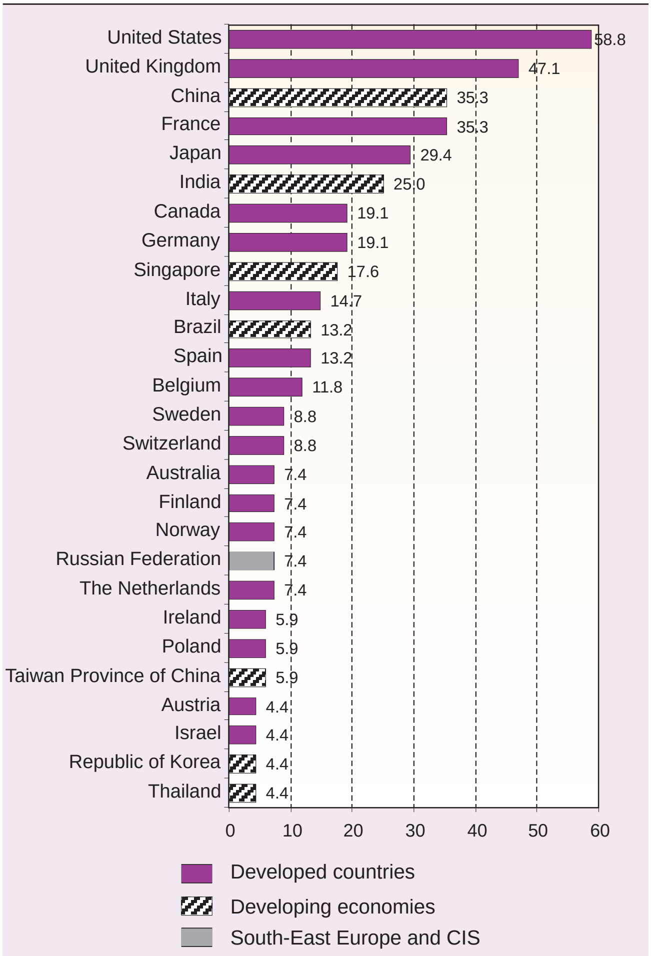
Figure 4. Share of foreign affiliates in business R&D, selected countries, 2003 or latest year available

(Per cent)

Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, figure IV.5.

Note: In Argentina, Chile, Israel, theRepublic of Korea and Mexico, the R&D expenditure of United States-owned affiliates has been used as a proxy for the R&D spending of all foreign affiliates. In India, the share of foreign affiliates in total R&D spending has been used as a proxy for their share in business R&D spending.

Figure 5. Current foreign locations of R&D in the UNCTAD survey, 2004
(Per cent)



Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, figure IV.8.

In the same survey, as many as 69% of the firms stated that the share of foreign R&D was set to increase; only 2% indicated the opposite, while the remaining 29% expected the level of internationalization to remain unchanged. The momentum appears to be particularly strong among companies based in Japan and the Republic of Korea, which until recently, have not been internationalizing their R&D to any large extent. For example, nine out of ten Japanese companies in the sample planned to increase their foreign R&D, while 61% of European firms stated such intentions. A further shift in terms of R&D locations towards some developing, South-East European and CIS markets is also envisaged (figure 6). China is the destination mentioned by the largest number of respondents for future R&D expansion, followed by the United States. In third place is India, another significant newcomer location for R&D. Other developing economies mentioned as candidates for further R&D by some respondents include the Republic of Korea, Singapore, Taiwan Province of China, Thailand and Viet Nam. Very few respondents indicated any plans to expand R&D to Latin America or Africa. The Russian Federation was also among the top 10 target locations.

Another new and notable trend in the internationalization of R&D is the emergence and fast growth of foreign R&D activities of developing-country TNCs. This trend is driven by the need to access advanced technologies and to adapt products to major export markets. Some of these TNCs are targeting the knowledge base of developed countries, while others are setting up R&D units in other developing economies.

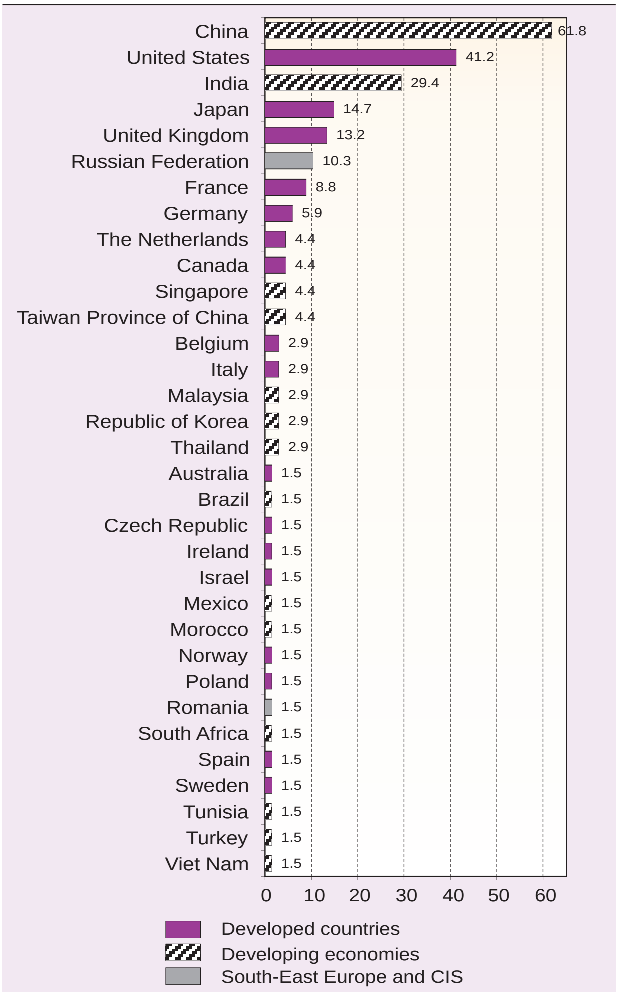
… and the type of R&D undertaken varies by region.

The R&D conducted in different locations varies considerably by region and economy. For example, in 2002, three-quarters of the R&D of United States majority-owned foreign affiliates in developing Asia were related to computers and electronic products, while in India over three-quarters of their R&D expenditure went into services (notably related to software development). In Brazil and Mexico, chemicals and transport equipment together accounted for over half of all R&D by United States foreign affiliates.

Moreover, TNCs carry out different types of R&D abroad. Foreign affiliates of TNCs may undertake *adaptive R&D*, which ranges from basic production support to the modifying and

Figure 6. Most attractive prospective R&D locations in the UNCTAD survey, 2005-2009

(Per cent of responses)



Source: UNCTAD, *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*, figure IV.11.

upgrading of imported technologies. *Innovative R&D* involves the development of new products or processes for local, regional or (eventually) global markets. *Technology monitoring* units are established to keep abreast of technological development in foreign markets and to learn from leading innovators and clients there.

While it is difficult to quantify R&D by type, among developing host economies the evidence points to the predominance of Asia in innovative R&D for international markets. R&D activities in selected Asian economies such as China, India, the Republic of Korea and Taiwan Province of China are becoming increasingly important within the global R&D networks of TNCs. Examples include the Toyota Technical Center Asia Pacific in Thailand, Motorola's R&D network in China and Microsoft's sixth global research centre in Bangalore, India. Some of the innovative R&D conducted there is at the cutting edge. The semiconductor industry is an example. One of the earliest to move production into developing countries, it has also been among the first to move advanced design to selected developing economies in Asia. Some of the design is done by foreign affiliates and some by local firms. A few firms from the Republic of Korea and Taiwan Province of China, and to a lesser extent from China and India, for instance, are now at the technology frontier of design work.

TNCs have so far located limited R&D in Latin America and the Caribbean. Relatively little FDI in Latin America and the Caribbean is in R&D-intensive activities; when it is, the R&D conducted is mostly confined to the adaptation of technology or products for local markets, called "tropicalization" in the Latin American context. Some important exceptions exist in Brazil and Mexico in particular. In Africa, the R&D component of FDI is generally very low; with the exception of some countries such as Morocco and, especially, South Africa, R&D by TNCs is virtually non-existent. This is partly because of weak domestic R&D capabilities, and in many cases the absence of institutional mechanisms that create sufficient incentives for investors to devote resources to R&D.

In some of the new EU members, foreign affiliates have emerged as important R&D players. In the Czech Republic, Hungary and Poland, R&D by foreign affiliates is often linked to manufacturing, mostly in the automotive and electronics industries. Some foreign affiliates also conduct "innovative" R&D for regional or global markets.

The process is driven by new push and pull factors, and is facilitated by enabling technologies and policies ...

The need to adapt products and processes to key host-country markets has always been an important motive for TNCs to internationalize R&D. The need to tap into knowledge centres abroad to source new technologies, recruit the best skills and monitor the activities of competitors is also well known in the literature. However, the recent surge of R&D by TNCs in selected developing host economies also reflects the quest for cost reduction and for accessing expanding pools of talent in these locations. It can be seen as a logical next step in the globalization of TNC production networks. It also resembles the international restructuring that has taken place in export-oriented manufacturing and ICT-based services through which TNCs seek to improve their competitiveness by exploiting the strengths of different locations.

R&D internationalization to new locations outside the Triad is driven by a complex interaction of push and pull factors. On the push side, intensifying competition, rising costs of R&D in developed countries and the scarcity of engineering and scientific manpower along with the increasing complexity of R&D, reinforce the imperative to specialize as well as to internationalize R&D work. On the pull side, the growing availability of scientific and engineering skills and manpower at competitive costs, the ongoing globalization of manufacturing processes, and substantial and fast-growing markets in some developing countries increase their attractiveness as new locations.

The expanding pool of talent in selected developing countries and economies in South-East Europe and the CIS is very important in this context – notably in science-based activities – especially for companies that fail to find a sufficient number of skilled people in their home countries. In recent years, there has been a dramatic increase in the number of people enrolled in higher education in developing countries and economies in transition. In 2000-2001 China, India and the

Russian Federation together accounted for almost a third of all tertiary technical students in the world. In addition, more scientists and engineers are staying in, or returning to, China and India to perform R&D work for foreign affiliates or local firms or to start their own businesses. In Bangalore, for example, some 35,000 non-resident Indians have lately returned with training and work experience from the United States. Reflecting the growing importance of the human resource factor, both developed and developing countries are now adopting new policy measures to attract skills from abroad.

The internationalization of R&D is also facilitated by improvements in ICT and associated cost decreases, new research techniques that allow greater "fragmentation" of R&D and better information on research capabilities that are available worldwide. At the same time, overall improvements in host-country investment climates have all contributed to creating a more enabling framework. Important policy developments relate, for example, to intellectual property rights (IPR) protection, reform of public research activities, infrastructure development, and investment promotion efforts specifically targeting R&D-related FDI and R&D incentives.

There are some fundamental reasons why the current trend towards R&D internationalization is set to continue. First, the competitive pressure on firms is likely to remain intense, forcing them to innovate more. Second, the need for greater flexibility in R&D in response to rapid technological change requires sizeable numbers of research staff with a range of specializations, and it necessitates locating R&D activities where such pools of researchers are available. Third, ageing populations in many developed countries are likely to result in an insufficient supply of specialized, up-to-date skills, forcing TNCs to look elsewhere for fresh talent. Fourth, through cumulative learning processes involving local enterprises and institutions, the developing countries that take part in the internationalization of R&D will progressively enhance their own ability to conduct more R&D. At present however, it appears that only a few developing countries led by China and India, and some economies of South-East Europe and the CIS, can effectively meet the conditions required to participate.

… and has important implications for both host and home countries.

The creation of knowledge is a driver of economic growth, but no single country can produce all the knowledge needed to stay competitive and to grow in a sustained manner. Countries are therefore eager to connect with international networks of innovation. Outward and inward FDI in R&D are two ways of doing so. R&D internationalization opens up new opportunities for developing countries to access technology, build high-value-added products and services, develop new skills and foster a culture of innovation through spillovers to local firms and institutions. FDI in R&D can help countries strengthen their innovation systems and upgrade industrially and technologically, enabling them to perform more demanding functions, handle more advanced equipment and make more complex products.

At the same time these benefits do not appear automatically, and unwanted effects can also arise. The main concerns in economies hosting FDI in R&D relate to the potential downsizing of existing R&D when FDI involves takeovers of domestic firms, unfair compensation to local firms and institutions collaborating with TNCs in the area of R&D, the crowding out of local firms from the market for researchers, a race to the bottom in attracting R&D-related FDI and unethical behaviour by TNCs. There may also be tensions between TNCs and host-country governments, in that the former may seek to retain proprietary knowledge while the latter seek to secure as many spillovers as possible.

A key determinant of the development impact on a host economy is its absorptive capacity. Indeed, technological capabilities in the domestic enterprise sector and technology institutions are necessary not only to attract R&D but also to benefit from its spillovers. Other determinants are the type of R&D conducted, and whether the R&D is linked to production.

The more a TNC interacts with a host developing country's local firms and R&D institutions, and the more advanced the country's national innovation system (NIS), the greater the likelihood of positive effects on a host economy.

R&D internationalization also has implications for home countries – both developed and developing. It can help a country's TNCs improve their competitiveness by accessing strategic assets and new technologies, acquiring unique knowledge at competitive prices, increasing specialization in their R&D, reducing costs, increasing flexibility and expanding their market shares. By extension, the improved competitiveness of TNCs often has positive impacts on their home economies. Foreign R&D can generate opportunities and spillovers in the home economy to the benefit of local firms and the home economy as a whole.

At the same time, the transnational expansion of R&D may give rise to concerns in home countries, especially with regard to the risk of hollowing out and the loss of jobs. These concerns resemble those voiced in connection with the general debate on services offshoring. The trend is so new that any assessment must be tentative. However, it does seem that protectionist measures to limit the expansion of R&D abroad will not effectively address these concerns as they would risk undermining the competitiveness of the country's enterprises. Rather, to turn the internationalization process into a win-win situation for host and home countries alike, policies aimed at advancing the specific innovation capabilities and the functioning of the NIS are key.

Appropriate policy responses are needed at the national level…

Enterprises are the principal agents of innovation. However, they do not innovate and learn in isolation, but in interaction with competitors, suppliers and clients, with public research institutions, universities and other knowledge-creating bodies like standards and metrology institutes. The nature of these interactions, in turn, is shaped by the surrounding institutional framework. The complex web within which innovation occurs is commonly referred to as the "national innovation system". Its strength can be influenced by government intervention.

A number of policy and institutional areas need to be addressed to attract FDI in R&D, to secure the benefits that it can generate and to address potential costs. The starting point is to build an institutional framework that fosters innovation. Particular policy attention is needed in four areas: human resources, public research capabilities, IPR protection and competition policy. Efforts to secure an adequate supply of human resources with the right skills profile involve educational policies – not least at the tertiary level – and measures to attract expertise from abroad. For public R&D to contribute effectively to the NIS, it is essential that it links with enterprise R&D and that public research institutes promote the spin-off of new companies. The attractiveness of a location for conducting R&D may increase if the IPR regime is more effective, but a strong IPR regime is not necessarily a prerequisite for TNCs to invest in R&D. The policy challenge is to implement a system that encourages innovation and helps to secure greater benefits from such activity, notably when it involves TNCs. At the same time, in order to balance the interests of producers and consumers, IPR protection needs to be complemented by appropriate competition policies.

Efforts in these areas need to reflect the comparative advantage and technological specialization of each country as well as the development trajectory along which a country plans to move. FDI policy is also vital to promote the desired forms and impacts of FDI. Selective policies in this area can include targeted investment promotion, performance requirements and incentives along with science and technology parks.

IPAs can play an important role in a country's strategy to benefit from R&D internationalization by TNCs. It can potentially serve two prime functions. The first is to communicate and market existing investment opportunities, for example, through targeted promotion, based on a careful assessment of the locations' strengths and weaknesses and a good understanding of the relevant locational determinants. If a location is unlikely to be able to offer the conditions needed to attract R&D by TNCs, an IPA may be better off focusing on its policy advocacy function. It may draw the attention of other relevant government bodies to areas that are important for making a location better equipped to benefit from R&D by TNCs.

In a global survey of IPAs conducted by UNCTAD, a majority of the respondents were found already to target FDI in R&D. A large majority of IPAs in developed countries actively promote FDI in R&D activities (79%), and 46% of those based in developing countries do so as well. The highest percentage (94%) was noted for IPAs in Asia and Oceania. Conversely, a majority of IPAs in Africa promote it actively, and only 11% of the IPAs in Latin American and the Caribbean do so.

Finally governments need to pay attention to more focused policies aimed at boosting the capabilities of the domestic enterprise sector, notably through industry-specific and small and medium-sized enterprise policies.

The various objectives of education, science and technology, competition and investment policies can be mutually reinforcing. Whether a country tries to connect with global networks by promoting inward FDI, outward FDI, licensing technology, the inflow of skills or through any other mode, policies need to be coherent with broader efforts to strengthen the NIS. The stronger the NIS, the greater is the likelihood of attracting R&D by TNCs and of benefiting from spillover benefits generated by such R&D. In essence the policies pursued need to be part of a broad strategy aimed at fostering competitiveness and development.

Indeed, the emphasis on policy coherence may be one of the most striking lessons learned from those developing countries that are now emerging as more important nodes in the knowledge networks of TNCs. In most of these countries, the starting point has been a long-term vision of how to move the economy towards higher value-added and knowledge-based activities. The success of some Asian economies is no coincidence; it is the outcome of coherent and targeted government policies aimed at strengthening the overall framework for innovation and knowledge inflows. In some form (and to varying degrees), they have actively sought to attract technology, know-how, people and capital from abroad. They have invested strategically in human resources, typically with a strong focus on science and engineering; invested in infrastructure development for R&D (such as science parks, public R&D labs, incubators); used performance requirements and incentives as part of the overall strategy to attract FDI in targeted activities; and strategically implemented IPR protection policies.

For many developing countries at the lower end of the UNCTAD Innovation Capability Index any expectation of a major influx of R&D by TNCs would be unrealistic in the short term. However, that is not an excuse for a lack of action. Rather, countries should consider how to begin a process through which economic and technological upgrading could be fostered. The creation of innovative capabilities is a path-dependent and long-term task. For latecomers, ensuring that a process aimed at strengthening their NIS gains momentum is an essential first step.

For home countries, current trends accentuate the need to rely even more on the creation, diffusion and exploitation of scientific and technological knowledge as a means of promoting growth and productivity. Rather than regarding R&D internationalization as a threat, home countries should seize opportunities arising from it. It is important to explore new ways of collaborating with the new R&D locations (e.g. through joint research programmes and careful attention to the benefits and costs of outsourcing and R&D-related outward FDI). Countries should also try to remove bottlenecks and "systemic inertia" in their NISs to be better positioned to benefit from R&D internationalization. They may also see the need to specialize more in areas where they hold a competitive edge to strengthen existing world-class centres of excellence and build new ones. …taking developments at the international level into account.

Policy-making at the national level also has to consider developments in international investment agreements at various levels. Many international agreements give special attention to investment in R&D activities. Key issues relate to the entry and establishment of R&D-related FDI, the treatment of R&D performance requirements (whether by restricting or explicitly permitting them), incentives encouraging investment in R&D activities, and the movement of key personnel.

In general, international investment agreements confirm the importance of policies that seek to facilitate FDI in R&D. While most countries welcome FDI in R&D, many governments do not allow foreign companies to draw on certain kinds of public R&D support. Many bilateral agreements also state explicitly that governments are free to apply R&D requirements as a condition for receiving preferential treatment (e.g. an incentive). A small number of agreements prohibit the use of mandatory performance requirements in the area of R&D.

Most international investment agreements do not have provisions that specifically protect R&D-related FDI; they protect FDI in general. Related provisions include the definition of investment, the free transfer of returns arising from R&D activities and the application of the national treatment and most-favoured-nation standards to foreign investors.

The protection of IPRs at the international level and minimum standards set by international treaties are of particular relevance for R&D-related FDI. The most important instrument in this area is the WTO Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS). Some recent agreements at the bilateral and regional levels have extended the minimum standards set in the TRIPS Agreement. The protection of IPRs enshrined in these agreements is intended to encourage the development of proprietary knowledge; but at the same time, it limits the policy space of States in an area that is directly relevant to R&D activities. For developing countries it is therefore important to understand and make use of the flexibilities contained in the TRIPS Agreement. There is also a clear need for additional technical assistance to facilitate the implementation of IPRs in a development-friendly manner.

Some international investment agreements also encourage home countries to support the strengthening of NISs in developing countries, by promoting outward R&D-related investment in developing countries. In addition, international cooperation agreements in the areas of science, technology and innovation help create an enabling framework for R&D internationalization by facilitating the flow of information, the formation of alliances, the pooling of financial resources, the improvement of access to technological expertise, matchmaking and the establishment of private-public sector partnerships.

But there is scope for more cooperation to foster policy formulation and stronger innovation systems in developing countries. One key area is human resource development. The international community could play a more active role in this area, for example, by supporting the strengthening of the local educational infrastructure and by making educational opportunities to developing countries available in developed countries. Home countries could contribute to the improvement of the institutional framework for innovation in developing countries by assisting in the establishment of technical standards and certification systems through access to and provision of testing equipment for standard setting and quality assessment. Similar steps could be taken with regard to the implementation of IPR systems and through R&D collaboration between institutions in developed and developing countries.

Policies at the international level have direct implications for the ability of developing countries to formulate their R&D policies and to create the conditions that will enable them to benefit from the internationalization of R&D by TNCs.

BOOK REVIEWS

Multinational Firms in the World Economy

Giorgio Barba Navaretti and Anthony J. Venables
(Princeton, NJ, Princeton University Press, 2004), xiii+325 pages

In this book, Giorgio Barba Navaretti and Tony Venables, together with a team of contributors, address some of the main questions on transnational corporations' (TNCs) activities and behaviours. The book seeks to provide a comprehensive assessment of motivations and consequences of TNCs' action in an increasingly interdependent world economy.

The eleven chapters of the book follow a clear logical order, which goes from a presentation of stylized facts and key questions in the easily readable introductory chapters (chapters one and two), to an elegant formalization of the main theoretical hypotheses on the determinants and effects of foreign direct investment (FDI) (chapters three and four), followed by a transaction costs-based conceptual and analytical framework (chapter five). The review of the empirical evidence and the hypothesis testing are carried out from both the "host" and "home" country perspectives throughout the following four chapters (chapters six to nine), leading the authors to draw consistently policy implications (chapter ten) and main conclusions (chapter eleven).

The organization of the book is admirably coherent and lucid. Chapter one provides a clear statement of facts about TNCs' activity and trends, as well as of some critical issues at the centre of the discussion in both academic and practitioner circles. A non-technical presentation of the focus of the book is given in chapter two, in which determinants of multinationality and locational choices, effects on both home and host economies, and a costs-benefits balance are discussed by taking into account the type of investment (horizontal versus vertical FDI) and relating motivations to both firm-specific and country-specific features. These two non-technical chapters should be highly recommended to anyone interested in having a clear and concise picture of FDI in current times. The overview of the key questions, main concepts and most visible trends could be greatly useful also to introduce undergraduate students to such issues. The analysis of the outcomes of the trade-off between costs and benefits of market-seeking, or horizontal, FDI (HFDI) is the focus of chapter three. It sets the hypotheses on HFDI determinants – firm and country characteristics affecting the choice of a firm to go transnational – and effects in a partial equilibrium framework. The theory of production fragmentation – cost-minimizing or vertical FDI (VFDI) – is the subject of chapter four. The trade effects of both HFDI and VFDI are also addressed here. Chapter five is devoted to extending the conceptual discussion to the choice between internalization or outsourcing on the basis of the dichotomy market-hierarchies underlying transaction costs approaches. The explanation of internationalization modes (own subsidiaries versus arm's-length agreements) is conducted in the light of different market failures, each one giving rise to different types of trade-offs.

The empirical investigation is preceded by a theoretical and conceptual framework provided in chapters three to five. The hypotheses on the determinants of foreign investment (both of HFDI and VFDI) are empirically tested in chapter six. Consistent with the theoretical construction, the review concentrates on firm/industry-specific determinants and country-specific motivations, placing special emphasis on heterogeneity and sources of increasing returns in the case of the former, and considering trade and transport costs, taxation, production costs and factor endowments, and market size among country-specific motives. The review goes beyond the formal modelling of chapters three and four by addressing fundamental processes, such as regional economic integration (e.g. European Union, North American Free Trade Agreement) and spatial agglomeration phenomena. Notably, in connection with the latter, the role of technological sourcing is particularly stressed as an important determinant of TNCs' activity.

The effects of FDI on product markets, factor markets and spillovers, and on the overall economy equilibrium, are empirically tested in the following three chapters. The main issues addressed in chapter seven, on the basis of micro-oriented empirical evidence (at firm and industry level) from the host economy viewpoint, are two: how and to what extent foreign TNCs are different from (and, specifically, whether they are more productive and more technically efficient than) local firms; and the impact of TNCs on domestic firms through a variety of channels (market transaction, pecuniary and technological externalities, pro-competitive effects). The review of host-country effects also offers interesting insights on the methodological problems encountered in empirical analyses of FDI impact (e.g. cross-section versus panel data, sample selection, counterfactual, conditional comparisons). Chapter eight reports the results of a detailed case-study from a host economy perspective. The Irish experience is here reviewed, giving a particular emphasis to the wide range of policy tools that have been used to attract FDI. Evidence on the same questions as those addressed in chapter seven is provided in chapter nine, but from the home economy perspective: the impact of outward FDI on home production, employment, skills and wages, technology upgrading, and productivity. The main conclusion emerging from the empirical review provided in these three chapters is broadly positive both for active (outward) and passive (inward) TNCs' activities, although no direct causal relationship between foreign ownership and performance could be established.

Finally, chapter ten draws the wider picture on both general and specific policies, highlighting the two-way relationship between policy and TNC activity, and supporting the increasing significance of incentives schemes already discussed in the case of Ireland. The huge obstacles to, as well as the pressing necessity for, an international/global level of governance of TNCs' activity are convincingly illustrated at the end of this chapter. The main conclusions, as the most promising directions for future research, are briefly identified in chapter eleven.

This book is a rich, complex and, at the same time, accessible contribution to the study of TNCs in the current age of economic globalization. It is written clearly, and it integrates important theoretical and empirical perspectives on both microeconomic and macroeconomic dimensions of TNC activities in a unified analytical construction.

In the past decades, there has been a dearth of comprehensive material on the determinants and the implications of TNCs' actions. This book assumes an important place in the literature as it bridges, in a coherent and systematic framework, formal modelling and econometric estimates, and also updates statistical trends and case studies. Indeed, the genesis of the book itself shows a rather original character, being the outcome of the joint work of a whole research team with different and complementary competencies, coordinated and integrated by the efforts of the two authors of the book. A thoughtful discussion of some of the most pressing issues in the current economic debate on TNC activities emerges from such a sapient combination of different research skills, levels of analysis and methodological tools.

A limitation of the book is that it underestimates the role of innovation and technology in TNC operations. This is a weakness of the transactions costs perspective itself, where hierarchies (particularly, but not exclusively, firm structures) are viewed and reduced to a consequence of changes in transaction costs, whereas dynamic factors such as learning, accumulation and knowledge creation are largely ignored. Corporate technological capabilities cannot be transferred through market-like exchanges, as they have to be internally learned, whether the process of learning is externally assisted or not (Cantwell, 1992). When narrowing the notion of technology to something akin to information and concentrating on the organization of the exchange of such information, there is a tendency to over-emphasise the issue of appropriability in markets (Winter, 1993), while discounting the relationship between innovation processes and production structures, as well as between transnationality and innovativeness.

Although the transaction costs view is here integrated with some resource-based aspects of the nature of the firm (see, for example, chapter five, 5.4), TNCs' innovative activity across countries and regions is not fully acknowledged. A major transformation brought about by globalization consists of an increasing cross-border interdependence and integration of all kinds of TNC operations, including those aimed at creating new knowledge and technology. Consequently, among scholars of TNCs and innovation, there has been a shift in attention away from the TNC as a mere vehicle of technology transfer towards the crucial role it plays as a creator of innovation and technological knowledge (among others, Pearce, 1989; Cantwell, 1989, 1992; Birkinshaw, 1996). It has been shown that higher degrees of transnationality are associated with a greater use of foreign sources of technology (e.g. Dunning and Wymbs, 1999; Ietto-Gillies, 2001). Firms pursue this aim by establishing integrated networks of affiliates, as a means of building a sustainable competitive advantage based much more on capabilities and dynamic improvements than on static efficiency criteria (e.g. Zanfei, 2000; Veugelers and Cassiman, 2004).

Therefore, while until recently the main question was "why do technologically advanced firms go transnational to exploit their advantages?", the critical issue has now become "why and how do TNCs create technology internationally through intra- and inter-firm networks"? Attempting to include the latter question would have made this volume much more complex and probably less coherent. Nonetheless, a more explicit acknowledgement of technological competence in the determinants of TNC strategy and locational choices would have strengthened the interpretation of empirical cases (including, for example, the case of Pirelli and the MIR technology). Furthermore, TNCs may act as intermediaries in the international cross-fertilization of localized knowledge clusters, providing a strong rationale for the global-local growing interdependence (as mentioned in chapter six).

Despite this lacuna, the book concludes with a number of sound recommendations for policy action and further research efforts. In particular, chapters ten and eleven call attention to a lack of TNC-oriented policy strategies (while plenty of SME-oriented tools are in place in advanced and developing economies). Such strategies would, presumably, target TNCs as a whole, and their interaction with local environments in the home and host locations. However, developing such policies would require an analysis of the nature, structure and dynamics of TNC (intra- and inter-firm) networks and local (often sub-national) institutions. Identifying measures of institutions and policies within innovation systems is a challenging task, still rather underdeveloped in the literature on TNCs.

Overall, the book should be recommended for any scholar's bookshelf for whom TNCs, economic integration and globalization are of interest. Particularly for postgraduate students working in this area, this work is a must reading and highly valuable as a teaching and reference aid. It is hoped that it will serve as a stimulus for further theoretical and conceptual systematization, as well as empirical investigation, of the various still insufficiently explored aspects of TNC activities worldwide.

Simona Iammarino
SPRU (Science and Technology Policy Research)
University of Sussex
United Kingdom

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Measuring Political Risk: Risks to Foreign Investment

Charlotte H. Brink
(Aldershot, Ashgate, 2004), 200 pages

The significant increase in foreign direct investment (FDI) and the growth of transnational corporations' (TNCs) activities across countries have been one of the most visible signs of the increasing globalization of the world economy over the past couple of decades. Whereas most international investment takes place within developed countries and regions, such as the European Union and the United States, FDI flows to developing countries have increased enormously since 1990. Over the past decades, researchers have identified numerous determinants of foreign investment flows, including economic and political factors, that influence the level of FDI. Evidently, political risk is one of them, in particular in emerging market economies and developing countries.

Most TNCs do not invest in the poorest countries of the world, including most of sub-Saharan Africa, partly due to high uncertainty regarding political risk in many of these countries. This is unfortunate as FDI inflows may particularly benefit developing economies, since foreign investors are likely to introduce new technologies, augment the capital stock of the host country, increase competition within key sectors of the economy and benefit local workers through more and better-paid jobs. Hence, political risk analysis is of particular importance to developing countries, in order to shed new insights on how to measure and to deal effectively with political risk. This is exactly the main focus of the present book. It provides insights on the theory and measurement of political risk by developing a new model that goes far beyond other approaches that have been published in the previous literature.

The present book consists of seven chapters. Chapter one introduces the topic of the book and provides a first definition of the term political risk from the perspective of a TNC. In short, political risk is the probability that the action of stakeholders within the political system affects the return on investment of TNCs in that country. The chapter then precisely lays out the research problem (and main questions) to be addressed, and gives an overview of the research methodology used as well as of the structure of the book. The opening chapter does a good job in motivating the reader and provides valuable information on the most important concepts and methodologies. In the following, I will review each of the remaining six chapters and then conclude with an overall assessment of the book, that is, what I consider as its main contribution to the literature and its omissions.

The second chapter carefully provides more details on political risk and related concepts, such as country risk. This approach makes sense, as both terms are often used in a confusing way. In short, country risk relates to the inability of a country to repay its debt, whereas political risk is associated with a country's unwillingness to do so. In addition, chapter two sensibly differentiates between predicting, forecasting, forewarning and anticipating political risk, since most users of political risk models demand information on the likely impact of events to come. The book carefully describes the different concepts and specifies that any forecast has to be seen from the perspective of a probability that a country might pose a certain degree of political risk to foreign investors.

Chapter three compares political risk rating methodologies provided, for instance, by risk rating agencies such as BERI, International Country Risk Guide (ICRG), the Economist Intelligence Unit, Moody's Investors Services, Euromoney, or Standard and Poor's Ratings Group. The chapter reveals the somewhat embarrassing failure of existing risk rating agencies and methodologies to spot the Asian financial crisis in 1997. The present book argues convincingly that the Asian crisis, while predominantly a financial and economic crisis, was partly related to the political risk aspect. If different political systems had been in place and the reaction to the actual events had been different, the crisis would probably have been less severe. For the risk analysis systems used by political risk rating agencies, it is pointed out that most macro-type models did not send any warning signals for the severe crisis that followed. Therefore, the chapter underlines the need for a more careful methodology to measure political risk.

In the fourth chapter, various factors that determine political risk are presented. More specifically, the political, economic and social risk factors that are used in the design of the subsequent model are extensively discussed. This approach is reasonable, since a careful explanation of the different indicators (and their interactions) is essential to grasp the complex issue of political risk and to convince the reader that the model adopted is a useful extension of previous attempts to measure political risk across countries. Overall, 103 measurable risk factors and their 411 risk factor indicators are presented. Furthermore, qualitative measures are incorporated in the analysis, which is more difficult to measure in comparison to quantitative indicators. Importantly, the factors chosen originate not only from political events and financial economic statistics, but also from the socio-cultural characteristics of each country. By focussing on such an exhaustive list of indicators, this approach ensures a thorough analysis of political risk, in particular in comparison to previous attempts in political risk analysis.

Following the presentation of the various factors, chapter five specifies the model for political risk analysis. It provides the scoring guidelines, weights and calculations that are behind the model for political risk analysis. Since the model itself is relatively simple in its structure, the chapter in effect explains the weights and aggregation procedures for the different indicators. It is pointed out in this chapter that the weights themselves are rather arbitrarily chosen, which leaves the reader somewhat unconvinced about the particular figures assigned. Nonetheless, any quantitative analysis of political risk involves the challenges of both aggregation and weighting and it is unclear how other approaches would look like. Crucially, it is explicitly stated that the weights may vary depending on the investor and the industry concerned.

Chapter six introduces political risk management, that is, how TNCs can effectively deal with political risk after having identified potential risk to their operations abroad. By identifying the most important aspects of political risk, a certain structure is given to the complexities of the decision of the management. While most TNCs use political risk insurance offered by, for instance, the Multilateral Investment Guarantee Agency (MIGA) or national insurance corporations, to reduce or eliminate political risk, not all projects and countries can be covered by this type of insurance. Importantly, it is emphasized that any effective risk management means that foreign investment in a region like sub-Saharan Africa would increase if TNCs improve their risk reduction management. This, in turn, would provide some of the poorest countries in the world with much needed additional capital. Finally, chapter seven concludes with a summary of the most important results and a discussion for further research in the field of political risk analysis.

Overall, this carefully written book is an important contribution to political risk analysis. In particular, the meticulous presentation of different risk factors and the explanation of the aggregation methodology provide a significant improvement of previous risk models. However, one part that seems to be missing is an application of the model. It has been pointed out in many different sections in the book that existing models of political risk analysis and services failed to give any early warning signals before the Asian financial crisis in the late 1990s. As an empirical economist focussing on trade and FDI in emerging market and developing countries, I would be very interested in an application of the model to the Asian crisis or any other major crisis in which political risk has played an important role.

Above all, I am curious as to whether the proposed model would give any signals or, more realistically, show that the probability of a crisis (in terms of increasing risk) increased in the first half of 1997, that is, shortly before the Asian crisis took place. But there are numerous other events, for example, the Mexican “tequila crisis” in 1994 or the currency and financial crisis in Argentina in 2001-2002, which were partly related to political risk too, for which the model would have been quite useful. Needless to say, since both global tensions and uncertainties are growing, the issue of political risk increases in significance. Hence, we do have a need for more research on the determinants of political risk.

Taken as a whole, the book makes a valuable contribution to the literature on political risk. In addition, it provides rather useful tools for research analysts and TNCs in analysing and managing risk in difficult and uncertain environments.

Matthias Busse
HWWA – Hamburg Institute of International Economics
Germany

The Financial Economics of Privatization

William L. Megginson
(Oxford, Oxford University Press, 2005), 522 pages

This new book by William Megginson aims to tell, in an interesting and well-founded manner, a story of how privatization policy rose from a rather radical notion of economic orthodoxy to a widely implemented process that, over the past 25 years, substantially changed the view on how we perceive the role of the government in business and in the economy as a whole. The author is well known to academics and analysts for his extensive published works on the topic, many of which were based on comprehensive empirical cross-country research.

The book begins with a brief history of the rise and fall of State ownership in order to enable the reader to understand better the actual economic rationale and need for privatization policy. In the starting chapter, "The scope of privatization", the author attempts to answer several crucial questions associated with the privatization process, such as why have so many countries adopted privatization programmes?; what are the costs and benefits of State versus public ownership, both in theory and in practice?; how do governments privatize State-owned enterprises (SOEs)?; how much privatization has actually occurred?; and most importantly, has privatization worked as an economic tool and accomplished its goals?.

The author surveys the role of State ownership as an economic model from ancient times to the late 1970s and attempts to explain what motivated governments to establish SOEs or to nationalize private businesses. Then, he turns to the discussion of the first privatization programmes – their intentions and outcomes. After the initial Chilean and the United Kingdom privatizations in the late 1970s, one could observe a truly phenomenal growth of privatization programmes and the reduction of State ownership throughout the world. The author explains that many governments have enthusiastically embraced privatization, mostly because they bring large revenues without having to increase taxes. The cumulative value of privatization proceeds is now estimated at more than $1.25 trillion, of which a large part has gone directly to the government, rather than to the SOEs themselves. Two thirds of the total proceeds originate from privatization of utilities, oil and gas companies and financial institutions.

In the second chapter of the book, the author attempts to answer the question of why governments actually privatize. He starts with a discussion of the theoretical arguments in favour and against State ownership of business enterprises. He suggests that the main rationale for privatization always arises from dissatisfaction with the actual performance of SOEs and a strong belief that private investors could significantly improve their performance. However, the question of whether private ownership of enterprises is inherently superior to public ownership has been at the centre of economic debate for many decades, even centuries, and still remains unresolved. A strong theoretical case could be made for public ownership in specific cases, such as natural monopolies producing essential goods or services, e.g. electricity generation, water distribution or sewerage services. Nevertheless, the empirical evidence surveyed in the book, which includes practically all the major published studies, challenges this argument, and the author strongly supports the view that private ownership is more efficient than State one. This is true even for natural monopolies, which now operate in more competitive markets than ever before. The empirical evidence is especially overwhelming when it comes to the operation of industrial firms. The author concludes that there is no realistic alternative to privatization as a means of improving the performance of SOEs.

The empirical evidence clearly indicates that the introduction of competition into monopolized State-owned industries increases the efficiency of the firm. However, introducing competition alone would not be sufficient; privatization is also needed. The surveyed empirical studies document well positive impacts on the efficiency of such firms that arises from privatization. Almost without exception, these studies suggest that, in order to effectuate the reforms of monopolized State-owned industries, the government should introduce competition, install an effective regulatory regime and sell off or reduce the State's holdings in them. Empirical evidence also shows that the benefits of reforms that are short of ownership change (i.e. privatization) are very hard to lock in. Measures designed to improve the performance of SOEs without privatization, such as corporatization or the introduction of management contracts, have been found to be less effective if they are not coupled with privatization. The author's thorough examination of the theoretical and practical arguments on the "privatization versus competition" debate is concluded with arguments in favour of tandem "privatization and competition" processes. Since there are complementarities and interfaces between competitive pressures and ownership structures in promoting better firm performance, these two processes could not be substitutes but complements.

The text of the third chapter focuses on the practical aspects and methods of the privatization process. The author touches upon several important questions related to the practical implementation of a privatization policy, such as commercialization and restructuring of SOEs prior to their sale; adopting privatization legislation; establishing a privatization agency and a related institutional framework; setting up accounting, financial and human resource systems; identifying key objectives and trade-offs of the privatization process; and selecting the method of privatization. As the author aptly put it, there is a long process of making industrial performance healthier through implementing the privatization policy:

> "*A government that has decided to launch the privatization programme is somewhat like a person who has decided to go on diet: the decision, while difficult in itself, marks only the beginning of what promises to be a long and painful process.*" (Megginson, 2005, p. 100).

The author emphasizes that each step of the privatization process has its challenges and hazards and is unavoidably prone to controversy. In this chapter, he elaborates on the three main privatization methods and their merits: direct sale, mass privatization through vouchers and public offerings (i.e. share issue privatizations). The author presents the evidence in favour of share issue privatizations. In his opinion, it is the most transparent and the least corruptible method of divesting SOEs. It could be undertaken in several stages or series, and there is evidence that such a method could bring the government larger revenue than direct sale.

The fourth chapter deals with the empirical evidence on the effectiveness of privatization in non-transition economies. It reviews 87 empirical case studies – single-industry and single-country studies as well as comparisons of pre-privatization and post-privatization performance studies – from all over the world. It is a particularly valuable contribution as most of the published works on the topic in the past fifteen years were dedicated only to the progress of post-socialist (i.e. transition) economies. Most of these studies point to improvements in the operating and financial performance of the privatized firms; they record a noticeably positive change in output, sales, efficiency, profitability, capital investment spending. However, the studies are not very conclusive when it comes to measuring the impact of privatization on employment in the privatized firms. Many studies document the significant employment declines in privatized firms, especially in the early post-privatization stages; however, the level depends on countries and specific industries. The general conclusion of the chapter is that the post-privatization performance improvements tend to be larger in developing non-transition economies, where firms have stronger efficiency gains, and also in regulated industries and firms that restructure their operations after privatizations, as well as in countries that provide better shareholder legislative protection.

The following chapter deals with the comprehensive empirical evidence on privatization programmes in 26 transition economies. Privatization policy has played a substantial role in transforming the centrally-planned economic systems of the post-socialist countries towards market based ones. Such a transition was a massive evolutionary process unprecedented in scope and in many other aspects and drew a huge academic interest and almost fascination with the process. At the beginning, the transition looked almost like an experiment, and therefore policy makers in these countries required a lot of expert guidance. The primary motivation for the privatization process in transition economies lay in the premise that the economic system based on private ownership greatly enhanced the operational efficiency of the companies. The aim of the privatization process in transition economies was thus not just a mere change of ownership, but rather the change of the incentive system and market for corporate governance that led to a changed attitude of the management towards the realization of business objectives of the company. Consequently, the main aim of privatization was actually increased efficiency and effectiveness of the company.

The author analyses the results of empirical studies on transition economies to examine the effectiveness of privatization in promoting enterprise restructuring and economic growth. The author cites over 70 academic studies that examine the impact of privatization policy on economic performance in transition economies at the micro- and macro-levels. The conclusion is that ownership change in transition economies yields economic gains only from "deep privatization", i.e. after key institutional and agency-related reforms have exceeded some threshold levels. The research also documents that the ownership structures that emerged from the various privatization schemes have different impacts upon the nature of governance and the market success and economic performance of divested companies. In general, firms that gained "real owners", such as financial institutions, foreign investor or local entrepreneurs, fared much better in efficiency terms than firms controlled by insiders, whose performance was comparatively poorer.

A large part of the book is devoted to examining the impact of privatization programmes on financial markets development and corporate finance practice, as well as on global finance. The author feels that this is a critical issue but inadequately addressed in the literature, and therefore dedicates his thorough attention to these issues in two chapters of the book.

His special focus is on measuring the impact of share issue privatization (SIP) programmes on financial and especially capital market development. The author states that, while it is very difficult to establish a direct and causal relationship between SIP programmes and stock market development, indirect evidence suggests that the impact has been very significant, especially for non-United States stock markets and for the participation of individual and institutional investors in those markets. Stock markets capitalization and trading volumes have significantly increased as a result of privatization programmes in the 1990s around the world, as privatized firms often account for sizable fractions of the total capitalization of national stock markets. This is the case not only in emerging market economies (China, Czech Republic, Hungary, Russia), but also in most advanced economies. The author also concludes that privatization deals have significantly improved stock market liquidity over the past ten years. Furthermore, the privatized companies are the most valuable companies in most of non-United States stock markets, and they usually represent four of the five largest firms.

Privatization programmes have also enormously increased the number of shareholders around the world, thus helping the "democratization" of the capital markets. However, the author points out that the vast initial shareholding structures that are created as a result of SIP programmes tend not to be stable and decline by one-third within five years. The author also discusses how privatization programmes had an impact and actually promoted the development of effective corporate governance systems. The author concludes the chapter with some practical recommendations for governments contemplating share issue programmes aimed at attracting a large number of domestic investors. In order to yield economic and political dividends, effective legal protection and large liquid capital markets ought to be in place. An effective system of corporate governance should be developed for publicly traded companies, and a strict regulatory regime needs to be in place in order to protect first-time individual investors from the possible expropriation by corporate insiders. Empirical studied have shown that countries that have neglected investor protection usually have less developed stock and bond markets.

The following three chapters of the book examine privatization case studies and experiences throughout the world in specific industries, such as airlines, commercial banking, energy and telecommunications.

The final part of the book identifies lessons learned from the implementation of privatization policy over the past 25 years and what might be the future of this process. The author offers several straightforward messages after examining no fewer than 300 empirical studies on the privatization processes in 125 countries over the past 15 years. The first is that privatization improves a company's financial and operating performance, which was the starting premise behind the process. The second message is that the best outcome of the ownership change happens when it is combined with deregulation, introducing competition and other reforms at the micro-level and also in the business operating environment at the macro level. The author also emphasises that privatization works but it is no panacea, and therefore no unrealistic expectations should be raised. It creates easily identifiable winners and losers and, therefore, policy makers should not over-sell the benefits of the policy. One of the qualities of this book is that the author attempts to be a non-biased analyst who assesses the benefits of the policy in the realistic terms. He concludes: "*While real, these benefits are never large enough to solve a society's ills, and disappointment at privatisation's inability to transform lies at the root of much of today's popular dissatisfaction with the policy*" (Megginson, 2005, 390).

The third conclusion is that "efficiency maximization" is better than "revenue maximization", especially in the case of State-owned monopolies. Also, the author takes the stand that privatizing well is better than privatizing fast, which is also supported by the empirical evidence. A measured, slow but steady approach could enable the government to build on success and give time for financial markets to develop. Furthermore, the author is of the opinion that ownership matters, as it affects corporate governance incentives. The author also considers that the design of the privatization policy matters too, as it should maximize the transparency and legitimacy of the process. Furthermore, the author emphasises that governments should deliberately use privatization policy to develop financial and capital markets, because they promote economic growth. This includes adopting legal and institutional settings that protect private property rights as well as establishing an effective regulatory and supervisory regime.

At the end of the concluding chapter, the author lists unresolved issues in the privatization policy debate that need further research. The most important of those include the aggregate employment effects of privatization; income and wealth distribution effects; exemption from privatization; and the desirability of privatization in severely underdeveloped countries. The author also provides his views on the future of privatizations in several regions of the world. The most interesting is the author's identification of long-term mega trends in privatization policy worldwide for the next 20 years, such as the privatization of national oil-producing enterprises; public transport companies and non-transportation networks. The author expects a further blurring of the lines between what economic activities are considered inherently "public" and "private", and the role of privatization policy remains important in the future.

A unique contribution of this very topical book is that it attempts to put privatization and all the controversies associated with it into a wider economic perspective and, through detailed analyses, provides a measure of its effects and impacts, especially when it comes to the development of capital and financial markets, a largely neglected area. The diversity of the topics covered and the scope of the information collected and surveyed, in particularly when it comes to published empirical studies, are truly fascinating and really thorough. This makes for the book's enormous strength. At the same time, however, this approach has some weaknesses, too. While the author's ambition has produced quite a comprehensive result, it has inevitably forced him to over-simplify sometimes in order to make the text easily understandable for a wider audience. The plethora of the different, sometimes even controversial empirical evidence of the privatization process is very difficult to categorize precisely in "pro" and "contra" arguments, as many issues on the effects of privatization remain debatable.

The potential readership of this book should be rather wide, but given the scope of the analysis, it will be particularly beneficial for practitioners, such as international portfolio investors, accounting and legal consultants and other advisors who assist governments in selling SOEs. The book is also a valuable source of information for academics, professional economists, analysts and graduate students who are interested in privatization as an economic policy.

Nevenka Cuckovic
Senior Research Fellow
Institute for International Relations Zagreb, Croatia

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RECENT TRENDS IN INTERNATIONAL INVESTMENT AGREEMENTS: NEW UNCTAD RESEARCH NOTE	31/08/05	UNCTAD/PRESS/EB/2005/004

Books received since August 2005

Dunning, John H. and Rajneesh Narula, eds., *Multinationals and Industrial Competitiveness: a New Agenda* (Cheltenham, Edward Elgar, 2004), x+287 pages.

Ito, Takatoshi and Andrew K. Rose, eds., International Trade in East Asia (Chicago, University of Chicago Press, 2005), 419 pages.

Kline, John M., *Ethics for International Business: Decision Making in a Global Political Economy* (London and New York, Routledge, 2005), xvi+269 pages.

Lipsey, Richard G., Kenneth I. Carlaw and Clifford T. Bekar, Economic Transformations (Oxford and New York, Oxford University Press, 2005), xxi+595 pages.

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Dunning, John H. (1979). "Explaining changing patterns of international production: in defence of the eclectic theory", *Oxford Bulletin of Economics and Statistics*, 41 (November), pp. 269-295.

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