Richmond Journal of Global Law & Business

Volume 3 | Issue 1 Article 5

2003

Corporate Governance in the Emerging Markets of the Global Village: Latin and South America

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CORPORATE GOVERNANCE IN EMERGING MARKETS OF THE GLOBAL VILLAGE: LATIN AND SOUTH AMERICA[1]

Remarks of **Rhoda Karpatkin** given during the *Richmond Journal of Global Law and Business' symposium: International Corporate Governance,* conducted at the University of Richmond School of Law, Richmond Virginia, October 25, 2002.

I am very pleased to participate in this symposium. Corporate governance scandals in America have focused public attention once again on global governance issues. Issues that are not solely corporate or business concerns, they have become public, political, and ethical concerns. They have become economic concerns, particularly due to the erosion of public confidence in the integrity of corporate leadership and the institutions that are charged with their oversight. Finally, they are global concerns. The most important corporations today are global; corporate governance must be addressed globally.

A discussion of the global village should begin with the definition of "globalization." Thomas Friedman defines globalization as "the inexorable integration of markets, nation-states and technologies to a degree never witnessed before – in a way that is enabling individuals, corporations and nation-states to reach around the world farther, faster, deeper and cheaper than ever before," and the world to reach into them in the same way.[2]

This system, "shapes virtually everyone's domestic politics, commerce, environment and international relations."[3] It means "the spread of free-market capitalism to virtually every country in the world."[4] It creates its own set of economic rules about opening, deregulating, and privatizing a nation's economy in order to make it more "competitive and attractive to foreign investment."[5]

This is the global village in which corporations must be governed. It would be a formidable task anywhere in the world. It is even more formidable in the emerging economies of Latin America.

Although we share a hemisphere, Latin American history is very different from the history of the United States. In the early twentieth century, economic development and democracy expanded in the United

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[1] References to Latin America include the countries of both South and Central America, as well as Mexico.

[2] Thomas L. Friedman, THE LEXUS AND THE OLIVE TREE 9 (2000).

[3] *Id.*

[4] *Id.*

[5] *Id.*

States, and the economic and political infrastructure took shape. Latin America was left far behind. It was a continent largely marked by persistent underdevelopment, brutal dictatorships, and extreme impoverishment, by powerful landowners, of peasants and workers.[6]

During the second half of the last century, politically turbulent dictatorships ruled many Latin American countries. Such countries experienced internal chaos, continuing poverty and egregious violations of human rights, including the torture and murder of thousands of people, inspired and led by reigning governments and tolerated by the United States.[7]

The dictatorships eventually fell, but Latin America became an economic basket case. With a few exceptions, the economic situation is grim and the political situation unstable.[8]

While globalization has produced growth in developed economies, it has failed to do so in Latin American countries, with the exception of Chile and Mexico. Latin American economies grew in the 1990s at an average annual rate of 2.9%, half that of the 1960s.[9] At the end of the 1990s, "11 million more Latin Americans lived in poverty than at the beginning of the decade."[10]

Today, for example, Argentina is a disaster. The poor and middle classes are suffering; the currency is falling by more than 70% against the dollar, and the emerging barter economy seems to be pre-capitalist. Thousands of Argentine people have become scavengers.[11] Uruguay has been swept up in Argentina's maelstrom. The International Monetary Fund (IMF) is helping to bail out Brazil, the largest and strongest economy in the region, and a massive and tantalizing market for developed economies.

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[6] *See* Joseph S. Tulchin & Knut Walter, *Nicaragua: The Limits of Intervention*, *in* EXPORTING DEMOCRACY: THE UNITED STATES AND LATIN AMERICA 247 (Abraham Lowenthal ed., 1991); Jeffrey D. Sachs, *Globalization and the Rule of Law*, *in* YALE L. OCCASIONAL PAPERS, 2nd Series, No. 4, at 7 (1998).

[7] *See* Stephen Kinzer, *U.S. and Central America: Too Close for Comfort?*, N.Y. TIMES, July 28, 2002, at 14; James Dao, *The 'Dirty War'; Ally or Enemy? America Couldn't get a Fix on Post-Coup Argentina*, N.Y. TIMES, Aug. 25, 2002, at 5; Tulchin, *supra* note 6, at 250-51; Human Rights Watch, Lawyers' Committee for Human Rights, *The Reagan Administration's Record on Human Rights in 1988*, at 4-7; Human Rights Watch, Lawyers' Committee for Human Rights, *Critique*, 1988; Jacobo Timerman, PRISONER WITHOUT A NAME, CELL WITHOUT A NUMBER (Toby Talbot trans., Alfred A. Knopf 1991).

[8] Tina Rosenberg, *Globalization*, N.Y. TIMES MAGAZINE, Aug. 18, 2002, at 28.

[9] *Id.*

[10] *Id.*; *see also A Backlash Against the Free Market*, ECONOMIST, Aug. 17, 2002, at 12.

[11] *Slump Turns Argentine Jobless Into Scavengers*, N.Y. TIMES, Sept. 22, 2002, at 14.

Venezuela's economic and political problems grow, after an aborted rightist coup failed to unseat the democratically elected president, who has the support of the poor, but faces strong political opposition from businesses.[12]

Mexico is described as a North American Free Trade Agreement (NAFTA) success story. However, a large gap remains between the rich and poor, and the middle class is worse off than before. The top 10% of the population controls 40% of the wealth.[13] Serious problems are expected following the elimination of Mexico's duties on American subsidized agriculture, dairy, and meat products under NAFTA American exports will likely threaten the survival of millions of Mexican farmers.[14]

Corruption is persistent. Nicaragua's ex-president Aleman, a United States protégé, faces prosecution on charges of stealing one hundred million dollars during his presidency.[15] He is only one of a series of corrupt conservatives backed by the United States over the years. Paraguay was rated the third most corrupt country in the world by Transparency International.[16] This year, the organization noted that, "Latin America in general has slipped down the rankings of perceived corruption of its politicians and public officials."[17]

This is the quagmire in which we should now consider issues of corporate governance. How do you create a meaningful system of corporate governance in which the emerging countries of the global village are in the throes of rampant economic failures, political instability, and corruption? Such countries are among the less developed nations in the world and wield virtually no power with respect to the global bodies that largely determine global financial outcomes. How do you create such a system when trade, marketing, and investment opportunities in those countries are lusted after by rich and powerful developed economies and global corporations?

The critical issue today is how powerful global corporations should be governed when they do business in Latin American countries. Can weak economies – economies beset by multiple problems, that need the benefits of economic growth, adopt and enforce governance rules that such corporations will be bound to follow? It seems most unlikely.

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[12] Marc Lifsher, *Venezuela's Economic Turmoil Grows Despite Higher Oil Prices*, WALL ST. J., Sept. 17, 2002, at A18.

[13] Ginger Thompson, *Free Market Upheaval Grinds Mexico's Middle Class*, N.Y. TIMES, Sept. 4, 2002.

[14] Tim Weiner, *Mexico Fears Migrant Deaths Will Increase With Despair*, N.Y. TIMES, Oct. 20, 2002, at 4.

[15] *Ex-President Ousted*, N.Y. TIMES, September 20, 2002, at A11.

[16] *Study Rates Bangladesh Most Corrupt Country*, N.Y. TIMES, Aug. 29, 2002, at A15.

[17] *Id.*

An effective approach to corporate governance in the developing global village of Latin America must recognize the realities of globalization: the powers exercised by global corporations, the troubled economies of the region and its poverty, and its need for growth, development, and equity. For that, we need a global architecture for corporate governance.

National laws and regulations – such as the ones that have monopolized American debates on corporate governance – can be helpful. However, they are not intended to, and do not, address the global transformation described by Mr. Friedman as an exuberant and irresistible march of globalization. Nor do they address the dramatically changing balance of power between governments and global corporations. The rules do not address development issues or concepts of social and economic justice. Furthermore, they do not consider the future of the globe and its resources. Global corporate governance requires a new vision.

The 1999 United Nations Human Development Report, "Globalization with a Human Face," is a good starting point.[18] It urged that governance concepts be reinvented.[19] At the core of this new paradigm, are concerns of equity and human development.[20] The report called for a framework of laws and rules that do far more than promote economic and corporate growth.[21] Rather, the framework should promote social and economic equity, within and among nations, to address issues of poverty.[22] It should be one that creates binding norms for ethical conduct and respect for the human rights of all people.[23]

That is very different from today's global architecture. The institutions that make the decisions and exercise the power globally have not concerned themselves with human development and public interests. Perhaps it would be fairer to say that they believe free trade, foreign investment, privatization, and competition, as practiced by the powerful economies, will in time produce all the human goods and values any society could want.

As a result, today's global trade and investment system benefits developed economies, but has worsened the lot of the least developed.[24]

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[18] *Human Development Report 1999: Globalization with a Human Face*, U.N. Development Programme (1999), *available at* http://hdr.undp.org/reports/global/1999/en/.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *See, e.g., A Different Manifesto*, ECONOMIST, Sept. 27, 2001 (stating that "Rich countries' trade rules, especially in farming and textiles, still discriminate powerfully against poor countries.").

"Since 1990, the number of people living on less than \$2 a day has risen by more than 100 million, to 3 billion people."[25] That figure represents approximately half of the world's population.[26] It is no wonder that at the World Trade Organization (WTO) Ministerial meeting in Doha, last year, the developing countries insisted that the next round of trade talks be devoted to a "development round."[27]

If we were to follow the UN Report, and reinvent concepts of corporate governance, we might begin by looking at the major institutions that wield the decisive global power today: the IMF, the World Bank, and the WTO. These institutions provide a substantial framework for global corporate conduct.

The arrogant and misguided policies of the IMF and the World Bank are believed to have caused many of the problems experienced by poor borrowing nations.[28] The banks have worsened the economies of poor nations with their insistence on liberalization, free trade, open capital markets, privatization, austerity, and the withdrawal of safety-net supports in countries that could not sustain such rapid and harsh programs.[29] More than one critic has charged that IMF policies have been a major contribution to the sorry situation now faced by Latin American economies.[30]

The World Bank, for example, required the government of Bolivia to privatize the water system of Cochabamba as a condition for debt relief and subsidies.[31] The result was an increase of 50% in water costs to the residents, which started a water war.[32] Protests, general strikes, mass arrests, and death eventually induced the government to revoke the privatization license.[33] In global trade, water has become a commodity and companies are free to make profits in its trade.[34]

The WTO is more than an umbrella for the new free trade system established by the General Agreement on Tariffs and Trade (GATT). It

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[25] John Cassidy, *Master of Disaster*, NEW YORKER, July 15, 2002, at 82, 84; Benjamin Friedman, *Globalization: Stiglitz's Case*, N.Y. REV. OF BOOKS, Aug. 15, 2002, at 48, 53.

[26] *Id.*

[27] Frances Williams, *Patents Challenge Top Ministers' Agenda*, FIN. TIMES, Nov. 14, 2002, at 13.

[28] *Doubts Inside the Barricades*, ECONOMIST, Sept. 28, 2002 – Oct. 4, 2002, 63. Cassidy, *supra* note 25.

[29] *Id.*

[30] *Id.*

[31] William Finnegan, *Letters from Bolivia: Leasing the Rain*, NEW YORKER, Apr. 8, 2002, 43, 44.

[32] *Id.* at 47.

[33] *Id.*

[34] *Id.* at 43.

implements a group of international trade agreements that have worked to the disadvantage of developing countries in several ways. It is dominated by rich, powerful nations, whose resources, staffs, and expertise easily overwhelm the weaker members.[35] Lacking any transparency, and with no right to participation by any citizen interests, its dispute resolution panels have final authority to decide trade disputes between countries, including those that affect the environment, safety, and pocketbooks of consumers.

NAFTA does more than provide for trade relations between the United States, Canada, and Mexico. Its Chapter 11 investor provision enables foreign investors to bring proceedings claiming that state measures that protect health, safety, and the environment are expropriations of property, entitling them to government compensation.[36] The chilling effect on social legislation can be profound. Yet, private citizens affected by the outcomes of these closed-door tribunals have no right to be heard, either as interveners or amici.

Large scale protests against this kind of globalization first received global attention in Seattle, Washington in 1999. There have been many protests since then, in countries around the world, directed at the WTO, the World Bank, and the IMF. Protestors have called for a system based on social and economic equity, more equitable trade rules and practices, and a democratic and transparent global governance system. They reject existing and proposed trade agreements that have harmed developing nations, have failed to protect workers' rights, and have eroded or threatened the essential consumer and environmental rights and protections built up in various countries over the years.

The protestors have certainly launched a compelling global dialogue on free trade, corporate practices, and the roles and responsibilities of global, regional, and national institutions. As a result, an increasing number of voices within the system have also voiced doubts about the direction globalization has taken, a direction charted by corporations doing business globally and intended for their benefit.[37]

In this context, we need a new direction. And for that, we need a new concept of corporate governance. Corporate behavior can no longer be accountable only to the interests of shareholders. It must be accountable to those of the larger society in which we live and in which corporations do business. Corporations must take responsibility for their policies and conduct that affect all the corporations' public stakeholders.

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[35] World Bank, *Entering the 21st Century*, WORLD DEVELOPMENT REPORT 1999/2000, *available at* http://www.worldbank.org/wdr/2000/fullreport.html.

[36] Anthony DePalma, *Mexico is Ordered to Pay a U.S. Company $16.7 Million*, N.Y. TIMES, Aug. 31, 2000.

[37] *Doubts Inside the Barricades*, *supra* note 28.

This important group includes the employees who produce the products and services and their families, the consumers who buy them, and the citizens of the communities in which they are located. It can include the many interests indirectly affected by corporations.

Corporate policies and practices affect city, state, and federal tax revenues; and therefore, affect the public services we depend on and the quality of the lives we lead. They can affect the air we breathe, the atmosphere above us, the water we drink, the food we eat, our natural resources, our health, and our safety. This overwhelming power over our lives and well being is not merely national power. As Thomas Friedman said, this spread of free market capitalism to virtually every nation in the world creates its own set of international and environmental relations, its own economic rules, its own domestic policies.[38]

It also creates its own giant corporations. The world's one thousand largest corporations account for four-fifths of the world's industrial output.[39] These figures indicate corporations have an enormous amount of clout. There is reason to worry and Americans have been doing just that. Indeed, Business Week magazine, in 2000, reported that "72% of Americans say business' have too much power over too many aspects of American life."[40]

The call for global codes of corporate responsibility is not a new concern. In the 1970s, the United Nations Centre on Transnational Corporations (the Centre)[41] proposed a voluntary code to create a positive link between the multinational corporations, which sought to do business in developing economies, and the development goals of the host country. The draft code included specified rights and responsibilities of both the corporation and the government involved. Specifically, the proposal sought to ensure that the corporation would respect host country's development goals, abide by their domestic laws, respect human rights, support social and cultural objectives and values, abstain from corrupt practices, and observe environmental and consumer protection objectives. Additionally, the corporation would abide by international standards, operate transparently about its products and processes, and would refrain from interfering in national politics.

Those provisions were a roadmap for corporate governance and accountability in the emerging global age. Unfortunately, the proposed code

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[38] Friedman, *supra* note 2.

[39] *The World's View of Multinationals*, ECONOMIST, Jan. 29, 2000.

[40] Aaron Bernstein, et al., *Too Much Corporate Power*, BUS. WEEK, Sept. 11, 2000, at 144, 145.

[41] The United Nations Centre on Transnational Corporations was established in 1974 by the United National Economic and Social Council. Although the draft code of conduct on transnational corporations was never adopted, the issues raised by the code were widely debated.

of conduct died when, under attack by business groups, the work of the Centre was transferred to another part of the United Nations and its activities largely vitiated. The purposes and provisions of the proposed code, however, remain relevant today as a compelling set of global principles for corporate governance.

Other international voluntary codes have also been on the table for decades. Some examples include: the International Labor Organization Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, the OECD's Guidelines for Multinational Enterprises, the United Nations Conference on Trade and Development Principles for the Control of Restrictive Business Practices, and the United Nations Guidelines for Consumer Protection.

Civil society groups have also presented similar proposals. One such proposal from Business Ethics, a Minnesota publication, is to change the laws governing a directors' duties to ensure that shareholders' gains may not be pursued at the expense of the community, the employees, or the environment.[42]

Another proposal comes from Friends of the Earth International (FOEI). They propose establishing an effective, legally binding international framework for accountability and liability, establishing social and environmental duties for corporations, their directors and officers, and establishing a body of rights for citizens and communities affected by corporate activities.[43] Additionally, FOEI proposes to require the corporation to consult with civil society and to report.[44] The group also proposes legal aid for challenging corporate conduct in developing nations.[45]

Business for Social Responsibility, a United States group, suggests a voluntary proposal that presses corporations to conduct themselves as corporate citizens, to combine bottom line realities with socially responsible behavior. The group calls for stronger codes of conduct, operations that avoid polluting water and air, energy efficiency, labor relations, and human rights.[46]

Businesses and non-governmental organizations have formed the global reporting initiative, to create voluntary global reporting on the

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[42] Marjorie Kelly, *Four Ideas for Reforming Corporate Governance after Enron*, BUS. ETHICS, Mar.-Apr. 2002, *available at* http:// www.business-ethics.com/corporate.htm.

[43] *Id.*; *Toward Binding Corporate Accountability*, *available at*, http://www.foei.org/publications/corporates/accountability.html.

[44] *Id.*

[45] *Id.*

[46] Michael Anft, *Toward Corporate Change*, CHRONICLE OF PHILANTHROPY, Sept. 19, 2002, at 9.

economic, environmental, and social dimensions of their activities, products, and services. [47]

The European Academy of Business in Society was formed with the goal of integrating corporate social responsibility into management education.[48] It rejects the United States model of shareholder value as the only corporate objective. Instead, it wants to change corporate thinking and business school teaching so that corporations deliver value for society and external stakeholders.[49] An opinion poll conducted in March 2000, showed that Americans who support growth in international trade also desire, by an overwhelming majority, compliance with international labor standards in trade agreements and more international agreements on environmental standards.[50]

Such views of corporate behavior may be gaining some traction. The corporate scandals of the past year have shown that wrongdoing has harmed not only shareholders, but other stakeholders as well. We have only to look at the major financial harm inflicted on California energy consumers by the gross misconduct of Enron in its energy trading.

The citizen movements that challenged the nature of globalization today have made some gains. The newly appointed Director-General of the WTO, Supachai Panitchipakdi, has said that he would urge global corporations to develop more codes of conduct to help him take the edge off of anti-globalization protests.[51] The Economist has reported that a growing number of inside critics question whether the IMF and the rich countries that control it know what they are doing.[52] The book on globalization and the IMF by Joseph Stiglitz, "Globalization and its Discontents" has stimulated a robust debate on the extent to which the onerous terms the IMF imposed on poor countries, as a condition of loans, have actually caused them serious economic harm.[53]

Some change may be possible. The developing countries in the WTO were strong enough at the last ministerial meeting in Doha, Qatar, in November to compel the richer countries to agree to a "development round" as the basis for the next trade negotiations, and to overcome US and pharmaceutical industry resistance to greater access for poor nations to life-saving drugs.

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[47] Global Reporting homepage, *available at* http://www.globalreporting.org.

[48] Roger Cowe, *Embracing Companies' Social Role: Business Education*, FIN. TIMES, July 15, 2002, at 10; Linda Anderson, *Wave of Applicants Jostle for Places*, FIN. TIMES, Sept. 9, 2002, at 2.

[49] *Id.*

[50] *Globalization Blues*, ECONOMIST, Sept. 30, 2000.

[51] *Globalization's New Cheerleader*, ECONOMIST, Sept. 7, 2002.

[52] *Doubts Inside the Barricades – the IMF*, ECONOMIST, Sept. 28, 2002.

[53] Cassidy, *supra* note 25.

Intellectual property issues have certainly invigorated the debate over corporate responsibility, as they should. The World Bank has estimated that WTO intellectual property rules – the TRIPS Agreement – will result in the transfer of $40 billion a year from poor countries to corporations in the developed economies.[54]

The excessive quest for profits reflected in that agreement underpinned a misguided lawsuit, instituted by thirty-nine multinational drug companies in Johannesburg against the South African government, to challenge a law that allowed the government to obtain cheaper versions of brand name drugs for their AIDS victims. The suit was widely covered by world media, and was withdrawn by the companies because of very hostile world public opinion.[55] The Economist reported the view that this was a failure of good governance, "failing to acknowledge that the issue is not just the price of drugs but fuzzier things such as social responsibility and accountability."[56]

I want to close by asking you to grapple with the consequences of the issues I have discussed. Lawyers often find themselves in the front lines of corporate decision making, either as counsel, CEOs, or board members. They should be leaders in the growing efforts to govern corporations so that they responsibly serve all of their stakeholders' interests. I ask you to think about the course you would follow in the following hypothetical - or not so hypothetical – instances:

- The board of a global pharmaceutical company is strongly urged by civil society groups to drastically reduce the cost of its AIDS drugs in poor countries with raging AIDS epidemics, and to cooperate with those countries in their efforts for greater flexibility under the TRIPS Agreement, so that poor AIDS victims can have greater access to lifesaving drugs. Board members argue that the real treatment problem is not the cost of drugs but the absence of an effective health care system. Management says that the long-term consequences of this action will be the erosion of profits and patent rights, and a weakening global price structure.
- The board of a global pharmaceutical company, faced with the marketing of a competing generic drug, is advised that management has prepared a challenge to the generic drug that, while spurious, can effectively delay the global marketing of the drug. This will enable the company to continue to market its drug without generic competition for an additional period, and will add millions of dollars to the bottom line.

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[54] Rosenberg, *supra* note 8.

[55] *Drug-Induced Dilemma*, ECONOMIST, Apr. 21, 2001.

[56] *Id.*

- By relocating its corporate office to Bermuda – a mere paper transaction – an established American corporation can save very substantial sums in American taxes, adding to shareholder value. The board is asked to approve this simple step.
- Your corporation is asked to bid on operating a newly privatized water system in Bolivia. Your shareholders will benefit by raising the price of water, although many consumers will be unable to afford the increased prices.

What would you do in those instances if called upon to choose a course of action? I hope you will ponder these questions.

Thank you for inviting me here today.