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Democratic Regulation of Transnational
Corporations

David Humphreys

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From Corporate Social Responsibility to the Democratic Regulation of Transnational Corporations

David Humphreys, The Open University, Bucks, UK

Abstract: This publication examines the role of transnational corporations in governance and critically evaluates the dominant self-regulatory approach of corporate social responsibility (CSR). By placing the onus for change on the corporation, CSR represents an agent-led approach to a systemic problem, and as such it is flawed. After distinguishing between the ideas of CSR and corporate accountability, the latter of which emphasises the answerability of the corporation to public authorities and citizens, the publication then offers an original model for the democratic regulation of the corporation. The model proposes, first, the negotiation of a new corpus of international law to be agreed by states but ratified by those corporations that wish to trade or invest internationally and, second, the reinvigoration of the public charter as an active instrument of public control. The model aims to provide a nested framework within which corporations can trade and compete, while restoring to local communities final decision making authority on the conditions under which corporations may, or may not, operate. Some possible objections to the model are anticipated and addressed.

Keywords: Accountability, Charter, Limited Liability, Neoliberalism, Rationality, Responsibility

Introduction

THOSE WHO WORK in the public education sector and are funded from the public purse should promote debate on matters of public importance. As Edward Said argued in his 1993 Reith Lectures, the public intellectual is ‘someone whose place it is publicly to raise embarrassing questions, to confront orthodoxy and dogma (rather than to reproduce them), and to be someone who cannot easily be co-opted by governments or corporations’ (Said 1996: 11). To Said, the public, broadly defined, is the intellectual’s natural constituency. In this respect today’s scholars can arguably find no more pressing public welfare issue on which they should speak than global environmental degradation.

One of the drivers of environmental problems is the transnational corporation. This publication analyses the increasing ease with which corporations are now able to evade public oversight. It also seeks to move beyond analysis to address the normative issue of the political systems and governance structures that are necessary if corporations are to be brought under democratic public control. Grappling with such an issue raises the question of whether scholars should engage in advocacy and, if so, on whose behalf should we claim to speak? I would suggest that scholars should be free to engage in advocacy providing that the advocacy in question is expressly intended to promote human rights or otherwise enhance the public interest. Of course, and as Said notes, the public interest is an essentially, and perpetually, contested concept. The spatial scale at which we analyse ‘the public’ may vary significantly between communities, while in sustainability discourse the notion of ‘the public’ should include the needs of generations that have yet to be born.

This publication first outlines why we should study the role of transnational corporations in environmental governance. It then introduces and critiques the idea of corporate social responsibility (CSR), differentiating between CSR and corporate accountability. The final substantive section presents an original model for the democratic regulation of corporations.

The Transnational Corporation and Environmental Governance

A transnational (sometimes called multinational) corporation is 'a company that operates in a number of different countries, either in terms of productive or service activities or in terms of having subsidiaries or affiliates in several countries' (Thompson 2009: 406). The last fifteen years has seen the emergence of a burgeoning literature within the academic and activist communities on corporations, the power they wield and how they may evade public oversight, especially in the majority world of Latin America, Africa and Asia (for example, Bakan 2004; Bollier 2003; Christian Aid 2004; Clapp and Utting 2008; Cromwell 2001; Derber 2002; Drutman and Cray 2004; Gates 2001; Korten 1995, 1999, 2006; Litvin 2003; Monks 2008).

The modern business corporation was originally conceived to serve public policy. There are three attributes of the modern corporation that affect its role in environmental governance. First, corporations have a legal personality. The legal right of a corporation to exist and raise money through issuing shares is provided by public authorities in a charter. In 1886 a US court case, *Santa Clara County v. Southern Pacific Railroad*, ruled that a corporation should be considered a legal person with the same constitutional rights as a US citizen, in effect giving to corporations a status that is equal to people (Korten 1995: 1; Drutman and Cray 2004: 63). Second, corporations have a fiduciary responsibility to act in the interests of their shareholders. The doctrine of shareholder primacy was established in the Michigan court case, *Dodge v. Ford Motor Company* 1919. Third, the shareholders of corporations have a limited liability, a principle first introduced in England in 1851. If a corporation is sued shareholders are liable only for their initial investment, and not for any damages greater than this. For limited liability corporations it is the personality of the corporation that is liable, not its shareholders or directors. Corporations can divide themselves into legally separate entities, such as holding companies and subsidiaries, so that if successfully sued any damages will be confined to a small 'firm' within a larger organisational structure. This makes it more difficult for plaintiffs to obtain legal redress for any environmental damage corporations may cause.

Sustainability, however defined, cannot be attained unless corporations actively promote it. If the world's largest economies are measured by either the annual gross domestic product (GDP) of a country, or the annual turnover of a corporation, then over half of the world's largest economies are corporations. Transnational corporations are major users of natural resources and owners of industrial and agricultural land. They generate a significant percentage of global carbon dioxide emissions. The 200 largest corporations control approximately 30% of GDP, while the 500 largest control approximately 80% of foreign direct investment and 70% of world trade (Elliott 2004: 117). International trade increasingly involves the movement of raw materials and components between different divisions within a corporation. Environmental standards may be progressively driven down as countries compete to offer more attractive investment terms to transnational corporations, the so-called 'race to the bottom'. Yet many corporations operate with no effective control from their shareholders

or from governments; indeed increasingly it is corporations that influence governments. Some corporations effectively conduct their own diplomacy, with political and legal departments that specialise in negotiating with governments (Ross 2007: 216). Big businesses have become standard setters rather than standard takers. Some corporate alliances, such as the World Business Council for Sustainable Development, the European Round Table of Industrialists and the US Council for International Business, have prepared the first drafts of international legal agreements tabled in intergovernmental negotiations (Humphreys 2001; Derber 2002). The increased influence of corporations in international negotiations has led to what may be termed the ‘privatisation’ of the United Nations, in which international law increasingly reflects the interests of business (Lee, Humphreys and Pugh 1997).

Deregulation has freed corporations from public oversight. Many now function with little, if any, commitment to the spaces and communities within which they operate. They increasingly operate not only beyond local community control but beyond the control of national governments, wielding enormous power yet protected from the worst consequences of their action by limited liability law. They have rights, including some important rights in international law, but without concomitant responsibilities. If corporations are growing in size and political influence then how can local communities regain democratic control over them?

From Corporate Social Responsibility to Corporate Accountability

In the contemporary neoliberal era mandatory national and international environmental legislation is eschewed in favour of voluntary and market-based initiatives (Falk, 2001; Giroux 2004, Harvey 2003). Corporate social responsibility (CSR) fits comfortably into neoliberal logic. CSR refers to a wide range of voluntary initiatives by corporations, sometimes in conjunction with other stakeholders, ‘to promote ethical corporate behaviour and minimise the negative impacts of business activity on society and the environment’ (Clapp and Utting 2008: 1). CSR is based on the assumption that corporations themselves best know how to improve their social and environmental performance. There are various forms of CSR including voluntary statements of principles from individual businesses, schemes agreed collectively by several corporations (such as the UN Global Compact), and market-based certification and labelling schemes. While it originated from business, CSR has been accepted as the dominant approach to business (self)-regulation by many developed governments and by the European Union (European Commission 2002).

Companies may adopt CSR schemes for a variety of reasons, including improving resource and energy efficiency, public relations, demands from stakeholders and to ward off tougher mandatory regulation. Some corporations adopt CSR schemes for genuinely altruistic and ethical reasons (Thompson 2009). CSR schemes vary enormously but typically include commitments against sweatshop or child labour and the promotion of gender equality, fuel efficiency, waste management, nature conservation and carbon dioxide emission reduction. Proponents argue that CSR helps to fill a global regulatory vacuum by exercising an independent normative pull that raises standards. Corporations that take a lead in CSR can set new standards that laggard businesses will later adopt in order to avoid reputational damage (Assadourian 2006). To John Ruggie, schemes such as the Global Compact signify ‘the emergence of a new advocate for a more effective global public sector: business itself’ (Ruggie 2003: 115).

But CSR has many critics. It may be seen as a contradiction in terms; under the law the corporation has no social responsibility, only the fiduciary duty to maximise its shareholders' interests. Corporations often evade the voluntary commitments they make (Christian Aid 2004). Commitments are usually vague, often taking the form of generalised principles. Timebound and quantifiable targets and verifiable performance benchmarks are the exception rather than the rule. Because of the voluntary nature of CSR schemes there is no mandatory verification, no obligation for independent auditing and no penalty for corporations that fail to adhere to their commitments.

One argument against collective CSR schemes such as the Global Compact focuses on the relationship between the strength of standards and the number of participating corporations. Schemes with strong standards will have low uptake; they will achieve significant impacts for the limited number of corporations that adopt them, but low impact overall. Schemes with weak standards will achieve high uptake, but because they promote only minor changes in corporate practices, again there is only a limited overall impact. Uptake is uneven, both by sector and across space, with some types of business and some countries more active on CSR than others. There remain regulatory gaps through which unscrupulous businesses can slip.

CSR schemes have had some impact in ratcheting up standards for some firms. But whether CSR schemes may be considered effective depends on how 'effectiveness' is defined. If effectiveness is defined as behavioural change that would not otherwise occur then some CSR schemes should be considered effective. But if effectiveness is defined as solving the problem at hand, such as maintaining or enhancing environmental quality, then CSR must be seen as fundamentally ineffective, as environmental problems have worsened since CSR was first introduced in the early-1990s. CSR leaves the onus on responding to environmental problems to corporations; it is an agency response to systemic problems that can only be solved with a coordinated system level response. CSR did not emerge primarily as a response to global environmental and social problems, and has failed to engage meaningfully with them. CSR focuses primarily on changes that will benefit the corporation, such as providing predictability in an uncertain policy environment and improving resource efficiency. But there is no reason to conclude that improving business efficiency will arrest broader systemic problems, such as nature degradation and decarbonisation of the global economy. Questions such as whether sustainability requires a reduction in international trade, a macro-level restructuring of global financial markets or a worldwide reduction in resource-intensive modes of production modes are not admitted into CSR discourse.

CSR constitutes a weakening of the public sphere at the national and international levels. Governments have, in effect, passed responsibility for standard setting from the public to private sectors. At the international level the Global Compact enhances the status of the UN secretary-general, but bypasses, and thereby diminishes, intergovernmental bodies within the UN system. It presumes that the era of state regulation has ended, supplanted by a new era of global governance in which the state is just one actor amongst many. As David Coleman has argued, by appealing directly to corporations to adopt global standards and, in so doing, inferring that states and international organisations are the laggards at standard setting, the Global Compact has subverted the idea of global public regulation (Coleman 2003: 253).

So there are problems with both the means of CSR (often untransparent and profoundly undemocratic) and the ends (simply not fit for the purpose of arresting environmental degradation and achieving sustainability). CSR is a surface phenomenon: it does not penetrate deep

into corporate governance. Under limited liability law corporations can impose environmental externalities on society by, for example, clearfelling forests, polluting waterways and dumping toxic waste, while internalising the financial benefits, leading to huge imbalances between private profits and social welfare. In a neoliberal policy environment it is 'rational' to degrade the environment for private gain.

The work of Arild Vatn on rationality is relevant here. Vatn argues that rationality is a plural concept that encompasses the 'I' rationality of self-interested utility maximising states and corporations, and 'we' rationality that focuses on cooperation and collective gains (Vatn 2008). Institutions are guided by different types of rationality, and whatever notion of rationality is internalised in an institution will shape the behaviour of those who work within it. As Elinor Ostrom (1990) shows, institutions can be designed that prevent commons tragedies, at least at the local level. But the modern corporation is the result of the progressive weakening of collective 'we' rationality and the strengthening of individualistic 'I' rationality, justified by the utilitarian/neoliberal theory that the common good is best realised by the interaction of buyers and sellers in 'free markets'.

To Vatn, therefore, the behaviour of corporations is in large part determined by the particular socio-historical context in which they operate. The voluntarism of CSR generates a free rider problem: businesses that do not sign up to CSR, or sign up but do not implement their commitments, avoid environmental costs that more principled businesses incur. A corporation motivated by a strong notion of 'we' rationality will inevitably suffer a comparative disadvantage relative to those governed by a ruthless and instrumentalist 'I' rationality. From this argument it follows that if the notion of rationality that governs corporations has evolved as it has due to changes within the socio-political environment that have led to neoliberalism, what is needed in order to promote corporate behaviour that serves the common good is a further shift in this broader environment.

This is what corporate accountability advocates. Proponents of corporate accountability seek to stipulate the duties and obligations of corporations, emphasise the answerability of corporations to stakeholders and publicly accountable authorities and reassert the role of public policy in governance (Clapp and Utting 2008; Pogutz 2008). The next section develops an original model for corporate accountability. Drawing from and building upon earlier work (Humphreys 2006) the model seeks to reconcile two pressing governance challenges: to uphold tough international standards that provide a framework within which corporations can compete fairly, while passing the final decisions on corporate activities back to local communities.

Towards the Democratic Regulation of Transnational Corporations

Local action can promote and enhance environmental, cultural, social and economic sustainability, but even the best local responses will ultimately fail if they take place within a neoliberal economic system that places the rights of investors above those of communities. To be effective, local responses need to be embedded within an international framework dedicated to the promotion and enhancement of life values (McMurtry 1999, 2003). The democratisation of globalisation and the democratisation of local spaces should thus be seen as symbiotic and mutually reinforcing processes.

Central to the model proposed in this section is the democratic regulation of the corporation. The social and environmental consequences of corporate practices should no longer be

subordinated to the quest for profit. The fiduciary duty of corporations to maximise shareholders' interests – a duty that from a legal standpoint currently trumps all moral and ethical considerations – should be replaced by an explicit legal responsibility for the corporation to act *pro bono publico* (for the public good). To infuse accountability into corporate practices, the notion should be revived that the right of the corporation to operate is conditional upon its satisfying public needs as stipulated in public charters. The final arbiters on the standards to which corporations should adhere should be local public bodies.

Under the Westphalian system of international law that has emerged over the last four centuries, states both make international law and are subject to it. However, the state is no longer the main international actor. A new corpus of international law is needed that regulates corporations rather than states. States, as the legitimate representatives of national publics in international politics, will negotiate this corpus of law, which will stipulate the standards to which corporations should adhere if they are to be permitted to trade and invest internationally. This new body of law should be agreed free of interference from corporations, which, as regulatees rather than regulators, would be denied access to the legislative process.

The first step would be the negotiation of a Convention on Transnational Corporations outlining the responsibilities and duties of corporations. This would set a raised plateau of tough obligations and standards for corporations. Whereas an individual state adopts a treaty by signing and ratifying it through its domestic legislature, a corporation would adopt the convention by endorsing it through its board of directors and shareholders' meetings. No corporation could trade or invest internationally without first adopting the convention. By doing so a corporation would recognise that its right to engage in transnational economic activity is conditional upon the observance of obligations to the global public. These obligations would, at a minimum, include commitments to uphold environmental quality, respect the precautionary principle, undertake environmental and social impact assessments, allow independent environmental and social auditing and respect community rights and traditions. A corporation endorsing the convention would receive an international charter permitting it to trade and invest across international borders. In terms both of intent and content, the convention would be the mirror opposite of the contemporary corpus of international trade law, which outlines investors' rights rather than duties.

To invest in a country, a corporation would then need to obtain a country-level charter from a public authority in the host country. This would stipulate the terms and standards that the corporation should observe. The granting or withholding of country-level charters would be a matter of public debate, with the final decision being made by the national government. The conditions stipulated in a country charter could be stronger, but not weaker, than those outlined in the convention. A corporation would need a charter from every country in which it operated. Inevitably the contents of charters would vary as different corporations would be admitted to different countries under different circumstances to meet different publicly-defined needs.

A corporation with a country-level charter would then be free to find a locality in which to invest. Publicly accountable groups at the sub-state level would have the right to determine which corporations invested in their space. The conditions would be stipulated in a local charter. The provisions contained in a local charter could strengthen, but not weaken, those laid out in the country-level charter. Actors at the sub-state level charged with upholding the public interest will come in many guises, reflecting the rich diversity of local cultures, economies and commons regimes that are to be found in most countries. They will include,

for example, democratically elected local councils and more traditional local community governance structures. Irrespective of the form of governance at the local level, a community or authority would be under no obligation to issue a charter if it did not consider this to be in the interests of its public.

The revitalisation of the charter as an instrument for accountability will stimulate citizen engagement and participatory democracy. Citizens' views would now count. Corporations would have to adjust to the needs of local communities rather than, as now, communities being forced to adjust to intrusions from big business playing by international trade rules. In a post-neoliberal world, a new mode of doing business would emerge based upon the needs of the local economy. This will benefit, for example, those communities that wish to conserve local fishing and forest resources and those that do not want large superstores or global brands disrupting the cultural distinctiveness of the local economy. If local communities exercise greater control over their economies then a greater share of the income from the local economy will flow to the local level where it can be used to fight poverty and social exclusion.

But the local level cannot entirely dominate. Global targets should be set on public good provision and international agreement would be needed on the responsibilities of individual countries with respect to global targets. Targets would be necessary on, for example, forest cover and greenhouse gas emissions. Multilevel coordination between the different layers of governance would be necessary to ensure that these targets were met. Within countries, coordination will be necessary between the state and sub-state authorities on the responsibilities that local spaces should make to public good provision.

Corporations adopting the Convention on Transnational Corporations would be obliged to ensure its implementation by all subsidiary companies and to undertake to trade only with businesses that respect and implement the convention. This would reinforce standards amongst market players. Standards adopted by one business would thus be passed along supply chains, which would act as transmission belts along which norms are passed and enforced. Insisting that a corporation know its supply chains is not unreasonable, but it would call for mandatory international certification schemes. Some reform of international financial markets would also be necessary, including a minimum period for holding shares. There is no public interest in share dealers buying shares and selling them at the click of a mouse a few minutes later to earn a profit. A minimum period of, say, five years would promote shareholder activism in corporate governance, encouraging shareholders to monitor corporate social and environmental performance and to invest only in reputable businesses.

If the courts were to find that the convention had been violated then a corporation would be liable to penalties, such as fines, suspension of the international charter or, in severe cases, the revocation of the international charter. Similarly, if a corporation breaks a national or local charter it would answer to national and local authorities, and may suffer financial penalties or the withdrawal of its charter. Where a corporation causes environmental damage due to unsustainable, unscrupulous or negligent practices, it should be required to make good (as far as possible) on the damage caused and pay a financial penalty. Should the corporation have insufficient funds to pay these costs, the courts should have the power to dissolve the corporation and seize its assets. Limited liability legislation should be repealed and the courts should have the power to seize the private assets of company directors.

Some might argue that this is draconian. In response three points should be made. First, in most countries the law can be used to pursue assets gained from illegal and immoral

activities, such as drug smuggling and prostitution. There is no reason to deal differently with those enrich themselves from the degradation or asset stripping of nature. Second, the principle of limited liability has enabled corporations to shift risks and costs from the corporation to society as a whole. The repeal of limited liability legislation will mean that those whose policies generate environmental and social externalities will be those who pay for them, thus providing a strong financial incentive for corporate policies to promote long-term sustainable practices. Third, financial penalties would co-opt the world's financial markets into promoting sustainability. Financial investors want profitable businesses. If knowledge emerged that a corporation had engaged in unsustainable practices that violated a charter, the result would be a fall in the value of the corporation's stock as the markets reacted to the possibility of heavy fines or the dissolution of the corporation. Financial investors would thus have an incentive to monitor corporate environmental practices. This would help to repair the problem of what Robert Nadeau (2003) has termed the absent feedback loop, whereby the depletion of natural capital simply does not register with corporations and international financial markets.

A further objection may be that international rules outlining the obligations of corporations are 'impractical'. Yet business leaders and their political allies have consistently pressed for strong international rules on neoliberal objectives, such as trade, investment and intellectual property rights. On what basis can it be claimed that international rules for sustainability and human rights are, in some way, impractical? It may also be claimed that a multilevel system of charters would be 'bureaucratic' and 'protectionist', both of which are pejorative terms for neoliberals. But if bureaucratisation is the price of accountability, then let these charges be made, as the social and environmental costs of allowing corporations to penetrate new spaces without effective public oversight have already proved too large. And it is hardly protectionist to point out that local and, sometimes national, businesses are at a significant disadvantage when competing with powerful transnational corporations. A nested system of public charters would help to equalise the huge power asymmetries between local communities and corporations. Indeed, on what basis would anyone seek to deny public authorities the right to decide which corporations can have access to their economies, and which should not?

It may also be claimed that if environmental and social standards are set 'too high' then corporations will stop investing in local communities. But given that a key driving force of environmental degradation is investment that is not constrained by strong safeguards, this argument should be dismissed. Irrespective of the regulatory environment, corporations will continue to search for investment opportunities. They will soon learn to adjust to the needs of local communities if the alternative is not to invest at all. With effective public safeguards in place, only environmentally and socially irresponsible investment will be blocked.

Finally, it may be argued that it is utopian, even naive, to argue that corporate-driven environmental degradation can be reversed using the same institutions – the state and intergovernmental organisations – that so far have failed. In response, it should be asked that if publicly accountable bodies, such as the state and intergovernmental organisations, are not going to represent the interests of citizens and promote public goods, then who, precisely, will do this? The problem is not so much with publicly accountable bodies, but with their penetration by corporate interests. The solution is to reform and strengthen public bodies rather than to submit to the neoliberal approach which, premised on the notion that a weakened state and ineffective intergovernmental regimes are 'inevitable' under globalisation, searches

for new forms of governance that hand more power to business, such as CSR. Far from being abandoned, public government and intergovernmental organisations should be reclaimed, revitalised and democratised.

Conclusions

Public authorities have both the right and the duty to govern business in the public interest, yet economic decision making is driven in large part by corporations whose sole duty is to serve private shareholders. This represents an unreconciled tension in global governance, one that often passes unrecognised. The model of corporate accountability proposed here seeks to reconcile this tension by establishing as paramount the shared public interest to which all other considerations, including shareholder value, should be firmly subordinated. It would reinvigorate the principle that corporations should be free to operate if, and only if, they provides benefits for the public good. It would render CSR obsolete, restore full political authority to a dynamic, inclusive and democratically accountable public domain and reconnect corporations to the communities within which they are embedded.

There will, admittedly, be huge costs to corporations if they are to adopt more sustainable and responsible practices. But the environmental and social costs that have arisen from predatory and exploitative corporate practices – including massive displacement of communities, species loss and climate change – have also been vast, although they have not always been accurately chronicled. Simply put, nature and communities are currently paying the costs of corporate enrichment. In any case, the governance reforms advocated here will be minimal and small scale compared to the massive interventions and curbs on corporate activity that will be necessary in, say, another half-century if global environmental degradation continues unchecked.

Under the system of nested and differentiated governance proposed here, countries and communities would not adopt identical rules, although they would adopt minimum rules. The system would promote universal values and standards while respecting and promoting the diversity and right to self-determination of countries and communities. It would seek to govern corporations in the interests of people and communities, at both the local and global levels. It would enable local spaces to sustain their cultural and social diversity while also providing a non-discriminatory framework within which corporations can compete in global markets. As such, the proposed model could provide an embryonic framework within which the interconnected fundamentals of environmental, social, cultural and economic sustainability can flourish and thrive. It is in this spirit, and in line with Said's entreaty to scholars to strive to speak on behalf of the public at large, that this proposal is offered for debate.

Note: The section 'Towards the democratic regulation of transnational corporations' draws from and builds upon work published in David Humphreys (2006) *Logjam: Deforestation and the Crisis of Global Governance*, London: Earthscan. The kind permission of Earthscan is acknowledged.

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About the Author

Dr. David Humphreys

David Humphreys specialises in global environmental governance with a particular interest in forests. His book *Logjam: Deforestation and the Crisis of Global Governance* won the International Studies Association's 2008 Harold and Margaret Sprout Awards for the best book on international environmental problems. He is interested in how neoliberalism establishes the parameters of international environmental policy and is currently researching the balance between public and private spheres in environmental governance and how business can be rendered publicly accountable. For the last three years his teaching work at the Open University, United Kingdom has focused on the production of a third level course, entitled *Earth in Crisis*, on environmental policy in an international context.

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