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Transnational Corporations and Global Governance

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Notes on Contributors	2
Editorial Introduction: Transnational Corporations and Global Governance David Louk and Urvashi Aneja	3
The New Alliance Between the Mob and Capital (and the State) Rodney Bruce Hall	11
The Big Five International Oil Companies as Responsible Stakeholders in the Global Economy Susan Ariel Aaronson and David Deese	27
Corporate-State Relations and the Paralysis of Accountability: A Case-Study of the Khulumani et al. v. Barclays et al. Lawsuit Janet A. Jobson	55
The Business of Transnational Climate Governance: Legitimate, Accountable, and Transparent? Philipp Pattberg and Okechukwu Enechi	76
Constituting Capitalism: Corporations, Law, and Private Transnational Governance A. Claire Cutler	99
The Global Financial Crisis and its Impact on Transnational Corporations An Interview with John Gapper of the <i>Financial Times</i>	116
Review, Response, and Rejoinder: McKinsey and Oxfam Reports on Social Responsibility and Shareholder Activism Daniel Hemel and Taylor St. John	122
Book Reviews	133

Notes on Contributors

Susan Ariel Aaronson is Associate Research Professor of International Affairs at The George Washington University, teaching in the Elliott School of International Affairs and the School of Business.

A. Claire Cutler is Professor of International Law and Relations in the Political Science Department at the University of Victoria.

David Deese teaches and researches the politics and institutions of international economic relations at Boston College.

Okechukwu Enechi is an advisor at Multibase Investment Limited, Abuja, Nigeria. He holds an MA in Diplomacy, Law and Global Change from Coventry University, UK.

John Gapper is associate editor and chief business commentator of the *Financial Times*.

Rodney Bruce Hall is University Lecturer in International Political Economy at St Cross College and Course Director of the MSc in Global Governance and Diplomacy in the Department of International Development, University of Oxford.

Daniel Hemel is an MPhil student in International Relations at the University of Oxford. His dissertation is on global financial regulation.

Janet A. Jobson is an MPhil student in Development Studies at the University of Oxford.

Philipp Pattberg is Senior Researcher and Project Leader at the Institute for Environmental Studies/Instituut voor Milieuvraagstukken (IVM), Vrije Universiteit, Amsterdam.

Taylor St. John is a DPhil student in Development Studies at the University of Oxford. Her dissertation is on international investment.

Editorial Introduction: Transnational Corporations and Global Governance

3

DAVID LOUK AND URVASHI ANEJA

In the past year, the unthinkable has happened: yesterday's record profit-making investment banks are today's bankruptcies and bank holding companies.¹ American International Group (AIG), prominent US and UK banks including Citigroup and Lloyds, US mortgage buyers Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), and car giants General Motors and Chrysler have all desperately sought refuge in government financial assistance. The term "too big to fail," which had largely fallen out of the public discourse,² has returned with new prominence as the inner workings of transnational corporations (TNCs) have been splattered across the front pages of major papers like the *The New York Times*, *The Wall Street Journal*, and the *Financial Times*.³ In short, since the *St Antony's International Review* (STAIR) circulated its call for papers for this issue, the place of TNCs in the landscape of global governance has arguably changed.

It is too early to know if these corporations' fall from grace is a temporary phenomenon or the beginning of a profound shift in how corporations are constituted, monitored, and regulated. Nevertheless, we can be sure that the tension between TNCs and states will remain long after the current financial crisis has abated. This ongoing dialectical relationship between corporations and states raises crucial questions concerning the power, authority, and legitimacy of TNCs as actors in global governance and participants in international affairs, concerns which are at the heart of this issue of STAIR. TNCs may currently be making major headlines, but important issues related to corporate social responsibility (CSR), regulation, and the appropriateness of corporate influence require further exploration. The contributors to this issue raise these questions and others concerning the relationship between TNCs and global governance. The authors reach beyond existing literature that defines this relationship and toward an examination of the theoretical and normative bases of firm-state relations and the consequent implications for questions of global order. As A. Claire Cutler reminds us in her article in this volume, "Constituting Capitalism: Corporations, Law, and

Private Transnational Governance,” corporate social responsibility, laws regulating corporations, and even responsible stakeholderism are not intrinsically and unqualifiedly “good.” They must be deconstructed and interrogated to determine what norms they codify and institutionalize; what frameworks they seek to uphold; and what principles they help to legitimize. Readers should be mindful of these questions while reading all of the articles in this volume.

Authority and Legitimacy

Within International Relations scholarship, power is conventionally understood in instrumental terms, as the ability of A to affect the behaviour of B.⁴ TNCs undoubtedly have such instrumental power, as seen during the financial crisis; for instance, AIG, the investment banks, General Motors, and Chrysler all lobbied heavily for support from the US government. However, TNCs not only have direct lobbying power with governments and global governance institutions, but they also enjoy diffuse power over other large constituency groups: shareholders, employees, and communities that benefit from the important positive externalities created by these corporations. As Rodney Bruce Hall explores in “The New Alliance Between the Mob and Capital (and the State),” perhaps the ultimate culpability for the irresponsibility that led to the bulge and then burst of the recent asset bubble lies with central banks and governments that placated their citizens with easy money and cheap credit.

However, Hall also draws attention to the power of mass democratic publics (“the mob”) in strengthening the hand of financial institutions (“capital”) by asking for more liquidity at the slightest hint of a downturn. The viciousness of the current recession, in Hall’s view, has possibly been made more severe by pressure from the likes of Federal Reserve Chairmen Alan Greenspan and Ben Bernanke and Bank of England Governor Mervyn King to prolong the good times indefinitely, as though the contraction portion of the business cycle could be avoided through an ever-expansionary monetary policy. Where these two forces—“the mob” and “capital”—have different needs but desire similar outcomes, they can exert exceedingly powerful pressure upon states to create palliative short-term solutions with the potential consequence of devastating long-term bubble bursts. Thus, even in instances where firms alone might not wield the necessary power to exert their preferences over government policy, their interests are often so intertwined with those

of mass publics—whether it be easy access to credit, lower taxes, or the maximization of short-term profits—that their *de facto* influence is much greater than generally assumed.

Hence, the increasingly important roles such corporations play as political actors suggest that we must interrogate their structural and normative power both as proxies for the exogenous demands of mass publics, and also as power-seeking actors in their own right. It is important to consider the role that TNCs play in agenda-framing and rule-setting and in influencing global norms and values, as well as the effect that emerging global agreements and norms have on the conduct of private actors.⁵ Philipp Pattberg and Okechukwu Enechi explore this issue through the lens of transnational climate governance in “The Business of Transnational Climate Governance: Legitimate, Accountable, and Transparent?” Examining the roles of TNCs, governments, inter-governmental organizations, and non-governmental organizations in climate governance arrangements, Pattberg and Enechi highlight the importance of democratic legitimacy, accountability, and transparency as central factors in the wider debate on global governance. They argue that decisions emerging from these agreements and schemes are intended to influence the behaviour of corporations, and that serious attention must be paid not just to output legitimacy but also to *input* legitimacy. Questions of legitimacy are addressed in the context of the inclusiveness and openness of these arrangements, their accountability and transparency mechanisms, and the discourse surrounding them, with a specific emphasis on three transnational climate governance arrangements: the Global Gas Flaring Reduction Partnership, the Carbon Disclosure Project, and the Chicago Climate Exchange. Crucially, the article highlights that a focus on the efficacy of such agreements is inadequate unless accompanied by a consideration of democratic and procedural legitimacy. At present, the agreements in question are found lacking in terms of input legitimacy. While the future is not all bleak—since these agreements are still at an early stage—they raise important questions about whether agreements that seek to move beyond the state are viable options for global governance.

Accountability and Responsibility

Discussions of the input legitimacy of private firms in global governance fora also raise challenging questions about how, and by whom, TNCs can and should be held accountable. This is often complicated by the

international scope of their activities and the varied national jurisdictions under which they operate. As Janet A. Jobson argues in “Corporate-State Relations and the Paralysis of Accountability: A Case-Study of the *Khulumani et al. v. Barclays et al. Lawsuit*,” TNCs exert tremendous economic power across borders. Yet, in the absence of a supranational authority to oversee and enforce compliance with both local and international laws, the accountability of transnational corporations for their behaviour often falls by the wayside. In the case of the *Khulumani* lawsuit, Jobson traces attempts by South African victims of the apartheid regime to use a US statute to bring corporations that aided and abetted the regime to trial in the US for the crimes committed by the regime.

Jobson contends that, in the absence of such supranational authority, the Alien Tort Claims Act (ATCA), which permits aliens to sue in US courts for violations of the law of nations, stands as a promising alternative mechanism for international corporate accountability. Nevertheless, as she discusses, the vehement opposition to the trial by both the US and South African governments suggests that states may prioritize the concerns of TNCs over those of their own citizens, particularly if the locus of authority rests in a foreign court. The ATCA not only complicates notions of authority but also of liability: the universal jurisdiction to prosecute the crimes of the accused corporations in the case of *Khulumani* rests on criminal, rather than civil liability. Yet the ATCA grants jurisdiction for aliens to file a tort claim, effectively adjudicating the question of criminal liability in a civil suit. Although courts are still resolving the applicability of the ATCA to hold corporations liable, it is perhaps ironic that the same broad economic power that permits TNCs to exert influence across borders may also be their Achilles’ heel that keeps them accountable to the civil societies in which they operate.

Intriguingly, a case can be made that in reference to TNCs accountability is but one piece of the larger puzzle of responsibility. In “The Big Five International Oil Companies as Responsible Stakeholders in the Global Economy,” Susan Ariel Aaronson and David Deese address the responsibilities of the “big five” international oil companies—ExxonMobil, ChevronTexaco, and ConocoPhillips from the United States, and BP and Royal Dutch Shell from the European Union—as stakeholders in relation to the issues of energy security, climate change, human rights, and corruption. Aaronson and Deese describe a much more complicated set of market and policy constraints for these large TNCs than is often perceived in lay reporting. For instance, the emergence of state-operated national oil companies (NOCs) as competitors to the “big five” presents challenges not only to these firms, which must compete with NOCs for access to precious oil reserves, but also to scholars, who

must determine the impact that state-operated TNCs have on notions of responsible stakeholderism. Aaronson and Deese's article raises an intriguing dilemma related to growing Western concerns about human rights in resource-rich countries such as Sudan: if Western governments prohibit their private firms from participating in resource extraction in these countries, the subsequent vacuum may often be filled by state-operated firms with much less concern about, or civil society pressure against, potential human rights violations. As the authors note, several of the state-operated NOCs are leaders in responsible stakeholderism. However, the experience with the Extractive Industries Transparency Initiative, while correctly highlighting the relative lack of transparency of many private transnational extractive corporations, also suggests that NOCs face significantly less pressure to be responsible stakeholders over these issues. The possibility that the presence of private TNCs may actually be beneficial to the promotion of liberal values, serving as platforms to export certain political and discursive preferences in often corrupt, resource-rich regimes, is particularly ironic, given the immense pressure these corporations face from Western civil society groups concerned with human rights and responsible stakeholderism.

“Good” Governance?

This irony about responsible stakeholderism raises a final important theme. We would be remiss if we neglected to note that global governance is itself a contentious term. While in a broad sense it suggests a multi-actor, multi-level, political decision-making process,⁶ some critics charge that global governance represents an institutionalization of the prevailing status quo informed by a “problem-solving” approach.⁷ Thus, even if TNCs can be made more accountable as global governance actors, one must also question the normative frameworks to which they are being held accountable. In other words, whose interests determine the “good” of “good governance”? Viewed through this lens, we must interrogate not just how TNCs influence global politics, but what kind of global politics they constitute. Claire Cutler's article adopts such a critical perspective by demonstrating that it is insufficient only to ask whether TNCs can be made more legitimate as global governance actors. In fact, such enquiries perhaps obscure the more fundamental issue—that mechanisms for regulating TNCs and increasing their legitimacy result in institutionalizing and legitimizing transnational capitalism itself. She suggests that students of TNCs, private authority, and global governance

should shift their focus away from the question of the effectiveness of self-regulation, and should instead consider the principles from which these rules are derived and the manner in which they constitute the normative and material features of transnational capitalism.

Moreover, while discussions about CSR seem to have acquired increasing prominence in both academic circles and among corporate executives, these discussions might represent a false promise of progress by imposing “soft duties” on corporations that, as a consequence, also legitimize and strengthen their “hard rights” as business actors. This point is driven home in the *Review, Response, and Rejoinder* between Taylor St. John and Daniel Hemel in “Deal or No Deal? Social Responsibility and Corporate Decision-Making.” St. John and Hemel wrestle with the notion of corporations as norm entrepreneurs, focusing on reports by McKinsey & Co. and Goldman Sachs that aim to measure how environmental, social, and governance norms change corporate practices. The more interesting questions, which the authors rightly identify as ripe for debate, are whether and how corporations not only serve as agents bound by these norms but also as participants in shaping normative and discursive structures. Indeed, these reports might serve to actualize the very reality they describe. Hemel and St. John’s other *Review, Response, and Rejoinder*, on “Bottom-Line Activism: A Review of Oxfam’s Better Returns for a Better World Project,” also problematizes the accountability of socially responsible investment practices, noting that the most effective ways for socially responsible investors to hold corporations accountable may result in the destruction of their own capital, making it much easier for corporations to take the lead on socially responsible activity only when it enhances (or at least does not grievously inhibit) profitability.

A Unique Opportunity

The “too big to fail” crisis that started in the summer of 2008 has laid the groundwork for a unique moment among stakeholders in global governance. Despite many TNCs’ global trade flows, headquarters, employees, and markets, most firms and subsidiaries still remain firmly attached to a particular state. Even as the financial crisis imperiled international banking and business operations, the solutions sought by individual corporations were decidedly domestic, as were the responses from government central banks and treasury departments. As John Gapper, associate editor and chief business commentator for the *Financial Times*, discusses in an interview with *STAIR*, in the fallout

from the global financial crisis we are likely to see a normative and discursive power shift away from TNCs and back toward states. In turn, Gapper predicts that states will be more likely to collaborate on the regulation and responsibility of corporations at the international level. Stricter regulation and oversight and increased scrutiny of transnational corporations' activities is almost guaranteed. It is worth noting that even among traditionally anti-government coalitions, the rhetoric has begun to shift from "death to big government"⁸ back to "long live the state."⁹ Is this really the correct response to the increased prominence of private authority—even if only in terms of informal influence—in global governance? What remains to be seen, and what the articles in this volume highlight and Cutler challenges us to consider, is whether global stakeholders, while rewriting the rules of global governance in the aftermath of the financial crisis, will take seriously the task of scrutinizing the principles and structures they seek to reform and the global order they hope to remake. ■

Notes

¹ Jenny Anderson, "Wall St. Bonuses: So Much Money, Too Few Ferraris," *The New York Times*, December 25, 2006, <http://www.nytimes.com/2006/12/25/business/25bonus.html>; FT Reporters, "Lehman Brothers files for bankruptcy," *Financial Times*, September 15, 2008, <http://www.ft.com/cms/s/0/52098fa2-82e3-11dd-907e-000077b07658.html> (both accessed February 17, 2009); "And then there were none: What the death of the investment bank means for Wall Street," *The Economist*, September 24, 2008.

² Until recently, the term has been reserved primarily for banking regulation scholarship. See Gary H. Stern and Ron J. Feldman, *Too Big to Fail: The Hazards of Bank Bailouts* (Washington, DC: Brookings Institution Press, 2004).

³ See William Poole, "Too Big To Fail, or to Survive," *The New York Times*, July 27, 2008, <http://www.nytimes.com/2008/07/27/opinion/27poole.html>; Peter S. Goodman, "Too Big To Fail?," *The New York Times*, July 20, 2008, <http://www.nytimes.com/2008/07/20/weekinreview/20goodman.html>; "Debt Lessons: Too Big to Fail," Heard on the Street, *The Wall Street Journal*, November 25, 2008, <http://online.wsj.com/article/SB122755502190153877.html>; Deborah Brewster and others, "'Too big to fail' but where does bank go from here?," *Financial Times*, November 25, 2009, <http://www.ft.com/cms/s/0/b3c1d236-ba92-11dd-aecd-0000779fd18c.html?ncllick=check=1> (all accessed February 10, 2009).

⁴ See Robert Dahl, *Who Governs? Power and Democracy in an American City* (New Haven, CT: Yale University Press, 1961).

⁵ See Doris Fuchs, *Business Power in Global Governance* (Boulder, CO: Lynne Rienner Publishers, 2007).

⁶ See Commission on Global Governance, *Our Global Neighborhood: The Report of the Commission on Global Governance* (Oxford: Oxford University Press, 1995).

⁷ Robert W. Cox, "Social Forces, States and World Orders: Beyond International Relations Theory," *Millennium* 10, no. 2 (1981): 126–55.

⁸ See Peter T. Kilborn, "Reagan Plan to Privatize Government Is Gaining Support From Democrats," *The New York Times*, February 15, 1988, <http://query.nytimes.com/gst/fullpage.html?res=940DE5D61F31F936A25751C0A96E948260> (accessed March 3, 2009).

⁹ See Krishna Guha and Edward Luce, "Greenspan backs bank nationalization," *Financial Times*, February 18, 2009, <http://www.ft.com/cms/s/0/e310cbf6-fd4e-11dd-a103-000077b07658.html> (accessed March 4, 2009); and Philip Rucker, "At Meeting, Governors Share Plans for Stimulus Funds," A2, *The Washington Post*, February 22, 2009.

The New Alliance Between the Mob and Capital (and the State)

11

RODNEY BRUCE HALL

ABSTRACT

Governance regulating and mitigating systemic risk in credit markets developed in a piecemeal fashion and has long been distributed among public and private actors. Reliance on these private governance structures, which in turn depends upon “market discipline” and the dispersion of risk among participants, has recently proved naïve and unable to manage systemic risk adequately. I employ the metaphor, with apologies to Hannah Arendt, of a “new alliance between the mob and capital (and the state)” in order to explain how private global governance of systemic financial risk went so wrong and created a global financial crisis with ruinous effects on the global real economy. Few parties are found blameless in this evaluation: the cupidity and stupidity of private financial actors in creating complex structured investment vehicles (SIVs) and Collateralized Debt Obligations (CDOs); the highly leveraged, yield-hungry global investors who bought them; and the inadequacy of state regulatory agencies in responding to this leverage have all contributed to this crisis.

In addition, the insistence by mass democratic publics that the state attempt to abolish the business cycle (through the constant application of Keynesian demand management) is also at fault, because it results in chronically asymmetric monetary policy. Credit is quickly and violently loosened at the hint of an economic downturn, but only belatedly and insufficiently tightened as asset bubbles build. This hyper-responsiveness of monetary institutions to public demands for loose credit conditions may lie at the heart of the waves of excessive credit creation that generate destructive asset bubbles. There were some proper public regulatory responses to the failures of private financial governance; there were also many instances in which public actors were incapable of acting as a firewall against the failures of private governance. Mass democratic publics have been handed precisely what they demanded from private and public financial actors, and may now be experiencing the consequences of waves of cheap credit and the long (though never indefinitely) deferred contraction in the cycle of expansion and contraction that characterizes the market economy.

This article adapts the title of a famous argument by Hannah Arendt regarding the sources of New Imperialism during the late nineteenth century as a reasonable metaphor to begin explaining the more recent tragedy of the global financial crisis, for which few parties may be held blameless. In her famous tome on *The Origins of Totalitarianism*,¹ Arendt paused to examine the puzzle of why the masses of Europe took part so

Rodney Bruce Hall, “The New Alliance Between the Mob and Capital (and the State),” *STAIR* 5, no. 1 (2009): 11–26.

enthusiastically in the imperialist venture in the periphery. She argued (incorrectly, I believe, since more often trade followed the flag than the converse during the imperialist venture) that the reason was that the imperialist venture was an “alliance between mob and capital ... [an] alliance between the much-too-rich and the much-too-poor.”² Arendt had argued that the New Imperialism of the nineteenth century was a product of:

... superfluous wealth ... [and] ... another by-product of capitalist production: the human debris that every crisis, following each period of industrial growth, eliminated permanently from producing society. Men who had become permanently idle were as superfluous to the community as the owners of superfluous wealth ... in the imperialist era ... these two superfluous forces ... joined hands and left the country together ... The owners of superfluous wealth were the only men who could use the superfluous men who came from the four corners of the earth. Together they established the first paradise of parasites whose lifeblood was gold.³

Our present global financial impasse saw no vast migration of the mob to militant mastery of peripheral peoples. Ironically, the events that have led us to our present unenviable predicament instead have relied rather heavily on the hard-earned savings of the peoples of the developing world to finance an extended consumer debauch in the developed world. It nonetheless relied on an alliance between the much-too-rich and the much-too-poor, with significant assistance from the democratic state; and it resulted, for a time, in yet another “paradise of parasites whose lifeblood was gold.”⁴ As the lifeblood of a global financial system that was predicated on massive and unlimited leverage now ebbs, it is essential that we pause and outline the failures of both public and private financial governance that permitted the recent financial debauch in the developed world to be set in motion, failed to avoid its occurrence, and failed to prevent its collapse.

Those hoping to read an excoriation of the profligate practices of Western financial institutions and the inadequacy of regulatory structures of private governance will not be disappointed. Cupidity and stupidity may be found in abundance in the most casual survey of the lending practices and proliferation of complex, opaque financial vehicles attending the massive leveraging up of the global financial system in recent years. It may be found in the predatory cupidity of mortgage brokers who doled out “ninja loans” (no income, no job, no assets) to those who had no chance of repaying. It may be found in the latter’s ignorance in signing contracts that they had no chance of honouring. It may be found in the fiduciary irresponsibility of bankers who sold

hopeless mortgage contracts on to investment bankers. It may be found in investment banks that pooled these mortgages and then separated them into tranches based on risk appetite, building products that required sophisticated computer models in order to value them (poorly). It may be found in the credit rating agencies that legitimated structured products by validating senior tranches with “AAA” ratings, even though many of the underlying assets were not even investment grade. It may be found in the banks, insurance companies, and investment funds that subsequently purchased these securities for their customers’ portfolios, and, on behalf of their fiduciary responsibilities to their customers, limited their efforts to an uncritical acceptance of the published credit ratings of these securities.

Yet the footprints of the governments of mass democratic publics may also be found running throughout this particularly unsavoury dish. They may be found in an asymmetric monetary policy whereby publics demand that their central banks loosen credit not only in economic recession, but even at the hint of a future recession, while forgiving them for declining to tighten credit adequately at the appearance of asset bubbles.⁵ Mass democratic publics enjoy the feeling of wealth and prosperity that is felt across (most) classes in an expansionary phase of economic activity fuelled by cheap credit. Cheap credit and loose monetary policy, and the often temporary stimulus they provide the economy, with attendant rising living standards, are politically quite popular with mass democratic publics. Subsequent downturns in economic activity, as the cycle of expanding credit reaches its limit within safe parameters, are deeply unpopular with mass democratic publics. A downturn creates demand from publics for policies that appease in the short term but add to the long-term store of fiscal problems.

Examples may be found in policies that encourage banks to lend to those who often cannot repay. They may be found in the creation of Government-Sponsored Enterprises like Fannie Mae and Freddie Mac in the United States, to guarantee these likely defaults with taxpayer credit. They may be found in the conscious creation of “light touch” financial supervisors such as the Financial Services Authority in the United Kingdom with a preference for “principles” vs. explicit “rules” to minimize the burden of intrusive regulatory structures on the City of London. They may also be found in the inadequate application of rule-based regulatory systems. Most recently, and only by example, the “Madoff” scandal had been brought to the attention of the US Securities and Exchange Commission (SEC) years before anyone became troubled to investigate it.⁶ The SEC’s rules also dramatically failed to prevent risky transactions, storing up for years the wave of risky debt securitized by

institutions whose regulation was within its remit. Examples are plentiful of politicians pandering to public demands in the democratic developed world for cheap credit in order to maintain lifestyles that shrinking real wages in the era of global wage competition can no longer provide.

Migration of Financial Crises: From “Crony Capitalism” to “Buddy Capitalism”

What a difference a decade makes! Just a short decade ago, the global economy was at risk of imploding due to financial crises in the developing world. Today, we find financial stress in the developed world in the form of the global credit crunch. What happened? How can the world lurch from one financial crisis originating in Bangkok, Jakarta, and Kuala Lumpur to another emerging in New York and London, separated by a scant decade?

After an unprecedented level of investment in East Asia in the 1990s, East Asian economies melted down rapidly following a botched devaluation of the Thai baht in July 1997. Suddenly, western investors demonstrated a crisis of confidence in East Asian economies and rapidly withdrew over \$100 billion in capital from the region. FOREX market actors bid down the Thai baht, the Korean won, the Indonesian rupiah, and the Malaysian ringgit to paltry levels, demolishing the balance sheets of East Asian firms that had borrowed in western currencies at short-term maturities to finance debt. Most East Asian nations were forced to go to the International Monetary Fund (IMF) for financial bailouts with stiff conditionality. The IMF imposed both orthodox stabilization and structural adjustment measures on East Asian nations in financial distress.

Orthodox stabilization measures—ostensibly designed to restore confidence in the currency and access to global capital markets—required Asian governments to hike domestic interest rates, raise taxes, and slash government spending. These measures severely deflated these economies, with serious regional and global effects. The structural adjustment measures required East Asian governments to restructure both their domestic economies and financial institutions in order to enhance financial oversight. They were sternly lectured on the consequences of the sins of “crony capitalism” (bank/firm/state co-operation) and required to restructure their domestic financial institutions to ensure exercise of due diligence in approving and apportioning domestic credit.⁷

A vast literature developed apportioning blame for the Asian Financial Crisis of 1997 and the years that followed. Much of this literature suggests that while the IMF might have been offering good advice to these developing countries—newly vulnerable to the effects of rapid global capital flows—they were badly advised by being pressed to open their capital markets to Western portfolio flows prior to developing a financial institutional infrastructure capable of ensuring that the investment capital was used productively. Debates sprang up over the question of how to develop a New International Financial Architecture (NIFA) that would dampen the volatility of global capital flows and arrest the periodic recurrent financial and banking crises inherent in an environment of global capital mobility.⁸

While the various positions on a NIFA have ranged from anti-globalizers to financial stabilizers, from transparency advocates to *laissez-faire* liberals, debate among policymakers (in the developed world) has largely narrowed to differences among the financial stabilizers and transparency advocates. Financial stabilizers argue that the current global financial system is inherently unstable. They argue that institutional fixes—such as a global lender of last resort or bankruptcy court, regional currency arrangements, or a tax on portfolio capital flows—must be developed. Transparency advocates argue that financial crises arise due to inadequate transparency. They argue that owing to “crony capitalism” and attendant inadequate banking and financial institutional regulation, risks are inadequately clear to investors. Greater financial transparency, coupled with adequate financial regulatory structures to limit risky financial behaviour among counterparties, has been their preferred solution,⁹ yet it appears this has not been accomplished even in the developed world.

Today, the global financial system is suffering a global credit crisis brought on by the highly risky financial behaviour of financial institutions in the developed rather than in the developing world. The preference of *laissez-faire* liberals for untrammelled capital flows and lightly-regulated global capital markets have thus far prevailed. Their calls for greater transparency and fiduciary scrutiny have gone unheeded—in the *developed* world. Recall the stern advice (nay, the stern commands) imposed upon East Asian nations a decade ago regarding the importance of institutional and regulatory structures of fiduciary surveillance and restraint. Is it not that what is good for the emerging market goose is also good for the mature market gander? What has happened in developed world markets to generate the current credit crisis? The short answers are monetary profligacy and regulatory laxity in the public sphere, and financial opacity and excessive leverage in the private sphere.

Developed world financiers have failed to exercise the due diligence in lending that they advised to East Asia a decade ago. They have not practiced what they preached. They have made hundreds of billions of dollars of very bad loans, particularly in residential housing and in the consumer credit market. These asset bubbles are now bursting globally with double-digit plunges in property values in the United States, Ireland, Spain, Australia, New Zealand, and Britain. Massive defaults and banking losses have followed and will continue to follow.

In contrast to the “global savings glut” to which Federal Chiefs Alan Greenspan and Ben Bernanke had attributed vast seas of cash, bidding up prices on a shrinking pool of global assets, we now find a “great unwinding”; it has become clear that the global financial system built up a “global *leverage* glut.” In the words of one London banker, “[W]hat we thought was a wall of liquidity, turned out to be a wall of leverage.”¹⁰

Some of these problems have arisen in the wake of the bursting of previous asset bubbles, most notably the Asian Crisis bubble economies of the 1990s and the “dot com” bubble in equities. Since the bursting of these asset bubbles, the world’s central banks, particularly the US Federal Reserve, the European Central Bank, the Bank of Japan, and the Bank of England have lowered interest rates and printed money to flood the global financial system with liquidity. This was to ensure that the global payments system did not seize up—as it is doing now even in the face of unprecedented efforts on behalf of central banks to provide nearly unlimited liquidity.

This excess liquidity has been chasing a limited pool of assets for what returns might be gleaned around the globe. Banks have loaned at historically low rates, and people have bid up property to absurd prices with cheap credit, denominated in *de facto* badly debased currencies. Creditors loaned to increasingly uncreditworthy borrowers and to those who overestimated the appreciation and rents they could glean from “buy-to-let” ventures. The ever innovative financial markets “securitized” these mortgages, packaging complex tranches of variable quality, but high yielding, mortgage debt into Collateralized Debt Obligations (CDOs). These securities were awarded AAA credit ratings by global credit rating agencies, who participated in the design of these securities. Irreverent *Barron’s Financial Weekly* editor Alan Abelson cheerfully noted the hypocrisy of Western criticisms of Asian “crony capitalism” by referring to these benighted practices as “buddy capitalism.”¹¹ These securities were purchased by yield-hungry investors of all types, including investment banks, insurance companies, and pension funds around the globe. Subsequent defaults from uncreditworthy borrowers are now sending shocking losses rippling through the financial system. The CDOs booked

as assets on the balance sheets of investing firms must be written down as losses.

Uncertain about the extent of unrevealed counterparty losses, banks have hoarded the liquidity made available to them by their central banks. LIBOR (British interbank) rates have at times risen to as high as seven per cent, with spreads between interbank rates and central bank lending rates up to hundreds of basis points—a certain sign that banks do not trust one another to repay what is lent between them. When banks will not even lend to one another without charging a very substantial risk premium, it signals a collapse of trust in the financial credibility of financial counterparties. Prior to the crisis, banks would loan to one another their “excess reserves” in the overnight market for seven or eight basis points above the central bank’s lending rate. Bank of England Governor Mervyn King proclaimed in a speech in Leeds in October 2008 that “[t]he age of innocence, when banks lent to each other unsecured for three months or longer at only a small premium to expected policy rates, will not quickly, if ever, return.”¹²

Central banks have stepped into the breach to provide liquidity, consistent with their lender-of-last-resort charters. However, as a consequence, financial systems have come to represent hub systems, with the central bank not only constituting the preferred counterparty of commercial banks anxious to avoid risk, but often representing the only counterparty.

Irrespective of the regulatory oversight of financial institutions provided by central banks (though in some countries such as the United Kingdom, financial regulatory authority resides in a separate Financial Services Authority), the financial system remains a confidence game. Confidence and trust are social institutions. Money is itself a social institution; it is a promise. A resurgence of headline inflation in the developed world is not unrelated to the current crisis. Since central banks execute their monetary policy through open market operations, authority is delegated to private actors (especially in the bond and FOREX markets) to adjudicate the value of the promise that money constitutes. In executing monetary policy through open market operations, central banks delegate authority to the bond markets to determine the risk premium appropriate to assess the quality of a sovereign’s promise that debt will be repaid, and that it will be repaid in money of equivalent value to the value at debt issue. Rather than setting exchange rates at a fixed par value dictated administratively by government policy and fiat, they delegate authority to FOREX markets to daily (and hourly) revalue the money they issue.¹³ These market actors appear at this writing to deem the credibility of the promise to avoid printing too much money

and guard against inflation from the ECB and (oddly, given the prospect of trillion dollar deficits for years to come) from the US Federal Reserve as superior to the promise from the Bank of England. The British economy is facing structural fiscal and current account deficits owing to a decade of loose fiscal policy in Britain, and the anticipated effects of a comparatively high reliance of the British economy and Treasury on revenues from a flagging financial services industry. Thus, the FOREX markets are bidding up the euro and the US dollar against the British pound.¹⁴

We live in a world in which a great deal of authority for monetary and financial governance lies in the hands of market actors, who adjudicate with their market bids the credibility of our financial institutions and policies. A decade ago, East Asia suffered the consequences of a loss of credibility to their financial system in the eyes of these market actors, these “private authorities.” We in the developed world are suffering those consequences now. When earlier asset bubbles burst, our central banks printed money to bail us out. The result was new asset bubbles. We purchased highly overpriced property, now plunging in value, with badly debased currencies, themselves currently plunging and exacerbating the loss of value in property. Now many of us will pay higher mortgage debt servicing costs on these devalued assets in order to help self-mutilating banks recapitalize. Perhaps our governments could help our financial institutions properly define “due diligence in lending?” We might practice the discipline that we preached to East Asia. We are not, however, for three predominant reasons. All of these reasons involve misconceptions regarding the nature of the manner in which market rationality functions in the financial system. One of these misconceptions is the assumption that financial markets behave in accordance with the Efficient Markets Hypothesis of neoclassical economics. Another misconception was the assumption that market actors are in possession of adequate information and market-structured incentives to avoid excessive financial risk to their own balance sheets. The third was that structured finance would spread default risk to those most capable of bearing it, in a fashion that would adequately dilute the losses attending default by spreading it around numerous market actors to avoid systemic risk to the broader financial system. All of these assumptions proved false, and we are now bearing the consequences of our misconceptions about how basic processes of market rationality actually operate.

The Efficient Markets Hypothesis and the Financial Instability Thesis

19

Much of the difficulty in which we presently find ourselves may be traced to the belief by actors in the financial markets, and by central bankers with supervisory responsibility for the financial system, that financial markets behave in accordance with the Efficient Markets Hypothesis of neoclassical economics. According to this hypothesis, markets always clear at the “equilibrium price,” which represents the normal optimal state. The prices of commodities and assets are, always and everywhere, the “correct” price that constitutes an equilibrium between demand and supply. A continuous stream of new information regarding changing supply and demand functions govern price movements of these commodities and assets, and only an “external shock” will move asset prices away from the equilibrium clearing price that is the “correct” price determined by perfect information about supply of, and demand for, the commodity of asset in the marketplace.

With few perturbations, we see this thesis function for most commodities, particularly for consumables. However, in his classic text from which students of microeconomics normally learn the Efficient Markets Hypothesis, economist Paul Samuelson throws us a bit of a curve by asserting that “what is true of the markets for consumer goods is also true of markets for factors of production, such as land, labour, and capital inputs.”¹⁵ However, Karl Polanyi had referred to precisely these commodities, which Samuelson calls “factors of production,” as “fictitious commodities” which have to be commodified (somewhat artificially, given that two of them are found in nature) as a precondition for the creation of a “market society,” in which all social relations were subordinated to economic relations.

As Polanyi had been at pains to explain, markets and regulation grew up together. The idea of self-regulating markets was a complete reversal of historical arrangements, whereby economic relations had normally been subordinated to other forms of social relations. The foundational assumption underlying an economic system controlled, regulated, and directed by markets alone is the expectation that human beings behave to maximize monetary gains. Such a system requires that production is controlled by prices in this market economy, as is the distribution of goods. This requires that all production is for sale on the market, and that there must also be markets for land, labour, and money. A market society requires that all things must be commodified, including nature (Samuelson’s “factors of production”). So they were, from the enclosure

of the commons onward: the prices of land, labour, and money are now called rent, wages, and interest.¹⁶ In Polanyi's view, land, labour, and money, as factors of industry, must be commodified in a market economy (a view Samuelson seems to share). However, they are obviously not commodities. The notion essential to a market economy that anything that is bought and sold must have been produced for sale is clearly not true with respect to these "fictitious commodities," as labour is simply another name for human activity, land is another name for nature, and money is a social institution.¹⁷ This commodity fiction is, however, indispensable for the functioning of a market economy; land, labour, and money must be traded and exchanged as commodities, just like consumables, in order for a market economy to function in a "self-regulating" fashion.

We can see that there is no place for asset price bubbles in efficient, self-regulating markets. However, Samuelson did not demonstrate that what is true of markets for consumables, in which supply and prices respond to demand signals, is also true of "factors of production." In fact, "frequently in asset markets, demand does not stimulate supply, rather a lack of supply stimulates demand."¹⁸ It is precisely the "scarcity value" of Polanyi's "fictitious commodities" and Samuelson's "factors of production," and the occasions on which supply cannot be increased sufficiently to meet demand, particularly of "land" and "money" (property and financial assets), that make these assets desirable as investments. It is the expectation that scarcity will induce higher bids in the future for the same scarce assets that induce speculative market bids for them. So long as market actors believe that future prices for these assets can consequently only rise, and never fall, they have an inducement to bid up the prices of these assets into destructive asset bubbles.

Economist Hyman Minsky developed this observation into a Financial Instability Hypothesis, arguing that financial markets (markets for "assets" such as "land" [property] and "money" [shares and bonds]) do not return to equilibria governed by supply and demand functions. Instead, the internal dynamics of these markets generate waves of credit expansion and asset inflation, followed by rapid credit contraction and asset deflation.¹⁹ The problem for financial stability with asset bubbles that develop in these markets is precisely that the strictures of the Efficient Markets Hypothesis are flouted by market participants bidding on assets. The matter is put well in a recent, highly accessible explanation of the origins of financial crises by George Cooper:

The critical difference between markets for goods and those for assets is how the markets respond to shifting prices, or equivalently shifting demand. In the

market for goods, higher (lower) prices trigger lower (higher) demand; in the asset market higher (lower) prices trigger higher (lower) demand. One market is a stable, equilibrium seeking system and the other habitually prone to boom-bust cycles, with no equilibrium state ... In goods markets items are purchased for consumption; in asset markets items are purchased for their potential to change price; making the nature of how the markets participants respond to price changes fundamentally different.²⁰

Minsky's Financial Instability Thesis, of course, flies in the face of the Efficient Market Hypothesis and the orthodox expectations of market actors that there is a "Mr. Market," whose cumulative wisdom always gets prices right. Even former Federal Reserve Chairman Alan Greenspan, famous for his devotion to the free market ideology of Ayn Rand as a solution to the problem of regulating market behaviour, has recently admitted in a testimony before the US Congress that he "made a mistake in presuming that the self-interest of organizations, specifically banks and others, was such that they were best capable of protecting their own shareholders."²¹ In admitting this, Greenspan articulates the second misconception regarding the nature of market rationality that engendered the current crisis—the notion that market self-discipline will avoid excessive financial risk. He also points toward the fact that central bankers are loath to accept responsibility for identifying and pricking asset bubbles into their charters, preferring instead to focus on conducting monetary policy with an eye toward either assuring price stability or stimulating economic growth when threatened with a recession. However, there is some evidence that the US Federal Reserve may be willing to reconsider its long held assertions that it should not attempt to prick asset bubbles with monetary policy, or include their identification in the charter of the central bank.²²

It is important that they reconsider this assertion. Precisely because central banks in the era of fiat monies have taken up their Keynesian task of demand management with such alacrity, they have been an important source of excessive liquidity and—more importantly—excessive credit creation in the post-war economy since the collapse of the Bretton Woods Gold-Exchange Standard in 1971. Since central banks have been keen to intervene to supply liquidity not only in the event of an economic downturn, which is consistent with the recommendations of Keynesian demand management,²³ but also at the prospect of a recession, these banks have generated the expectation among the public and in the banking and financial system that the central bank may be relied upon to generate liquidity to the financial system whenever a downturn in the credit cycle looms. Never mind the fact that Keynes developed this demand management task of the central banks in direct contravention to

the strictures of the Efficient Market Hypothesis that otherwise captivates so many neoclassically-trained central bankers. Alan Greenspan, though Ayn Rand's devotee, never disappointed this expectation and chronically tipped his hat toward Keynes; thus, the market aphorism of the "Greenspan put" developed to indicate the market's expectation that Greenspan could be expected to cut interest rates, thereby boosting liquidity and credit, whenever the financial markets took a significant tumble. Only recently have central banks begun to consider measures to dampen asset markets that appear "frothy."²⁴

The central bank, however, not only creates money for the commercial banking system when it loosens monetary policy, but also makes it possible for the commercial banking system to extend credit to borrowers. Precisely because "credit is money too,"²⁵ endogenously supplied to the economy by the commercial banking system rather than exogenously supplied by the central bank, additional credit/money is injected into the economy at precisely the time that "demand" for credit should be falling in response to extant high levels of debt in the real economy. This creates pernicious incentives in the banking system to extend credit imprudently and encourages risky lending practices among financial institutions loath to eschew new opportunities for profit and market share relative to their competitors.

In addition to the (potentially false) security of deposit insurance, the lender of last resort function of the central bank only adds to the moral hazard if financial institutions develop severe liquidity or even solvency problems. The roots of this moral hazard may be located in the loosening of central bank credit during an economic downturn, when debt levels in the real economy are already substantial. In this environment, financial institutions who behave responsibly and exercise their due diligence in lending, and their fiduciary responsibility to their shareholders, find themselves at a commercial disadvantage with respect to more cavalier rivals. Cooper, following Minsky, argues that "over time this will lead to bad lending practice forcing out good lending practices ... a race to the bottom with all banks incentivized to take on more risk than their competitors."²⁶ Students of monetary economics will recognize this as a variant of Gresham's Law, whereby "bad money drives out good."

The “Self-Regulating Market” Thesis: Failures of Market Discipline and Private Governance to Combat Systemic Risk

23

These observations lead us quickly to an understanding of how our “wave of leverage” developed. When we couple these waves of credit creation (and subsequent contraction, which may not be invariably deferred) with the effects of securitization in an environment where faith in the “self-regulating market,” “market discipline,” and “private governance” of financial institutions holds sway, the basic structural outlines of the alliance between the mob, capital, and the state become clear. The “mob” is the public, anxious to draw upon credit to maintain high levels of consumption. Capital is represented both by financial professionals across the financial system, incentivized to maximize returns and persuaded by the moral hazard built into an asymmetric monetary policy weighed in favour of Keynesian demand management of the low costs of failure, and by faith in “market discipline” that the systemic risk of quite risky financial behaviour is rather low. The state panders to the mob and capital alike, with loose regulatory structures and a proclivity toward asymmetric monetary policy in favour of demand management. No state has ever pressured a central bank to raise interest rates and tighten credit. While states have granted independence to central banks, ostensibly precisely to avoid the inflationary effects and asset bubbles that attend asymmetric monetary policy in favour of demand management, it is difficult to find evidence that independent central banks have in any event avoided the asymmetry. The current “great unravelling” of a great “wall of leverage” built up over a couple of decades of asymmetric monetary policy in favour of looser credit rather suggests that the obverse trend has prevailed.

Securitization was initially developed as a means to permit firms (and governments) with higher levels of creditworthiness to access capital markets to meet their borrowing needs at lower costs than those who are less creditworthy. Intermediated lending by banks (as intermediaries between savers and borrowers) was replaced with non-intermediated lending, whereby firms (as well as governments and municipalities) approached investment houses who underwrote the debt and issued it as bonds for sale to bond market participants, whose bids (reflecting the risk premiums they would charge) largely determined the ultimate cost of capital to borrowers.²⁷ This worked well in that the cost of capital to creditworthy borrowers was lowered, and the financial risk of default was ostensibly born by those who could afford the risk. Ultimately, it

permitted the wave of leverage building over decades of asymmetric monetary policy to be granted the status of a high grade security, rather than an atrocious, obvious risk of default.

The Credit Rating Agencies (CRAs—the US-based duopoly of Moody's and Standard and Poor's, recently joined by Fitch's, the subsidiary of the French headquartered firm Fimalac, SA) were assigned the task of grading that risk. This system was the private sector solution to monitoring the risk of insolvency.²⁸ Coupled with standards setting fora in international organizations such as the International Organization of Securities Commissions, the Basel Committee on Banking Supervision—which has set capital adequacy and liquidity requirements for financial institutions and discusses supervisory control assessments of banking systems and controls and risk management structures—, and the Financial Stability Forum developed as an informal forum for cross-border regulatory issues. This system of publicly recognized, private creditworthiness assessments provided by the CRAs was largely expected to provide the information and transparency required to permit private market actors to employ market discipline to safeguard against systemic financial risk. The creation of complex Structured Investment Vehicles and CDOs, backed in many instances by “subprime” mortgages (securities tranches supported by the mortgage income streams of borrowers of variable creditworthiness), was supposed to tranche out the riskiest levels of debt securities at highest risk of default to those most able to afford the risk.

Unfortunately, these tranches were rated very highly by the CRAs, who helped to design them. Tranches rated “AAA” by the ratings agencies should have been highly unlikely to default, and protected by lower-rated tranches below them, which would be expected to suffer higher rates of default. The assumption that the prices of the homes underlying the higher rated tranches would not fall, however, proved baseless. Financial officers of commercial banks, investment banks, pension funds, and insurance companies around the globe took the ratings provided by the CRAs at face value and, lacking the capability to assess the risk themselves, excused themselves from their fiduciary responsibilities to engage in due diligence in assessing the level of risk of the securities they were purchasing for their portfolios. As a consequence, the financially toxic “chickens” of a multi-decade alliance between the mob, capital, and the state, to mask from themselves and others from the result of a fiscal, financial, and consumer debauch of epic proportions—financed in its last decade largely from high rates of consumer saving in Asia—have come home to roost on the balance sheets of Western banks, pension funds, and insurance companies.

The wall of liquidity in which we had believed has been revealed to be a wall of leverage. Excess leverage has cascaded over the structure of our financial system, which has been shaken to its core. The consequences for the real economy will be prolonged and painful. The national and transnational regulatory fixes now being designed to avoid a recurrence of the current crisis must dismantle the destructive alliance between the mob, capital, and the state, while avoiding the regulatory excesses that would undermine the wealth-generating effects of capitalist industry, trade, and financial innovation, which are, it must be noted, not necessarily characterized by the destructive excesses of the former “alliance.” We must also task our central banks to work self-consciously to develop fully symmetric monetary policy, one that is as quick to dampen excessive credit creation as to stimulate demand in a downturn. ■

Notes

¹ Hannah Arendt, *The Origins of Totalitarianism* (New York: Harcourt, Brace and Co., 1951).

² Carleton J.H. Hayes, *A Generation of Materialism, 1871-1900* (New York: Harper & Brothers, 1941), 216.

³ Arendt, *Origins of Totalitarianism*, 147–51.

⁴ Ibid., 151.

⁵ An asymmetric monetary policy is biased towards quick and violent loosening of monetary policy (cutting rates) during a contraction phase of the economy and a weak and delayed tightening of monetary policy (rising rates) during an economic expansion.

⁶ Joanna Chung, “Regulators condemned over Madoff,” *Financial Times*, January 27, 2009.

⁷ Rodney Bruce Hall, “The Discursive Demolition of the Asian Development Model,” *International Studies Quarterly* 47, no. 1 (2003): 71–99.

⁸ See, for instance, Joseph Stiglitz, “Must Financial Crises Be This Frequent and This Painful?,” *Policy Options*, July–August 1999, <http://www.irpp.org/po/archive/jul99/stiglitz.pdf> (accessed March 1, 2009); Michel Camdessus, “The IMF at the Beginning of the Twenty-First Century: Can We Establish a Humanized Globalization?,” *Global Governance* 7, no. 4 (2001): 363–70; Barry Eichengreen, *Capital Flows and Crises* (Cambridge, MA: MIT Press, 2003).

⁹ Leslie Elliott Armijo, “The Political Geography of World Financial Reform: Who Wants What and Why?,” *Global Governance* 7, no. 4 (2001): 379–96.

¹⁰ Paul J. Davies, “Insight: Traversing the Wall of Leverage,” *Financial Times*, October 2, 2008.

- ¹¹ Alan Abelson, "Buddy Capitalism," *Barron's Financial Weekly*, October 22, 2007.
- ¹² Speech by Mervyn King, Governor of the Bank of England, on October 21, 2008, <http://www.bankofengland.co.uk/publications/speeches/2008/speech362.pdf> (accessed March 1, 2009).
- ¹³ Rodney Bruce Hall, *Central Banking as Global Governance: Constructing Financial Credibility* (Cambridge: Cambridge University Press, 2008).
- ¹⁴ It is worth noting that the dollar's strength might be due to a "flight to safety," as the value of other financial assets has collapsed, though many analysts posit a new bubble in the Treasury bond market. Should it collapse, US rates will have to rise, to attract buyers of US T-bills, or the exchange rate will fall.
- ¹⁵ Paul A. Samuelson, *Economics: An Introductory Analysis*, 4th ed. (New York: McGraw Hill, 1958), 39.
- ¹⁶ See Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press, 1944), chap. 6.
- ¹⁷ John R. Searle, "What is an Institution?," *Journal of Institutional Economics* 1, no. 1 (2005): 1–22.
- ¹⁸ George Cooper, *The Origin of Financial Crises: Central Banks, Credit Bubbles and the Efficient Market Fallacy* (Petersfield: Harriman House, 2008), 8.
- ¹⁹ See, for instance, Hyman P. Minsky, *Stabilizing and Unstable Economy: A Twenty-First Century Fund Report* (New Haven: Yale University Press, 1986); and Hyman P. Minsky, "The Financial Instability Hypothesis," The Jerome Levy Economics Institute Working Paper No. 74, May 1992, available at <http://ssrn.com/abstract=161024> (accessed March 1, 2009).
- ²⁰ Cooper, *Origin of Financial Crises*, 101.
- ²¹ Alan Beattie and James Politi, "'I Made a Mistake,' Admits Greenspan," *Financial Times*, October 23, 2008.
- ²² Justin Lahart, "Fed Rethinks Stance on Popping Bubbles," *The Wall Street Journal*, October 17, 2008.
- ²³ John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (New York and London: Harcourt, 1964), 251–52.
- ²⁴ See, e.g., John Gieve, Deputy Governor of the Bank of England, "Learning from the Financial Crisis," Address to the European Business School London, November 19, 2008, <http://www.bankofengland.co.uk/publications/speeches/2008/speech367.pdf> (accessed March 1, 2009).
- ²⁵ Hall, *Central Banking as Global Governance*, 26–30.
- ²⁶ Cooper, *Origin of Financial Crises*, 60.
- ²⁷ Timothy J. Sinclair, *The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthiness* (Ithaca, NY: Cornell University Press, 2005).
- ²⁸ Howard Davies and David Green, *Global Financial Regulation: An Essential Guide* (Cambridge: Polity Press, 2008).

The Big Five International Oil Companies as Responsible Stakeholders in the Global Economy

27

SUSAN ARIEL AARONSON AND DAVID DEESE

ABSTRACT

The Big Five Oil Companies—ExxonMobil, ChevronTexaco, ConocoPhillips, BP, and Royal Dutch Shell—are among the world's most influential and profitable companies. This article explores the extent to which these companies act as "responsible stakeholders," seeking to understand how the big five international oil companies approach, incorporate, and interact with global norms related to responsible behaviour, while also dealing with rapidly changing energy markets. However, the big five have to deal with conflicting pressures: on the one hand, they are under legal obligation to enhance shareholder value; on the other hand, they must address issues of human rights, climate change, and transparency and accountability. The tension between these competing pressures is compounded by the fact that the countries with the most abundant extractive resources are often those with ineffective or corrupt governments. Nevertheless, the big five also have substantial influence as some of the largest investors in these countries. Accordingly, while they are obligated to respect host government sovereignty, they are under increasing pressure to change the behaviour of their host governments. The extent to which the big five can act as responsible stakeholders is questionable, as the concept of responsibility in this context is ill-defined, and while these firms have adopted a number of CSR policies, most of them are ad-hoc, voluntary, and limited. While we hope that the big five will invest in alternative energies and take human right and climate change issues more seriously, this "responsible" future looks doubtful.

For much of the twentieth century, the oil majors—the world's largest private oil companies—roamed the earth in search of energy to fuel the world's development. Some nine years into the twenty-first century, these corporate giants (ExxonMobil, ChevronTexaco, and ConocoPhillips from the US, and BP and Royal Dutch Shell from the European Union [EU]) still appear supreme. In recent years, their profits have grown to record levels.¹ However, the big five are not invincible. Although these firms remain among the world's most influential and most profitable companies, they operate in an increasingly complex and volatile environment where government interests loom large. The big five not only compete with national oil companies (NOCs) such as Petrobras (Brazil), Statoil (Norway), and PetroChina and Sinopec (China), but

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must also maintain good relations with the governments of states that control most of the oil and gas reserves worldwide.² On their own, the big five oil companies have relatively few fields where they can exploit their economic efficiencies and technological prowess.

The NOCs play a vital role in global energy development because they represent the top ten oil reserve holders internationally and control some seventy-seven per cent of total world oil reserves.³ More than half of the top fifty producers are majority state-owned; twenty-three have their headquarters in developing countries; twelve in south-east Europe and the Commonwealth of Independent States; and the remaining fifteen in developed countries. Many developing country oil exporters have used relatively high profits to control their reserves. Although world oil prices have declined from their peak in July 2008, these firms have retained tight control of oil output. For example, some oil-rich nations such as Saudi Arabia, Iraq, Iran, Kuwait, and Mexico do not allow the international oil companies to own wholly components of oil fields and infrastructure. Other countries, such as Venezuela and Russia, are restricting private sector access to their fields.⁴

The national oil companies and the big five private firms are managed differently. The big five are managed in accordance with market principles. They must enhance shareholder value and invest to meet shareholder timelines. Many, but not all, of the national oil companies are managed to meet political as well as economic goals. These goals can include distributing wealth, maintaining energy security, achieving foreign policy aims, providing training, and creating jobs.⁵ Moreover, many, but not all, of the largest national oil companies, such as Aramco and Petroleos de Venezuela, operate in countries which are members of the Organization of the Petroleum Exporting Countries, the global oil cartel. These national oil firms can co-ordinate to maximize profits and prices when it serves their interests, an option not available to private firms under national and international competition policies.⁶ Some of these NOCs are affiliated with governments that at times ignore international norms relating to the protection of the environment or respect for human rights. Thus, many of these state-owned NOCs are not under the same pressures from stakeholders to act responsibly in global markets.

We were asked by the Stanley Foundation in the US to examine whether or not the big five oil companies act as responsible stakeholders in the global economy. The term “responsible stakeholder” was first used by World Bank President Robert M. Zoellick. During his tenure at the US Department of State, he noted that official US policy encouraged China to become a responsible stakeholder that would work with the

United States and others to sustain, adapt, and advance the peaceful international system that has enabled its success.”⁷ Thus, in this essay, we discuss how the big five international oil companies approach, incorporate, and interact with global norms for responsible behaviour while simultaneously dealing with rapidly changing energy markets. These firms must consistently manage their operations to maximize shareholder value. However, at the same time, they must also consider the longer term interests of the world’s peoples regarding issues such as energy security, climate change, alternative energy, human rights, transparency, and accountability.

We make no claim that this survey of five oil companies is a representative sample of oil firms more generally. We do not compare the big five with the NOCs in any formal way, in recognition that these firms differ substantially in regulatory and political contexts, corporate governance, fiscal regimes, and degree of commercialization.⁸ Moreover, in general, the NOCs are much less international than their private sector competitors. While the top three private producers operated in several countries, none of the top three state-owned producers had significant foreign production in 2005. However, that statistic is changing rapidly. The United Nations Conference on Trade and Development (UNCTAD) reports that, by 2005, three Chinese oil and gas firms ranked in the top fifty non-financial transnational corporations in terms of their foreign assets.⁹ More specifically, for example, China National Petroleum Corporation (CNPC) dominates the oil sector in Sudan and Chinese firms also have several major investments in Nigeria and Angola.¹⁰

Although corporations are global market actors, international law generally applies to states, not to non-state actors. We believe that it is not possible to evaluate companies as responsible stakeholders in the same way that governments are evaluated. Companies are very different to states, and cannot be held to the same standards. Where managers have control, such as when an issue arises that affects their operations, companies can more easily conform to emerging international norms. But in other instances, as with climate change or national development policy, companies often have limited leverage to shape emerging norms. In such cases, we discuss whether they use their influence appropriately, if at all.

Although we cannot firmly define “responsible stakeholdership” for the big five, we can delineate some broad parameters for such behaviour. We believe that responsible private oil companies would benefit from providing affordable, plentiful access to various energy sources. They should also invest in alternative energies as part of plans for future energy sources when the supply of oil becomes limited. In addition, these

firms should strive to act responsibly in countries where governance of the environment, markets, and human rights is inadequate. Finally, managers of these firms should develop policies and monitor their firm's behaviour to ensure that they are not complicit with human rights abuses or damaging the environment. These managers should also work to ensure that their activities are not built on conflict or corruption.

In general, corporations do not have specific responsibilities under international law. Nonetheless, private firms do have some international responsibilities. As Georgetown Law Professor Carlos Manuel Vazquez has noted, corporations are artificial groups of natural persons. Just as individuals have some responsibilities under international law, so do corporations acting as conglomerations of individuals.¹¹ Corporations are not responding passively to this lack of clear standards; instead they are trying to shape such standards by active involvement in international organizations such as the International Labour Organization, the United Nations Environment Programme, the United Nations Development Programme, and the Organisation for Economic Co-operation and Development (OECD). In other instances, firms have lobbied at both the national and international levels to clarify their responsibilities. Some oil companies, for example, have sponsored research or developed joint projects with international organizations, governments, and non-governmental organizations (NGOs) to address issues such as poverty, corruption, and sustainability.¹²

Although international law does not clearly delineate corporate norms, responsible stakeholderism is a term that comes from corporate governance scholarship. These scholars recognized that firms are increasingly expected not only to meet shareholder demands, but also to meet the needs of their many stakeholders: employees, suppliers, consumers, NGOs, and so forth, who can affect a firm's long-term success. But companies are not required by law to meet the needs of their stakeholders; instead, they are managed to enhance shareholder value. Thus, firms strive to meet quarterly earning objectives.¹³ Moreover, managers confront a world where these norms for corporate behaviour are not only ill-defined, but often contradictory. For example, US oil companies are forbidden by US law to invest in nations such as Iran and Sudan, which are perceived by the United States (and many other governments) as rogue states. If these firms were to invest in such countries, policymakers from their home countries might have more economic leverage to change the behaviour of these outlier states. Yet, these firms could also be accused of propping up illicit or illegitimate regimes. The big five are under increasing public pressure to drill for more oil offshore, but that same drilling could undermine the environment

and the health of the seas. How should companies respond to these competing pressures? Managers have no road map to help balance these multiple issues.

Finally, all companies juggle to meet both their shareholder obligations and their stakeholder responsibilities. There is not a single set model for responsible stakeholder practice in the oil industry or the business community in general, although there are overlapping or common responsible practices required in some areas. But it is particularly difficult for extractive industry firms to balance these obligations and responsibilities for a number of reasons.

First, extractive industry firms must go where the extractive resources are located. As the supply of energy has declined and the costs of extraction have increased in the West, managers of these firms have increasingly sourced oil from countries where governance is weak, corruption is endemic, and the production costs arguably lower. Second, oil and gas production, like other extractive industries, is capital-intensive. Extractive firms must make large investments long before they begin to produce oil or oil products. These firms are especially vulnerable to political, legal and social risks, and in particular, corruption, given the huge sums involved. Finally, oil and gas producers are often the largest investors in such countries and therefore may hold substantial influence over the government. Although these firms are obligated to respect host government sovereignty, these firms are under mounting pressure to use their influence to change the behaviour of host governments.¹⁴ However, because of that same clout, oil and gas investors could crowd out the voice of other market and political actors. Yet these same oil and gas companies are increasingly under shareholder and stakeholder pressure to act in a responsible manner. What is entailed by “responsible”, however, remains unclear.

Energy and Security: Ensuring an Adequate and Sustainable Supply of Energy to Meet Societal Needs

Although energy policy is national, energy security is in fact a global public good. Energy security can be defined as having an adequate and sustainable supply of energy to meet the needs of citizens, commercial interests, and public sector functions. Energy security in any one country is a function of global energy security. Most states are determined to achieve energy security—a major foreign policy challenge for all governments.¹⁵

The link between energy and security is a complex calculation of the “vulnerability” of any specific individual, country, or set of countries to serious social, economic, political, or military disruption stemming from change in one or more dimensions of energy supply—including its price, availability, or geopolitical effects. A country might be only moderately dependent on any one exporter, but low levels of available stockpiles or storage of that fuel and rigidity in the market might make that country quite vulnerable. Since oil and natural gas markets are generally international, or at least regional, in nature, national and international vulnerabilities often can only be reduced by sets of governments and firms working in collaboration. Given the constant barrage of events that can influence market conditions, corporate and government leaders share a collective interest in effectively monitoring and managing supply.

A wide range of public and private, national and international actors collaborate to provide the world with energy. As they drill, these actors must also protect the physical flow of oil or natural gas from the producing field to the consumer. Friendly and hostile governments as well as business competitors must work together. Such collaboration is threatened by a wide range of political and market factors including price volatility.

The big five international oil companies sit in the middle of this quest to balance energy and security. They must find ways to profit between energy-exporting states keen to maximize prices and limit supply, and importing countries determined to maximize supply and limit price volatility. The International Energy Agency has estimated that massive new investments will be needed to develop and deliver energy to the world’s people.¹⁶ Current supplies are not meeting increases in demand. Thus, responsible stakeholders should invest heavily not only in new oil fields, but in energy efficiency and alternative energy sources as well.

But the big five energy companies have generally cut spending levels in real terms over the past ten years and reinvested in their own stock.¹⁷ Moreover, the huge mergers in the industry have not channeled the resulting lower costs toward exploration efficiencies. As a result, Baker Institute scholars Amy Myers Jaffe and Ronald Soligo conclude that these firms are unable to respond flexibly to market conditions.¹⁸ While buying back stock may well be in the short-term interest of shareholders, it is not in the long-term interest of energy consumers—i.e., global stakeholders. Thus, we believe that these firms have not acted as responsible stakeholders in regards to ensuring long-term energy security. Moreover, we do not find that they are acting responsibly toward their shareholders. According to Jaffe, “If a company is not replacing reserves, and they are spending their case to buy back shares, that is called liquidating the

company.”¹⁹ By their failure to invest early and sufficiently, many people are vulnerable to damaging price spikes, higher long-term prices, and possible supply disruptions from natural disasters, political upheaval, and/or terrorism.

Many of the world largest suppliers—with the prominent exceptions of the US, Canada, Britain, and Norway—experience significant political instability and/or policy uncertainty. As outlined in Table I below, almost seventy per cent of United States imported oil comes from Saudi Arabia, Venezuela, Nigeria, Algeria, Angola, Iraq, and Russia.²⁰ Each of these countries has a low ranking in terms of their democratic political institutions and a high risk of political, economic, and policy instability. The United States provides a good example of the repercussions of continued reliance on such states for oil and gas supplies. From 2002 to 2007, in fact, the US has become increasingly reliant on oil from fragile states such as Nigeria, Iraq, and Angola. The single largest absolute increase in exports to the US over this period was from Nigeria, which is among the very least stable and transparent states in the world.

Table I examines America’s leading sources of petroleum, the political stability of these sources, and their commitment to democratic and accountable governance. (All of these suppliers except Canada are relatively unstable, and all except Canada and Mexico rank low on scales of democracy and good governance.)

As energy companies, both private and state-owned, pursue energy security by drilling for oil in developing countries, they have poured their investments into countries that are also extremely vulnerable to political risk. For example, among 177 states in 2008, Sudan ranked second on the Failed State Index, Chad ranked fourth, the Democratic Republic of Congo sixth, Democratic Republic of Timor-Leste twenty-fifth, and Kyrgyzstan thirty-ninth. Many of these new energy suppliers have not effectively utilized the revenues to improve public welfare, diversify their economy, or develop sustainable democratic systems. While not all such countries are failed states, they are “fragile states” that are not well governed.²⁵ Many of these states suffer from the “resource curse”: they are not able to use their abundant resources to achieve both sustainable development and equitable economic growth. When firms decide whether to invest in these countries, they must weigh the world’s growing thirst for oil with a concern that governments might misuse oil rents.²⁶

Table 1: US Petroleum Imports, Political Stability, and State Efficacy by Source Country

Country	Rank in 2007	2002 ²¹ (1,000s of barrels)	2007 (1,000s of barrels)	Per cent change 2002-2007	Political Stability 2006 ²² (per cent)	Failed States Index ²³ 2008*	Economist Democracy Index 2006** ²⁴
Canada	1	1,864	2,243	20	80	167 of 177	9
Saudi Arabia	2	1,551	1,487	-4	26	84	159
Venezuela	3	1,387	1,336	-4	12	79	93
Mexico	4	1,292	1,258	-3	35	105	53
Nigeria	5	620	1,131	82	4	18	124
Algeria	6	264	663	151	20	80	132
Angola	7	332	507	53	27	56	151
Iraq	8	459	485	6	1	5	112
Russia	9		412	412	23	72	102
Ecuador	10	102	182	78	19	68	92

The table examines America's leading sources of petroleum, their political stability, and their commitment to democratic accountable governance. All of these suppliers except Canada are relatively unstable, and all except Canada and Mexico rank low on scales of democracy and good governance.

* Lower rank is less stable

** Lower rank is more democratic

Oil and gas firms can play a positive role in helping the world reduce its carbon footprint. The big five are responsible for much of the world's energy investment. Their investment choices could both promote energy efficiency and jumpstart the use of alternative energy sources such as batteries and wind power. Yet in general, executives at these companies continue to see their future in oil, and they seem to view alternative energy as a hedge against depleting hydrocarbon supplies. Moreover, the big five have significant political influence in both the developing and industrialized world. However, until recently, they had not used their money or clout to help bring about greater environmental sustainability. The European firms moved more rapidly than firms in the United States. The big five in general have been less responsible to the challenge of climate change than firms from (most) other sectors. For example, a 2006 study by the Investor Responsibility Research Center evaluated the performance of corporate executives and boards in establishing governance systems to address climate change. The results compiled scores in the areas of: board oversight, corporate management, public disclosure, emissions accounting, and strategic planning. According to the study's criteria, the oil and gas sector has performed below most industrial sectors, including the chemical and electrical industries (see Table 2).²⁷

None of the American companies have distinguished themselves in their response to climate change. European corporations BP and Shell began to address climate change issues in the late 1990s. By 2001, BP achieved its initial goal to reduce its operational greenhouse emissions to ten per cent below the 1990 levels. Shell's long-term target is to hold emissions from its facilities to at least five per cent below the 1990 levels through 2010. In contrast, ChevronTexaco did not set goals for reducing its gas emissions and enhancing its energy efficiency until 2004. ConocoPhillips was the first US oil company to join the US Climate Action Partnership of large firms, and its CEO, J. J. Mulva, has consistently spoken out in favour of a strong, mandatory national program to reduce emissions. But ExxonMobil, the largest, most profitable US oil firm, remains intransigent. ExxonMobil has resisted pressure to set targets for specific emission levels.²⁸

ExxonMobil focuses on increased efficiency at its refineries and chemical plants and reports a thirty-five per cent reduction in energy and CO₂ intensity rates of production from 1973 to 2005. In 2004–2005, ChevronTexaco and ConocoPhillips committed to invest at least \$100 million a year in renewable and clean energy projects. However,

committing to invest is not the same as investing. Chevron is spending about \$800 million per year on what it calls alternative energy, but most of that supports their large scale generation of geothermal power.

Table 2: Average Industry Scores

Industry	Total points (maximum 100)
Chemicals	52
Electricity	49
Autos	48
Equipment	42
Mining	42
Forests	38
Oil & Gas	35
Coal	21
Food	18
Airlines	17

Chevron is also investing in a large scale biodiesel plant in Texas, and they have set up a subsidiary to invest in energy technologies; however, they have not delineated their support for “alternative energies.” In 2006, ConocoPhillips spent \$80 million on alternative energy research and development, including oil sands. It expects to spend \$150 million for research on non-conventional oil and gas resources and new energy sources in 2008.²⁹ However, neither ChevronTexaco nor ConocoPhillips reported any specific energy efficiency targets. Major European oil companies not only moved earlier to address climate change, but they also invested more in alternative energy. In fact, BP acted at significant risk: it decided to remake itself as an energy company, stating that its initials stood for “beyond petroleum.” The company took a relatively early position in support of addressing climate change and, in 1997, began to reduce its own greenhouse gas emissions.³⁰ In 2005, BP established an alternative energy business unit and announced that it would invest \$8 billion over ten years in alternative energy by solar, wind, natural gas, and hydrogen. By 2007, it was investing almost \$1 billion per year in the development of renewable energy sources. In 2000, Shell committed to investing \$1 billion on alternative energy. Today, it is the largest

distributor of bio-fuels and it has hydrogen stations in five countries. The US companies are now playing catch-up.

Why were US firms slow to move on climate change? Managers at some of these firms not only rejected the concept of “climate change,” but also blocked policies that could have facilitated both adjustment and investment in alternative energy. In addition, these firms collaborated with government officials to thwart both international initiatives, such as the Kyoto Protocol, and domestic policy development. The George W. Bush administration was sympathetic to this perspective: it rejected the Kyoto Protocol as too costly and based on unproven science. In fact, the Bush Jr. administration rejected any approach with binding targets. Several senators put forward less stringent approaches, but none passed Congress between 2000 and 2006. Finally, in 2007, Congress passed the Energy Independence and Security Act of 2007, which was signed by President George W. Bush. It raised fuel economy requirements, provided incentives for bio-fuel development and usage, enhanced efficiency standards for buildings, lighting and appliances, and accelerated research and development of solar, geothermal, and marine energy. However, this bill did not end tax breaks for oil and gas exploration in the US.³¹ Late in 2008, Congress also extended the incentives for energy efficiency and renewable energy that were set to expire at the end of the year.

The EU policy environment, in contrast, helped business do a better job of responding to climate change. The EU Emissions Trading Scheme established a cap and trade system within which participants can trade emission permits. This policy has encouraged all firms to reduce emissions as part of their regular business operations, while removing much of the concern about a loss of competitive positioning to firms not participating. In addition, European governments have developed innovative strategies to encourage and stabilize investment in renewable energy. The feed-in tariffs (or set prices over time) for electricity produced from renewables implemented by Germany and Spain are crucial examples of leadership for sustainability. In the United States, a number of states have developed “renewable portfolio standards” in order to ensure that a specified percentage of electricity is produced with renewable energy. Until recently, the US federal government has been invisible in this policy area, leaving oil and gas firms on their own. However, the new administration of President Barack Obama has directed the relevant agencies to develop regulation and incentives both to reduce auto emissions and to require new vehicles to be more fuel-efficient.³²

In sum, compared to the big three US firms, the two European firms have been early actors on climate change and energy efficiency. But they also benefited from a proactive and responsive regulatory environment. The big three US firms, in contrast, arrived late to the party. However, the Obama administration is determined to reverse this slow start. The big three US oil companies will therefore have to rethink their political and investment strategies or risk hostility among key congressional leaders and committees, and executive branch officials.

Promoting Human Rights

In recent years, many oil companies have struggled to ensure that their operations do not undermine the human rights of host country citizens, particularly in nations with weak and corrupt governance. The connection between oil companies and human rights abuses first drew major international attention in 1995 when nine Nigerian activists, including the writer Ken Saro Wiwa, a leader of the Ogoni tribe, were executed by the authorities for protesting Shell's exploitation of his homeland. The Ogoni activists were calling for self-determination for their small ethnic group in the impoverished oil-producing region. They accused Shell of colluding with the military to control the land and its people and the oil revenues. In response to the execution of the activists and the arrest and torture of hundreds of other Ogoni, some other states adopted sanctions against Nigeria, which included suspension from the British Commonwealth.

Shell and the other oil companies operating in the region (including Chevron, Mobil, Elf, and Agip) were widely criticized for their stance of non-interference, which some individuals interpreted as tacit support for the Nigerian regime. In the years since, these firms have dramatically changed how they operate in the region, but the local populace believes these firms perpetuate poverty by continued collusion with corrupt officials at the provincial and federal levels. Despite significant changes made by the Nigerian government to achieve greater democratization and transparency, the companies are still subject to frequent protests, work stoppages, and animosity in the Niger Delta.³³

Other companies have encountered similar problems in other resource-rich developing countries, including Chevron in Ecuador, Unocal (now Chevron) in Burma, and ExxonMobil in Indonesia. ExxonMobil and Unocal have actually been compelled to defend their international human rights practices in courts of law. Some activists have argued that

in countries where human rights abuses are so egregious, the energy firm must withdraw (as the Canadian firm Talisman did from Sudan). But a withdrawal is not necessarily good for the local population in such countries: many workers and associated businesses will lose jobs and income, and the energy company will relinquish financial and political leverage to influence the government to act responsibly. Clearly, then, there is no one right strategy for oil companies confronted with these dilemmas.

In response to this quandary, the US and UK governments collaborated on a plan to help companies deal with some of the human rights issues related to their operations. The “Voluntary Principles on Security and Human Rights” are a set of guidelines adopted by governments, extractive companies, and human rights NGOs. The Voluntary Principles provide practical guidelines for ways in which companies can protect the safety and security of their operations, while respecting the human rights of people in surrounding communities. All of the big five international oil companies claim to follow the Voluntary Principles.³⁴

The Voluntary Principles do not cover other human rights issues such as corruption (a key obstacle the poor confront in trying to influence government and receive services); employment equity, resettlement of indigenous populations from mining areas, or the role that resource income plays in fomenting local conflict. A 2008 study prepared for the UN Special Representative on Business and Human Rights found that extractive industry firms are subject to more allegations of human rights abuses than other sectors, though it should be noted that allegations are not facts.³⁵ A 2006 study of the Fortune Global 500 firms found that the sixty-nine per cent of extractive industry respondents (this percentage was larger than other sectors) had experience dealing with at least one significant instance of human rights abuse. Such experience had taught these firms to adopt “an explicit set of principles and/or management practices to address the human rights implications of its operations.”³⁶

Yet, despite their efforts to adopt such codes and human rights strategies, oil company managers clearly struggle to incorporate human rights into their day-to-day activities at the local level.³⁷ Fundamentally, protecting human rights is not really a business problem—it is a problem of inadequate governance at the global and national levels. Nevertheless, the human rights responsibilities of corporations are not clearly delineated in international law. The Universal Declaration of Human Rights calls on all organs of society, whether civic groups, corporations, or governments, to protect and promote human rights. Executives, however, are unsure which human rights they should recognize and how they must act to ensure respect for those rights. Moreover, while some companies hold

their suppliers to human rights standards, many others do not. Finally, companies do not know how to monitor their human rights performance and have little incentive to do so—firms are rarely praised for positive steps, but consistently condemned for shortcomings.³⁸

In recognition that global business (and the global community broadly) need greater clarification of the human rights responsibilities of business, former UN Secretary-General Kofi Annan appointed in 2005 Harvard Professor John Ruggie as his Special Representative on the issue of human rights and transnational corporations. In April 2008, Ruggie put forward a framework to “anchor the business and human rights debate and guide all relevant actors.” The framework, which was approved by the member states of the UN Human Rights Council, highlights the responsibilities of states to protect against human rights abuses by third parties, including business, the corporate responsibility to respect human rights, and the need for more effective access to remedies.³⁹ Many business groups have responded positively to the UN Special Representative’s framework, but it remains to be seen whether they will make associated changes in behaviour and whether the markets will reward such actions. It is also unclear whether oil companies can effectively meet these evolving human rights norms at the same time that they struggle to meet shareholder and stakeholder demands regarding profits, investment, and sustainability.

The Resource Curse, Transparency, and Accountability

Oil companies may not be able to choose the countries where oil and gas are plentiful. However, they can work with policymakers, the public, and NOCs in such countries to reduce corruption and, in particular, to thwart a phenomenon economists call the “resource curse.” The resource curse is not inevitably the fruit of resource abundance: several countries including Botswana, Chile, and Malaysia have avoided this problem as they developed.⁴⁰ However, it is a function of weak governance. Many resource-rich developing countries lack the governance expertise to translate energy income into sustainable development and economic diversification. Policymakers may allocate resources to the energy sector and may pay little attention to other sectors of the economy. Without investment in sectors such as agriculture, manufacturing, or education, the economy will remain overly dependent on extractives for growth and development.⁴¹

This dependence on resources can undermine democracy. Although citizens “own” the natural resources of their country, policymakers often control natural resource wealth without the direct assent of citizens. In many cases, the citizens may not be aware of sales or have the political rights and expertise to challenge such sales in political and economic arenas.⁴² In most cases where governments rely heavily on revenue generation from the energy sector, citizens either are not taxed or they are taxed unevenly or ineffectively. Citizens have little information about state activities and this makes it difficult for them to press for public sector accountability. Finally, even as public expectations rise along with increased export revenues, citizens lack the mechanisms to hold their officials accountable and the information required for them to understand how increased revenues are allocated. This process can also hinder the development of governance expertise and legitimacy. As rulers funnel oil and gas revenue to their families, tribes, sects, or political allies, these elites may make it harder for citizens and civil service officials to influence government.⁴³ Citizens’ resentment and bitterness over the lack of social and economic progress in the midst of sharply-increased extractive revenues may lead citizens to use violence to achieve their goals. Rebel groups may oppose a government’s policies and corruption, yet such groups may also fund their operations through illegal trade in extractive commodities such as oil, diamonds, gold, or coltan.⁴⁴ Meanwhile, governments may rely on repression to stay in power and spend significant amounts of their Gross National Product on military expenditures.

Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative (EITI) is a response to the resource curse initiated by the British government in 2003 to help resource-rich developing countries manage extractive industry revenues more effectively. Since its inception, the EITI has become the most widely used and internationally accepted strategy to promote accountability and transparency in resource-rich countries. The EITI is supported by the members of the G8 and other countries, such as Australia. It is now managed by the government of Norway and has its headquarters in Oslo.

The resource-rich countries that adopt the EITI are supposed to take a number of specific actions. First, these governments require extractive firms operating within their territory to “publish what they

pay” for the right to explore and extract energy or minerals. Second, government officials must record the revenues they receive and entrust an independent administrator to compare extractive sales and revenues. Finally, governments are supposed to create a multi-stakeholder group which includes representatives of civil society. The multi-stakeholder group is tasked with evaluating the information provided by business and government and reviewing the independent evaluation. With this information, citizens can hold their government accountable for the management of resources (EITI: 2008). Over time, the EITI could have additional governance benefits. Citizens and policymakers alike will learn how their government performs on specific revenue collection, management, and data analysis tasks. Citizens could learn how to influence government, and policymakers could learn how to listen to citizen concerns.

Although the EITI is a process designed for the people, it is not always designed by the people. Citizens and civil society groups are the key to the EITI success, but not all governments let civil society fully participate in the process. Moreover, although some twenty-four countries (fifty per cent of all resource-rich developing countries) have committed to the EITI and taken many of these steps, as of December 2008,⁴⁵ no country has taken all of these steps.⁴⁶ As a result, the EITI is a work in progress.

The EITI is not intended to be a panacea for the resource curse. First, it does not address the fiscal system, where taxes can provide policymakers with the information they need about the sectors in which the economy is growing. Second, the EITI process does not delineate how civil society can take the discussion beyond extractive industry spending toward general budget spending, despite the fact that this budget is the principal policy document and instrument for distributing resources. The EITI cannot ensure that governments will use the revenues from their resource rents to diversify their economies, save for future generations, or guard against inefficiency.

The EITI does, however, provide a tool with which extractive executives can work with citizens to foster a more accountable system of governance. Both citizens in these countries and shareholders of extractive industry firms benefit from governance that is transparent, accountable, equitable, and efficient. Both want to avoid corruption: citizens want to avoid corruption because it makes it difficult for citizens to influence government, it can exacerbate poverty and inequality, and it can lead governments to ignore the needs of their citizens. Corporations want to avoid corruption because it increases many types of risks to the firm’s short- and long-term management.

The EITI's requirements of companies operating in countries that have chosen to implement the EITI are not stringent.⁴⁷ Such companies are simply required to disclose all material payments to the government, provide a clear endorsement of the EITI on their website, and fill out an international level self-assessment (company form), which the EITI posts on its website. As of June 2008, some thirty-seven firms, including several NOCs as well as many of the major extractive industry associations, have agreed to support the EITI. The supporters include firms from South Africa, Brazil, Mexico, and Argentina as well as all of the big five; yet only eighteen of the thirty-seven supporting firms had filled out a company self-assessment form. All of the oil majors had completed this form except for ConocoPhillips. That form affirmed whether: the company has published a public statement endorsing EITI; it has provided links to any validations of its payments; someone at the company was responsible for EITI; the company had attended an EITI conference; and the company discussed the EITI in its corporate social responsibility (CSR) or global sustainability reports.⁴⁸

These firms appear ambivalent about the EITI. Growing evidence suggests that firms are not sufficiently and consistently supporting either the EITI or disclosure as a means of preventing the resource curse in the countries where they operate. First, while some thirty-eight companies now say that they support the EITI this is still a relatively small number of oil and gas firms, as noted by UNCTAD.⁴⁹ Second, although the EITI is a relatively new initiative, governments are not doing their part to ensure that civil society can fully participate. In a survey conducted by the authors of fourteen of the thirty-eight firms supporting the EITI, seventy-one per cent of those responding (or ten companies) said they did business in countries where civil society was arrested or hampered from participating.⁵⁰ Some firms stated that they did push the EITI in specific countries. For example, ExxonMobil has worked to build knowledge of the EITI in Equatorial Guinea. BP played a similar role in Azerbaijan.⁵¹ In general, however, these firms did not use their influence to press governments to adopt the EITI or to ensure effective civil society participation—the heart of the EITI.

NGOs have done two analyses of extractive industry disclosure. In 2005, Save the Children UK examined corporate practice on disclosure of extractive industry royalty payments (the NGO did not aim to assess their commitment to EITI more broadly). The resulting study found that few companies were fully disclosing their upstream (exploration, development, and production) oil and gas operations. The researchers covered twenty-five companies with operations in Azerbaijan and Nigeria, among the first EITI countries, and then non-EITI nations

Angola, Democratic Republic of Timor-Leste, Indonesia, and Venezuela, during the calendar year 2004. EITI does not require supporting companies to disclose payments globally or to specify on a country-by-country basis except in EITI candidate countries. The researchers assessed whether firms were providing transparency on payments; disclosing additional supportive information; and disclosing information about anti-corruption and whistle-blowing policies.⁵²

The researchers found that twenty-three of the twenty-five companies provided little information at all. Two Canadian companies stood apart as exemplary: Talisman and TransAtlantic.⁵³ The biggest US and European oil companies showed much worse results. Of the big five, Shell was ranked highest, closely followed by ChevronTexaco, BP, and ExxonMobil. The worst performers were Total of France, Lukoil of Russia, and Petro China (partly state-owned), and state-owned energy companies CNPC and Petronas (Malaysia). These companies disclosed none of their revenue payments, provided little in supportive disclosure, and reported nothing related to anti-corruption and whistle-blowing activities.⁵⁴

Two years later, companies were doing more to disclose their payments in resource-rich countries, but such disclosure was still inadequate. In 2008, the NGO Transparency International examined forty-two companies operating in twenty-one countries.⁵⁵ The group found more companies were reporting systemically on a country-by-country basis. Their analysis included only one of the big five and two very large national oil companies. The exemplars on transparency payments to host governments, termed “proactive disclosers,” included Nexen (Canada), Petro Canada, Shell (Netherlands), Statoil (Norway), Talisman (Canada), and Petrobras (Brazil). Transparency International, however, found wide differences among what companies disclosed, even between different companies in the same countries. To some degree, this makes sense, reflecting specific contracts. Yet, in general they found that state-owned oil companies were less likely to report than international oil companies, unless the latter were listed on stock exchanges (i.e., with some degree of public ownership).

Clearly, the EITI is helping to change the behaviour of some oil industry firms, some of the time. But these companies do not disclose all such payments all of the time, and often do not provide useful data for all countries. Moreover, there is growing pressure both in the EU and the US to mandate disclosure as part of reforms to corporate governance rules. On November 14, 2007, the European Parliament called for a new international accounting standard requiring oil, gas and mining companies to report critical financial information, such as payments to

governments, on a country-by-country basis.⁵⁶ On May 15, 2008, US House Financial Services Committee Chairman Barney Frank introduced the Extractive Industries Transparency Disclosure (EITD) Act, which requires companies to report their country-by-country payments for oil, gas and minerals to the Securities and Exchange Commission (SEC). Senator Charles Schumer introduced companion legislation in the Senate. Although the bill grew to include over thirty co-sponsors,⁵⁷ it was cleared at the end of the 110th session of Congress.

We presume that these firms do not want to see disclosure mandated in the United States and the EU, since such mandates would only cover publicly traded firms and compliance is expensive. But a broad mandate could become the industry standard and gradually change global business practices, as in the case of the Foreign Corrupt Practices Act of the United States, which eventually inspired an international agreement, the OECD Anti-Bribery Convention.⁵⁸ Yet the question remains: given their economic interest in reducing corruption, why are companies not doing more? Executives offer several arguments. Some maintain that transparency demands placed upon them are unfair because many NOCs such as China National Petroleum are not subject to similar expectations. Yet many other firms are partly state-owned and are publicly listed. These firms are also subject to pressure to act against corruption. Moreover, some state owned firms are paragons of reporting, such as Brazil's Petrobras. Companies also complain that it is difficult to report these royalties because the accounting community has not yet agreed upon international accounting standards. However, the International Accounting Standards Board has developed such standards and is now soliciting public comments. These standards are also being reworked to align with the International Financial Reporting Standards and Generally Accepted Accounting Principles. Some companies have suggested that reporting on a country level is cost-prohibitive because of associated higher auditing fees. However, this is all the more reason for these firms to be supportive of the EITI. As noted above, the EITI does not actually require its supporting firms to disclose all their operations everywhere.

Conclusion

This article discussed whether or not the big five international oil companies act as responsible stakeholders in the global economy. We began by noting that all firms struggle to act responsibly, but that oil

and gas companies have special responsibilities. They have to go where the oil is: often, they operate in developing countries where governance may be weak, corrupt, or dictatorial. Moreover, these firms are often the largest private investors in these countries. Thus, executives from these firms may have excessive influence over local firms, the citizenry, and the government. In addition, because of the high costs of exploration and mining, these firms often bear extreme financial and political risk.

But these same firms are often subject to strong pressures from shareholders and stakeholders in the industrialized world. On one hand, their shareholders insist that these firms maximize shareholder value on a quarterly basis. Executives must show rising profits and control costs. On the other hand, stakeholders in the industrialized world (including a rising number of shareholders) are also demanding that these firms respect human rights, act in a transparent and accountable manner, protect the environment, and invest in alternative energy. Thus, the big five oil companies must somehow juggle an increasingly complex plethora of occasionally conflicting and expensive demands.

We then focused on the behaviour of these firms as relating to four key challenges: ensuring energy security, addressing climate change, respecting human rights, and attempting to reduce and avoid corruption. Today, these firms are increasingly embracing variants of CSR. They have developed industry- and firm-specific codes of conduct or CSR strategies to guide their operations. However, because these *ad hoc* strategies are voluntary and limited, these firms do not appear to be consistently responsible. Moreover, all five firms tended to develop policies as a defence when faced with embarrassing revelations about their behaviour. They rarely embraced sustainability or accountability because they believed in their inherent worth.

BP and Shell tended to act sooner to adopt new policies in these areas than their American peers. We do not attribute this difference between US and EU firms strictly to better management. In part, it reflects the fact that NGOs in Europe have been active and influential. They have played a major role in changing public and policymaker expectations of the European oil majors. In addition, US shareholders have retained relentless pressure on maximizing profits and shareholder value. Most importantly, officials from the Bush administration were much less supportive of global approaches to climate change policies or human rights norms when compared to their European counterparts.⁵⁹ However, the new Obama administration is clearly demanding that these firms act differently regarding climate change and alternative energy. They are also likely to face greater pressure to protect human rights. Moreover, the Senate Foreign Relations Committee has become increasingly interested

in resource curse issues and initiatives under the leadership of Senators John Kerry and Richard Lugar.

In recent years, policymakers and NGOs have put forward initiatives such as the EITI and the Voluntary Principles to help these companies ensure that their operations do not prop up repressive regimes and undermine human rights, perpetuate corruption and poverty, and fuel conflict. However, while BP and Shell have made significant progress in implementing these voluntary initiatives, the American oil and gas majors appear less committed.

The big five increasingly compete with state-owned firms and they have argued that these firms are not subject to similar stakeholder pressure. However, that allegation is not completely true. As we note, some state-owned firms have varied degrees of private ownership, while others have not escaped NGO criticism. In fact, some state-owned firms, such as Petrobras of Brazil and Statoil of Norway, have become leaders in transparency and human rights respectively.

We believe that the big five will increasingly embrace voluntary initiatives or else they may find their markets increasingly circumscribed by mandates. However, such steps could be too little, too late. As we noted above, they have built their future on oil and gas. However, oil and gas are increasingly scarce and circumscribed by governments, which also need energy and energy revenue.

Thus, executives in these companies can continue to build their businesses on oil, or embrace a different future. We hope it is one where they actively invest in alternative energy, act with respect for human rights, operate with the highest standards of accountability, and protect the environment. However, from our vantage point, that responsible future looks unlikely. ■

Notes

¹ Many global companies have huge revenues, bigger than the GDP of many governments. Thus, some observers presume that these companies have not only enormous influence but influence equal to governments of the same size. But this is not a fair comparison. Instead, we should look at firm's profit and GDP, the value added that an economy generates per year. See Baker Institute, "The Role of National Oil Companies in International Energy Markets," <http://www.rice.edu/energy/research/nationaloil/index.html> (accessed February 28, 2009); Amy Jaffe and Ronald Soligo, *The International Oil Companies* (Rice University: The James A. Baker III Institute for Public Policy, November 2007), 2–3, available at <https://www.policyarchive.org/bitstream/handle/10207/6801/NOC-IOCs-Jaffe-Soligo.pdf?sequence=1> (accessed February 28, 2009); and Robert Pirog, "Oil Industry

Profits: Analysis of Recent Performance," *CRS Report for Congress*, August 4, 2005, <http://assets.opencrs.com/rpts/RL33021-20050804.pdf> (accessed February 28, 2009). On profits, Marianne Levelle, "Exxon's Profits: Measuring a Record Windfall," *U.S. News and World Report*, February 1, 2008, <http://www.usnews.com/articles/business/economy/2008/02/01/exxons-profits-measuring-a-record-windfall.html> (accessed February 28, 2009). Exxon's profits in 2007 were eighty per cent higher than GE's, a company widely considered as well-managed and diversified. In 2007, *Fortune* reported that ExxonMobil was the world's most profitable company. See Telis Demos, "Global 500: Most Profitable," *Fortune* <http://money.cnn.com/galleries/2007/fortune/0707/gallery.global500-profits.fortune/index.html> (accessed February 28, 2009).

² NOCs range in their degree of state ownership from one-hundred per cent in the approximately twenty countries where the sector dominates the economy, to majority ownership in others such as PetroChina, Petrobras-Brazil, Sinopec-China, Statoil-Norway, and ONGC-India. Some have limited public sector ownership (minority control), for example ENI-Italy and Petro Canada. See Miranda Wainberg and Michelle Foss, "Commercial Frameworks for National Oil Companies," Working Paper, 2007, Center for Energy Economics, University of Texas, Austin, Texas.

³ World Bank and Center for Energy Economics, University of Texas, Austin, *A Citizen's Guide to National Oil Companies* (Washington, DC: World Bank, 2008), 3. However, on January 25, PFC energy, which ranks the world's largest energy companies, noted that the downturn had hit national oil companies more than the private oil companies. PFC concluded that the oil majors are better positioned to profit from the downturn. Ironically, ExxonMobil still managed to churn out record profits in the fourth quarter of 2008. See Carola Hoyos, "Downturn Hits National Oil Groups' Shares," *Financial Times*, January 25, 2009; Tom Bergin and Braden Reddall, "Oil Company Profits Dip with Crude," *Reuters*, January 29, 2009, <http://uk.reuters.com/article/businessIndustry/idUKTRE50S78I20090129> (accessed February 28, 2009); and Christine Seib, "Exxon Mobil Breaks its Own Profit Record," *Times Online*, January 29, 2009, <http://business.timesonline.co.uk/tol/business/industry-sectors/natural-resources/article5619925.ece> (accessed February 28, 2009).

⁴ UNCTAD, *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development* (New York: United Nations, 2007), Overview, xx-xxi.

⁵ In recent examples of how governments have used state-run oil companies to achieve foreign policy goals, Russia has interrupted natural gas deliveries to Europe; Saudi Aramco decided to raise output in the wake of the Iraqi invasion of Kuwait, and Chavez has used favourable oil pricing to gain political influence in Latin America. China is using loans to gain access to oil and curry favour in Africa. See Matthew Green, "China Oils Nigeria Talks With Loan," *Financial Times*, April 21, 2008, <http://www.ft.com/cms/s/0/c4f9e296-0fe8-11dd-8871-0000779fd2ac.html> (accessed February 28, 2009).

⁶ Robert Pirog, "The Role of National Oil Companies in the International Oil Market," *CRS Report for Congress*, August 21, 2007, <http://www.fas.org/sgp/crs/misc/RL34137.pdf> (accessed February 28, 2009). Pirog notes that five of the top ten oil companies are state owned, including the number one, Saudi Aramco. It is followed by ExxonMobil, NIOC (state), PDV (state), BP, Shell, Petro China (ninety

per cent state), Chevron, Total (French-private), and Pemex (State). The top ten reserve holders with the exception of the Russian company Lukoil were state-owned. Pirog stresses that national oil companies of more developed nations such as Statoil of Norway and Petronas of Malaysia tend to follow a more commercially oriented strategy than companies such as Petroleos de Venezuela or the Nigerian National Petroleum Company. See also Baker Institute, *The Changing Role of National Oil Companies in International Energy Markets*, Policy Report 35, April 2007, Rice University.

⁷ Robert M. Zoellick, "Statement on Conclusion of the Second U.S.-China Senior Dialogue," December 8, 2005.

⁸ Miranda Wainberg and Michelle Foss, *Commercial Frameworks for National Oil Companies*, Working Paper, Center for Energy Economics, The University of Texas, Austin, March 2007 revision.

⁹ UNCTAD, *World Investment Report 2007*, Annex table A.I.14, 232–33.

¹⁰ Erica S. Downs, "The Fact and Fiction of Sino-African Energy Relations," *China Security* 3, no. 3 (2007): 42–68, 44.

¹¹ Some international agreements regulate the behaviour of corporations but they do so by regulating states. For example, the Convention on Combating Bribery of Foreign Public Officials contemplates the criminalization of bribery by any legal person (including a corporation). However, rather than criminalizing bribery itself, the Convention requires states to criminalize such bribery when done on their territory. Carlos Manuel Vazquez, "The Four Doctrines of Self-Executing Treaties," *American Journal of International Law* 89, no. 4 (1995): 695–723, 695; Carlos Manuel Vazquez, "Direct vs. Indirect Obligations of Corporations Under International Law," *Columbia Journal of Transnational Law* 43 (2005): 927–59, 927.

¹² In this regard, see John Browne (Chief Executive, BP), *BP Sustainability Report 2006*, 1–2, available at <http://www.bp.com/liveassets/bp—internet/globalbp/STAGING/global—assets/downloads/B/bp—sustainability—report—2006.pdf> (accessed February 28, 2009).

¹³ Henry Hansmann and Reinier Kraakman, "The End of History for Corporate Law," *Georgetown Law Journal* 89 (2001): 439–68, 439, 440–41; and Milton Friedman, "The Social Responsibility of Business Is To Increase Its Profits," *The New York Times*, September 13, 1970, §6 (Magazine), 32: "[A] corporate executive is an employee of the owners of the business. He has [a] direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society."

¹⁴ Business Industry Advisory Committee to the OECD, "BIAC Statement on 'Conducting Business with Integrity in Weak Governance Zones: Issues for Discussion and A Case Study of the DRC,' DAF/INV/WP(2004)1," 2–3, available at <http://www.oecd.org/dataoecd/8/56/34304856.pdf> (accessed February 28, 2009).

¹⁵ See the detailed discussion of different threats and matching policy responses in Joseph S. Nye, David A. Deese, and Alvin L. Alm, "Conclusion: A U.S. Strategy for

Energy Security,” in *Energy and Security*, eds. David Deese and Joseph S. Nye (New York: Harper and Row, 1981).

¹⁶ National Petroleum Council, *Hard Truths: Facing the Hard Truths About Energy*, July 18, 2007, Washington, D.C.

¹⁷ Robert Pirog, “The Use of Profit by the Five Major Oil Companies,” *CRS Report for Congress*, April 11, 2008, <http://assets.opencrs.com/rpts/RL34044—20070619.pdf> (accessed February 28, 2009).

¹⁸ Jaffe and Soligo, *The International Oil Companies*, 6–8.

¹⁹ Jad Mouawad, “At Exxon, Making the Case for Oil,” *The New York Times*, November 16, 2008, <http://www.nytimes.com/2008/11/16/business/16exxon.html> (accessed February 28, 2009).

²⁰ Energy Information Administration, *Annual Energy Review 2007*, see Figures 12, 13, 25, 63, available at <http://www.eia.doe.gov/aer/pdf/aer.pdf> (accessed February 28, 2009).

²¹ Data from Net Crude Oil and Products Imports by Country of Origin in Thousands of Barrels, see Energy Information Administration, “Official Energy Statistics from the U.S. Government: Petroleum Navigator,” <http://tonto.eia.doe.gov/dnav/pet/pet—move—neti—a—epo—imn—mbblpd—m.htm> (accessed February 28, 2009).

²² Political Stability Indicators from the World Bank’s *Governance Matters 2007*. Political stability indicators are expressed in percentile (0–100) rank. Political Stability and Absence of Violence measures the perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means.

²³ The Failed States Index was created by the Fund for Peace and provides snapshots of state vulnerability or risk of violence during a window in time. It relies on social, political, and economic indicators of possible violence such as mounting demographic pressures, criminalization or delegitimization of the state, and rise of factionalized elites. See the Fund for Peace, “Failed States Index FAQ,” <http://www.fundforpeace.org/web/index.php?option=com—content&task=view&id=102&Itemid=327#3> (accessed February 28, 2009).

²⁴ Laza Kekic, “The Economist Intelligence Unit’s Index of Democracy,” in *The Economist*, The World in 2007, available at <http://www.economist.com/media/pdf/Democracy—Index—2007—v3.pdf> (accessed February 28, 2009).

²⁵ UNESCAP, “What is Good Governance?,” <http://www.unescap.org/pdd/prs/ProjectActivities/Ongoing/gg/governance.asp> (accessed February 28, 2009). Good governance is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive, and follows the rule of law. It assures that corruption is minimized and the views of minorities are taken into account.

²⁶ In 2001, the Human Rights and Business Project developed a template delineating when a human rights situation is so volatile that the firm should withdraw. The template is now widely used by extractives. Margaret Jungk, “Deciding Whether

to Do Business in States with Bad Governments," Human Rights and Business Project, 2001, <http://www.humanrightsbusiness.org/pdf—files/decidingwhether.pdf> (accessed February 28, 2009).

²⁷ Douglas G. Cogan, *Corporate Governance and Climate Change: Making the Connection* (Boston, MA: Ceres, 2006), 22–23.

²⁸ Ans Kolk and David Levy, "Winds of Change: Climate Change and Oil Multinationals," *European Management Journal* 19, no. 5 (2001): 501–9; and Mouawad, "At Exxon."

²⁹ Cogan, *Corporate Governance and Climate Change*, 233–35.

³⁰ See BP, "What BP Is Doing," <http://www.bp.com/sectiongenericarticle.do?categoryId=9021745&contentId=7041006> (accessed February 28, 2009).

³¹ See John Vidal, "Revealed: How Giant Oil Influenced Bush. White House Sought Advice from Exxon on Kyoto Stance," *The Guardian*, June 8, 2005; and Fred Sissine, "Energy Independence and Security Act of 2007: A Summary of Major Provisions," *CRS Report for Congress*, 2, available at <http://wikileaks.org/leak/crs/RL34294.pdf> (accessed February 28, 2009).

³² Steven Mufson and Juliet Eilperin, "Obama Issues Orders Toward More Fuel-Efficient Cars," *The Washington Post*, January 27, 2009, A04, <http://www.washingtonpost.com/wp-dyn/content/article/2009/01/26/AR2009012602028.html?wprss=rss—politics>; and see White House, "The Agenda: Energy and Environment," <http://www.whitehouse.gov/agenda/energy—and—environment> (both accessed February 28, 2009).

³³ BBC News, "Nigeria Hears Ogoni Oppression," January 22, 2001, <http://news.bbc.co.uk/2/hi/africa/1130555.stm> (accessed February 28, 2009); Human Rights Watch, "The Price of Oil: Corporate Responsibility and Human Rights Violations In Nigeria's Oil Producing Communities," <http://www.hrw.org/reports/1999/nigeria/nigeria0199.pdf> (accessed February 28, 2009); and Segun Owen, "Shell Contains Oil Spill Caused by Sabotage," *Reuters*, November 13, 2008, <http://www.reuters.com/article/marketsNews/idUSLD69608820081113> (accessed February 28, 2009).

³⁴ See Voluntary Principles on Security and Human Rights, "Participants and Companies," <http://www.voluntaryprinciples.org/participants/companies.php> (accessed February 28, 2009).

³⁵ For example, a report commissioned for the UN Special Representative on Business and Human Rights; see Michael Wright, "Corporations and Human Rights: A Survey of the Scope and Patterns of Alleged Corporate Related Human Rights Abuse," <http://www.reports-and-materials.org/Ruggie-scope-patterns-of-alleged-abuse-Apr-2008.pdf> (accessed February 28, 2009).

³⁶ John G. Ruggie, "Human Rights Policies and Management Practices of Fortune Global 500 Firms: Results of a Survey," September 1, 2006, <http://www.reports-and-materials.org/Ruggie-survey-Fortune-Global-500.pdf>; and see P Jeffery Flood, "Tools To Manage Business and Human Rights," April 3, 2008, <http://www.ipieca.org/activities/social/downloads/workshops/apr—08/p2—jlflood—human—rights—tools—for—the—o&g—industry—1350.09375.pdf> (accessed February 28, 2009).

³⁷ Look up oil companies on the [businesshumanrights.org](http://www.businesshumanrights.org) web site and follow the multiple articles/links; <http://www.business-humanrights.org/Search/SearchResults?SearchableText=oil+companies&x=0&y=0> (accessed February 28, 2009).

³⁸ Michael Wright and Amy Lehr, "Business Recognition of Human Rights: Global Patterns, Regional and Sectoral Variations: A Study Conducted under the Direction of John G. Ruggie, Harvard University," December 12, 2006, <http://www.reports-and-materials.org/Business-Recognition-of-Human-Rights-12-Dec-2006.pdf> (accessed February 28, 2009).

³⁹ Human Rights Council, "Protect, Respect and Remedy: A Framework for Business and Human Rights. Report of the Special Representative of the Secretary General on the Issue of Human Rights and Transnational Corporations and other business Enterprises, John Ruggie," A/HRC/8/5, April 7, 2008, <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf> (accessed February 28, 2009).

⁴⁰ See Paul Stevens, "'Resource Curse' and How to Avoid It?," *Journal of Energy and Development* 31, no. 1 (2006): 1–20. In his research Stevens links poverty and resource dependency and finds not only that Botswana, Chile, Indonesia and Norway avoided the curse but that Colombia, Suriname, and Tunisia performed better than expected. Also see Gavin Wright and Jesse Czelusta, "The Myth of the Resource Curse," *Challenge* 47, no. 2 (2004): 6–38. Wright and Czelusta find that countries can avoid the curse through sound economic and technological management.

⁴¹ Extractive industry windfalls can push up the real exchange rate of a country's currency, rendering non-oil exports relatively uncompetitive. As these sectors languish, the economy may become ever more dependent on extractives.

⁴² Open Society Justice Initiative, "Legal Remedies for the Resource Curse," September 6, 2005, <http://www.justiceinitiative.org/db/resource2?res—id=102966> (accessed February 28, 2009); and Macartan Humphreys, Jeffrey D. Sachs, and Joseph E. Stiglitz, eds., *Escaping the Resource Curse* (New York: Columbia University Press, 2007), 4. Kazakhstan provides a good example of this dilemma. On August 19, 2007, the ruling party of President Nursultan Nazarbayev said it had won eighty-eight per cent of the vote. See Anton Troianovski, "Ruling Party Sweeps Kazakhstan Election, Official Count Shows," *The Washington Post*, August 20, 2007.

⁴³ Humphreys and others, *The Escaping*, 11–12; Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley, CA: University of California Press, 1997). She examines Venezuela, Iran, Nigeria, Algeria, and Indonesia. Also see Michael Ross, "Does Oil Hinder Democracy?," *World Politics* 53, no. 3 (2001): 325–61; and Richard M. Auty and Alan G. Gelb, "Political Economy of Resource Abundant States," in *Resource Abundance and Economic Development*, ed. Richard M. Auty (Oxford: Oxford University Press, 2001), 126–44.

⁴⁴ Paul Collier and Anke Hoeffler, "Greed and Grievance in Civil War," *Oxford Economic Papers* 56, no. 4 (2004): 563–95; Macartan Humphreys, "National Resources, Conflict and Conflict Resolution: Uncovering the Mechanisms," *Journal of Conflict Resolution* 49, no. 4 (2005): 508–37; and James D. Fearon, "Primary Commodities Exports and Civil War," *Journal of Conflict Resolution* 49, no. 4 (2005): 483–507.

⁴⁵ As of December 1, 2008, twenty-four countries adhere to EITI; see Extractive Industries Transparency Initiative, <http://www.eitransparency.org> (accessed February 28, 2009).

⁴⁶ In 2008, Iraq and Norway agreed to adopt EITI. See Iraq Oil Report, "Iraq to Join Oil Revenue Transparency Pact," October 31, 2008, <http://www.iraqoilreport.com/2008/10/31/iraq-to-join-oil-revenue-transparency-pact>; and Anwar Ravat, "Improving EI: Emerging Lessons and Results from EITI implementation in the 'GAC' context," <http://siteresources.worldbank.org/INTEXTINDTRAINI/Resources/prem-week-2008-eiti-session-4-22-08.pdf> (both accessed February 28, 2009).

⁴⁷ Twenty-three countries as of June 2008.

⁴⁸ See Extractive Industries Transparency Initiative, "Supporting Companies," <http://eitransparency.org/node/218> (accessed January 7, 2008).

⁴⁹ UNCTAD, World Investment Report 2007, Overview.

⁵⁰ Survey data can be obtained from the authors.

⁵¹ Senate Foreign Relations, "The Petroleum and Poverty Paradox: Assessing U.S. and International Community Efforts to Fight the Resource Curse," Report to Members, 110th Cong. 2d Sess., October 16, 2008, 119-49.

⁵² Save the Children, UK, "Beyond the Rhetoric: Measuring Revenue Transparency—Home Government Requirements for Disclosure in the Oil and Gas Industries," March 17, 2005, <http://www.publishwhatyoupay.org/en/resources/beyond-rhetoric-measuring-revenue-transparency-home-government-requirements-disclosure-oil> (accessed February 28, 2009).

⁵³ Canadian companies had the best results because in 2005 it was the only country that required country-level disclosure. As of June 2008, Norway also requires such disclosure. In May 2008, US Congressman Barney Frank put forward H.R. 6066, the Extractive Industries Transparency Disclosure (EITD) Act that would require publicly listed companies to report any payments made to governments to extract resources. The European Parliament also called for country-by-country disclosure of revenue payments.

⁵⁴ Save the Children, UK, "Beyond the Rhetoric."

⁵⁵ Transparency International, "Promoting Revenue Transparency Project," April 2008, www.transparency.org/revenue-transparency (accessed February 28, 2009).

⁵⁶ Publish What You Pay International, "European Parliament supports mandatory reporting by oil, gas and mining companies for each country of operation," <http://www.publishwhatyoupay.org/en/resources/european-parliament-supports-mandatory-reporting-oil-gas-and-mining-companies-each-country> (accessed February 28, 2009).

⁵⁷ See Publish What You Pay, US, "Co-sponsors in the House of Representatives," <http://www.publishwhatyoupayusa.org/templates/System/details.asp?id=39924&PID=574592> (accessed February 28, 2009).

⁵⁸ OECD Directorate for Financial and Enterprise Affairs, "Steps taken by State Parties to implement and enforce the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions," <http://www.oecd.org/document/44/0,3343,en-2649-34859-36433004-1-1-1-1,00.html> (accessed February 28, 2009).

⁵⁹ In this regard, see Susan Ariel Aaronson, "Minding Our Business: What the US Government Has Done and Can Do to Ensure that US Multinationals Act Responsibly in Foreign Markets," *Journal of Business Ethics* 59, no. 1-2 (2005): 175-98.

Corporate-State Relations and the Paralysis of Accountability: A Case-Study of the Khulumani et al. v. Barclays et al. Lawsuit

55

JANET A. JOBSON

ABSTRACT

The corporation and the state are two of the most powerful contemporary social institutions. In the context of a globalizing world, the relationship between these two institutions is increasingly paradoxical: the state's territorially-bounded authority contrasts with the corporation's supra-territorial power. One of the most revealing realms in which the relationship between these institutions may be explored is the accountability of transnational corporations. Using a case study of the *Khulumani et al. v. Barclays et al.* lawsuit, which is currently under consideration in the Southern District Court of New York and was filed under the provisions of the United States' Alien Tort Claims Act (ATCA), this paper argues that the state has in many respects shifted from protecting citizen interests to protecting corporate-interests. By examining the active involvement of the South African and US governments in opposing the Khulumani lawsuit, I argue that methods of corporate accountability are largely paralyzed by the intersecting factors of corporate transnational economic power and mobility, and the lack of a supra-territorial enforcement regime. This paralysis leaves the ATCA as a unique means of negotiating the territorial/supra-territorial nature of transnational corporations and thus as a mechanism to hold them accountable.

The question of corporate accountability brings to the fore the relationship between two of the most powerful social institutions of our time, the state and the transnational corporation. These two stand as antithetical institutions in several respects: the former is based primarily on geographic boundaries, the latter operates beyond borders; states in their ideal form are governed democratically, corporations have essentially unelected hierarchies; in their intentions, the first exists—in theory at least—as a vehicle for public interest, the second as a vehicle for private interest. The relationship between corporations and states involves a number of complex interactions at the nexus of the global economy, a desire for investment and development, and the need to protect national interests. In negotiating these complexities, this paper argues, states tend by and large to favour corporate interests and hamper citizen attempts to hold corporations accountable. As a case-study, the *Khulumani et al. v.*

Janet A. Jobson, "Corporate-State Relations and the Paralysis of Accountability: A Case-Study of the Khulumani et al. v. Barclays et al. Lawsuit," *STAIR* 5, no. 1 (2009): 55-75.

Barclays et al litigation, under the provisions of the United States' Alien Tort Claims Act (ATCA), provides interesting insight into one mechanism of corporate accountability, as well as insights into the interplay between state and corporate interests in a paradoxically territorial yet increasingly globalized world. This paper will sketch an outline of the challenges of corporate accountability before turning specifically to the *Khulumani* lawsuit and exploring the specific challenges of the state-corporate nexus in this case.

The Evolution of Corporations and Corporate Accountability

The question of corporate accountability—in the broadest sense—has accompanied the realization that the corporate form, since its inception in the sixteenth century, has been a very powerful and influential social institution. Throughout the development of the corporate form, from its common law origins in special charters issued by the British Crown to the legal shifts in its status through legislation around limited liability, states and corporations have been engaged in a relationship that is both contentious and collaborative. By the twentieth century, the corporate form had firmly established itself as a social and economic form that occasionally challenged the state. As Adolf Berle and Gardiner Means, the authors of the seminal text the *Modern Corporation and Private Property* (1932), note:

The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state ... The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social organization.¹

That the corporation, while wielding enormous power, operates primarily in self rather than public interest has been flagged as a major concern since the early 1900s. As Ramage put it in 1902:

Here is a person who in this country of ours employs the larger number of people, owns probably the greater part of the wealth of the New World, claims an increasing amount of judicial time and attention, and wields in some quarters an influence of paramount importance, and yet ... the corporation knows no other rule of action than that of self-interest, although in its numberless transactions with men and states it may come in contact with some of the nicest ethical questions.²

That the corporation may face the “nicest” of ethical questions certainly poses a number of challenges for the public and states’ reactions to the corporate form.

Domestically, states often enact legislation that governs the behaviour of corporations. However, it is the rise of the *transnational* corporation that has proven a particular challenge to the organization of modern society. Today, approximately seventy thousand transnational corporations operate alongside roughly seven hundred-thousand subsidiaries and millions of suppliers across the globe.³ These corporations exist simultaneously as registered entities in each of the locations in which they are based and as a whole beyond any specific national boundaries. One challenge, then, is to consider how entities that operate beyond national boundaries can be held accountable in a global system that has not developed a rigorous supra-territorial legal regime to ensure corporate compliance. Within this transnational context, the ability of states to create legal sanctions and restrictions on the manner in which corporations do business is also hampered, especially in the developing world. If a country establishes laws that would increase the cost of doing business (such as, for instance, demanding a liveable minimum wage), corporations often have the option of shifting operations to another location.

While there is increasing global awareness about, and commitment to, “corporate social responsibility” and “corporate citizenship” initiatives, these concepts tend to be forward-looking, with almost no reference to corporate accountability for prior abuses and criminal misdeeds. In the absence either of a robust international legal regime or of states actively applying corporate sanctions for labour and human rights abuses themselves, a number of citizen-based initiatives have taken cases to the US district courts to make use of the ATCA.⁴

The ATCA, enacted in 1789 as part of the Judiciary Act, states in its entirety: “The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.”⁵ The origins of the legislation are murky, as are the intentions of the framers. Thus, the evolution and use of the ATCA has occurred through a series of important judgments and judicial interpretations of this succinct law. The first judicial reference to the ATCA statute occurred in 1795, when a federal court in South Carolina granted the court jurisdiction over a dispute concerning the ownership of slaves that had been seized on a captured enemy vessel.⁶

The law was invoked only a handful of times over the next two centuries until the breakthrough case of *Filártiga v. Peña-Irala* (2d Cir. 1980).⁷ The jurisprudential extension that the *Filártiga* ruling provided was that foreigners could sue in US courts for violations of “universal,

definable and obligatory” international law norms, known as *jus cogens* norms.⁸ This finding opened the door for a slew of cases to be filed in the next few decades. Critical to *Khulumani* was the progress made by the *Doe v. Unocal* case, which set the precedent of the justiciability of the ATCA both to bring cases against corporations as well as under the notion of “aiding and abetting” gross human rights violations.⁹

One of the most significant developments was the Supreme Court’s ruling in the case of *Sosa v. Alvarez-Machain* (2004),¹⁰ in which the Court held that *jus cogens* violations—gross human rights violations described in international customary law, such as slavery, torture, genocide, and war crimes—were actionable under the ATCA.¹¹ As will be reviewed later, the limited and specific categories used in *Khulumani*—extrajudicial killing, unlawful detention, torture, and cruel treatment—reflect the impact of the *Sosa* ruling in both defining the terrain for the kind of cases that can be brought and limiting the nature of the charges.

This acceptance of the universal jurisdiction for *jus cogens* offences reflects the complexity inherent in US courts’ adjudication of international cases. That the US courts have only allowed cases that contravene these principles of international customary law emphasizes that such laws *do* exist. Where the ATCA extends universal jurisdiction is in its application to corporations. This is a major shift in the understanding of international human rights law, which traditionally recognizes only states and individual actors. Thus, universal jurisdiction was primarily found in specific cases such as international tribunals, the International Criminal Court, and the 1993 Belgian law codifying the Geneva Convention into justiciable form. One of the major tensions that arises in any matter where a court could potentially hear cases relating to the crimes of foreign nationals is the question of sovereignty and the extent to which trying such cases can interfere in relations between states, something discussed more clearly below in relation to *Khulumani*.

The ATCA, in its current form, leaves us with a number of unresolved and difficult questions: To what extent should civil claims be justiciable under universal jurisdiction precepts? Does the corporation’s contemporary form and influence require this extension? To what extent could such extension taking place in the American judicial realm influence the potential for creating transnational fora for accountability? The adjudication of any ATCA claim, especially because of the reliance on previous interpretations and applications of this law, is thus embroiled in a much larger context and has far-reaching implications for the general state of global legal methods of corporate accountability. While this is arguably quite problematic, in light of the lack of attempts to create legally enforceable international avenues to adjudicate corporations’

gross human rights violations, the ATCA must be rigorously upheld as a useful and important legal space.

59

The Khulumani et al v. Barclays et al Case: The Role of Business During Apartheid

On November 11, 2002, the Khulumani Support Group¹² and eighty-seven named plaintiffs filed a complaint in the Southern District Court of New York against twenty-two named corporations for aiding and abetting the crimes of apartheid. The United Nations (UN) defined these crimes as: “forced labor, genocide, extrajudicial killing, torture, sexual assault, unlawful detention, and cruel, inhuman and degrading treatment.”¹³ In addition, the complaint alleges that these corporations

provided substantial assistance and/or encouragement to the apartheid regime ... participated in the criminal enterprise of apartheid ... acted in the face of an unjustifiably high risk of harm that was either known or so obvious that it should have been known ... acted with disregard of, and deliberate indifference to, a substantial risk of harm to the African population.¹⁴

In the original complaint, the Khulumani Support Group identified five different industries in which corporations had direct business links with the apartheid government and, in many cases, with the security forces committing human rights abuses. These included the oil (British Petroleum, Shell Oil, ExxonMobil, *et al.*), banking (Barclays Bank, Chase Manhattan, UBS, *et al.*), mining (RioTinto), automotive (Ford Motors, DaimlerChrysler, General Motors, *et al.*), and technology (Fujitsu, IBM, *et al.*) industries.

In terms of customary international law, the claim rests on the litany of national and international declarations referring to apartheid and more specifically its classification as a crime against humanity. The UN took a strong lead in denouncing the apartheid regime and in outlining what it considered unacceptable business practices under the circumstances. In December 1950, the United Nations General Assembly (UNGA) made the first international proclamation denouncing apartheid as a policy based on racial discrimination.¹⁵ This was followed by the creation of a dedicated commission intended to study the racial situation in South Africa and by a series of resolutions and pronouncements expressing concern over the situation. The UN Security Council (UNSC) took its first stand on apartheid in reaction to the Sharpeville Massacre on March

21, 1960 in which sixty-nine people were murdered by police during a peaceful protest. In 1968, international condemnation culminated in a resolution stating that the UNGA “*Reiterates its condemnation of the policies of Apartheid practiced by the Government of South Africa as a crime against humanity.*”¹⁶

From this point forward, the UN began to condemn the actions of corporations that operated within, or invested in, certain sectors of the South African economy, and called for the imposition of trade sanctions and embargoes. In the wake of the 1976 Soweto Uprising, the UNGA passed a resolution that condemned the actions of transnational corporations co-operating with the apartheid regime. This resolution stated that the General Assembly:

1. Proclaims that any collaboration with the racist regime of South Africa constitutes a hostile act against the oppressed people of South Africa and a contemptuous defiance of the United Nations and the international community;
2. Strongly condemns the action of those ... foreign economic and other interests which continue to collaborate with the racist regime of South Africa; ...
5. Condemns the intensified activities of transnational corporations, which continue to exploit the racially oppressed people of South Africa and plunder its natural resources and *thereby are accomplices to the crimes of the apartheid regime*[.]¹⁷ (author’s emphasis)

In 1977, the UNSC took the important step of calling for a mandatory arms embargo against South Africa.¹⁸ By 1979, the UN Special Committee against Apartheid reported that transnational corporations had a major share of responsibility for the maintenance of the apartheid regime, particularly through “strengthening the repressive and military power of the racist regime and for the undermining of international action to promote freedom and human dignity in South Africa.”¹⁹ By 1981, the international community had called for the existing, voluntary oil embargo to become mandatory. The rationale behind extending this embargo was that South Africa had no indigenous oil reserves, and thus an embargo would strike at the heart of the South African state.²⁰ The mandatory oil embargo never materialized, as the US, the UK, France, and Germany all vetoed the Security Council resolution that proposed the cessation of all trade in oil to South Africa.²¹

According to the plaintiffs, the UN resolutions that were passed against apartheid from 1950 onwards, in particular the 1960 resolution that described apartheid as a crime against humanity, put the defendants on notice that their involvement with the apartheid state violated international law. In light of this, the central claim of *Khulumani* is that

historical evidence demonstrates that the defendants were instrumental in “encouraging and furthering the abuses” of the apartheid regime and additionally, that the defendants’ conduct was so integrally connected with the nature of the apartheid regime and its abuses that apartheid would not have occurred in the same way without these corporations’ contribution.²² The lawsuit thus “seeks a measure of justice”²³ for the victims of the crimes of apartheid, which the defendants are alleged to have aided and abetted.

The original complaint describes a number of particular instances in which named corporations did direct business with the regime. One of the most egregious examples was the conduct of the armaments company Rheinmetall. As the only mandatory UNSC embargo, the trading of arms with the South African government was an explicitly illegal activity. Rheinmetall, under fraudulent export declarations, exported a complete ammunitions factory to South Africa that could manufacture 155mm extended range projectiles.²⁴ Rheinmetall managed this by applying for a permit to export a plant to Paraguay, using the fictitious company Sudamerika Paraguay Exportacion-Importacion. Once the shipment reached Brazil, the freight was moved onto a ship bound for Durban. The plant, located in South Africa, began its operations in 1979 and was fully functional by 1985.²⁵ Even after a criminal investigation into the incident in 1980, Rheinmetall continued to collaborate with the South African security forces, training members of the South African Defence Force at its Unterlüss training base.²⁶

If the arms industry provided the hardware for committing the crimes of apartheid, it was the banking sector that shored up the government’s ability to continue functioning. As Smith argues,

[f]oreign loans insure that the overall budget is in a strong position and the economy is viable. These factors relate directly to the strength of the military and police which are determined to preserve white power ... bank loans subsidize South Africa’s military capability and thus are a direct resourcing of machinery for the oppression of the black majority.²⁷

One of the more shocking actions by the banking sector took place in 1976, shortly after the Soweto Uprising. Barclays Bank purchased ten million rand worth of South African Defence Force (SADF) bonds, the proceeds of which went directly toward financing the South African armed forces.²⁸ This was the largest single purchase of SADF bonds and made up one-eighth of all the bonds sold.²⁹ Barclays turned the purchase of these bonds into a marketing opportunity and held a public handover of the cheque. At the ceremony, Barclays’ Managing Director

Bob Aldworth stated that “the bank regards the subscription as part of its social responsibility not only to the country at a particular stage in its history, but also to our staff members who have been called up.”³⁰

The transport sector was also particularly vital to the operation of the South African apartheid system. The *Khulumani* complaint argues that the defendant motor vehicle manufacturers knowingly supplied vehicles, parts, and other equipment to the South African armed forces.³¹ Further, it argues that the industry passed on the technology and skills that enabled the South African government to construct arms-related vehicles.³² One of the major players in this sector was the German company DaimlerChrysler AG, which owned the subsidiary Mercedes Benz South Africa. In 1978, DaimlerChrysler shipped six thousand Mercedes Benz Unimogs (a military vehicle) to South Africa despite the UN Security Council’s mandatory arms embargo.³³

A final example of the role of corporations in upholding the apartheid regime comes from the technology sector. The South African apartheid state was almost completely dependent on foreign corporations for its computing technology, importing ninety-five per cent of its computers and other technologies.³⁴ By 1979, despite a US embargo on providing computers to the South African state, US companies provided over \$60 million worth of computers and other technologies to the apartheid regime. The breaking of the embargo occurred when these companies used non-US components in the machines they sent to South Africa.³⁵ From 1970 onwards, the South African Department of the Interior relied on IBM for the hardware to administer its population registry.³⁶ US Congressman Howard Berman publicly argued that the technology provided by IBM was central to the apartheid state’s ability to control the black South African population through the insidious passbook system.³⁷ IBM knowingly leased the Model 370 computer system to the government for this purpose. Since the machines were owned by IBM and leased to the government, they could have withdrawn from the arrangement at any point; significantly, they did not.³⁸ As of 1976, at least one-third of IBM’s business in South Africa was conducted directly with the government and its agencies.³⁹ Like the technology company International Computers Limited (a South African subsidiary of Fujitsu Ltd.), IBM’s business model followed the line that worldwide growth was necessary and beneficial, and that although “the policies of the governments of certain countries with whom [they] trade may be unattractive but of necessity the companies that [they] operate throughout the world must be subject to the laws of the country in which they are located.”⁴⁰

The legal question of provision for claims on the basis of aiding and abetting gross human rights violations has a history stretching back to

the slave trade. In 1794, the US Congress enacted legislation that barred the building or equipping of any ships intended for the slave trade; by 1800, Congress had made it illegal for any US citizen to directly or indirectly have any interests in slave-trade vessels.⁴¹ By 1820, Congress determined that the slave trade was so heinous that even aiders and abettors should be subjected to the death penalty.⁴² The Nuremburg Trials confirmed the principle that those who aid and abet violations of customary international law are liable for those acts. For instance, the Military Tribunal convicted Emil Puhl, one of the leading Reichsbank executive officials, for participating in the disposal of looted assets. As the judgment held, “[h]e who participates or plays a consenting part ... is guilty of a crime against humanity.”⁴³ In addition, the International Criminal Tribunals for both the former Yugoslavia and Rwanda have upheld the principle of aiding and abetting crimes against humanity. As the International Criminal Tribunal for the former Yugoslavia held, an aider and abettor need not share the *mens rea*—or intention—of the perpetrator, or even know the precise details of the crime that the perpetrator intends to commit; it is enough that the aider and abettor is “aware that one of a number of crimes will probably be committed, and one of those crimes is in fact committed.”⁴⁴

Since its inception in 2002, *Khulumani* and other apartheid lawsuits have had an uphill battle to gain recognition in the courts, facing opposition from the corporate sector, the South African government, and the governments of the home countries of the corporations. The first major decision regarding *Khulumani* was the adjudication by the US Multi-District Litigation Panel to consolidate all cases brought under the ATCA, transferring them to the Southern District Court of New York to be heard by Judge Sprizzo. After hearing the heads of argument on November 6, 2003, Sprizzo dismissed the lawsuits on November 29, 2004.⁴⁵ The *Khulumani* legal team undertook an appeal to the Second Circuit Court and, on October 12, 2007, the appeal was upheld. A simultaneous right was granted to the defendants to appeal the ruling to the US Supreme Court.

This appeal to the Supreme Court was potentially the most difficult of challenges facing the *Khulumani* attempt to reach trial. In a beneficial turn of events for the plaintiffs, the Supreme Court was forced to dismiss the appeal on the grounds of an inability to reach quorum. Four judges of the Court recused themselves from hearing the case as they had financial and personal ties to the named corporations. Under federal rules, the Court requires a quorum of six judges to hear a case; with four of the nine judges recusing themselves, the case was redirected back to the district court without having been heard.⁴⁶ This was a notably graphic example

of the “revolving door” between business and government, although on this occasion playing out in favour of the “ordinary citizens” involved.

The deferral of the case back to the district court allowed the Khulumani Support Group to refine its complaints, and, in an effort to bolster its claim against the defence that corporations were “just doing business” in South Africa, the amended complaint lists only eight corporations that had direct and exclusive contracts with the apartheid government and security apparatus. These companies are: Barclays Bank, Daimler, Ford Motor Company, Fujitsu Ltd., General Motors, IBM, Rheinmetall Group, and UBS. The amended complaint calls for a jury trial and has been lodged as a class action suit, reducing the number of named plaintiffs to thirteen individuals whose rights violations stand as examples of those aided and abetted by the corporations.⁴⁷ The amended complaint was lodged on October 31, 2008, and the trial reopened on February 26, 2009.

The Role of the State in Corporate Accountability

The contemporary corporation has two major intersecting characteristics that evoke a paralysis in state-based measures to achieve accountability. First, modern corporations have tremendous economic power that they are able to leverage to limit minimal standards and legal frameworks for accountability by national governments, especially in the developing world. Second, the transnational nature of the corporation in the absence of a supra-territorial authority means that enforceability of standards is still the preserve of national bodies, which, as discussed above, are hamstrung by the need to ensure investment and positive economic growth.

It is at this paralytic intersection that the importance of the ATCA as a nationally based but universal jurisdictional legal avenue becomes clear. It is also the convergence of these factors that underlies the overt opposition that both the South African and US governments have to the case.

The South African government has been one of the most vocal opponents of the *Khulumani* and other apartheid lawsuits. As early as May 4, 2002, six months prior to the filing of the *Khulumani* case, Minister of Foreign Affairs Nkosazana Dlamini-Zuma had communicated with the US Secretary of State to convey the message that the government did not support the potential litigation.⁴⁸ In her correspondence, Dlamini-Zuma cited President Thabo Mbeki’s statement that

we consider it completely unacceptable that matters that are central to the future of our country should be adjudicated in foreign courts which bear no responsibility for the well-being of our country and the observance of the perspective contained in our Constitution on the promotion of national reconciliation.⁴⁹

This opposition was reiterated at the handing over of the final report from the Truth and Reconciliation Commission (TRC), in which the South African Cabinet declared that “it is imperative for the government to clearly express its views on attempts to undermine South African sovereignty through actions such as the reparations lawsuit filed in the United States of America.”⁵⁰

The most intriguing aspect of the South African government’s response, however, is that it has gone so much further than the private and public communications issued above. Former Minister of Justice and Constitutional Development Penuell Maduna, on July 11, 2003, submitted an *amicus curiae* brief to the New York District Court opposing the apartheid litigation. The move shifted the government’s involvement from that of commentator to critical actor in the general process of the lawsuit. Unsurprisingly, the “Maduna Declaration,” as it became known, was hailed by business interests such as the National Foreign Trade Council (a coalition of three hundred corporate members) and the US-South Africa Business Council as a highly positive development. Bridgette Mabandla, who succeeded Maduna as Minister of Justice, followed up his declaration by personally appearing at an appeal hearing in 2006.

The “Maduna Declaration” rests on three central claims. First, that the litigation undermines South Africa’s sovereignty:

[T]he issues raised in these proceedings are essentially political in nature. These should be and are being resolved through South Africa’s own democratic processes. Another country’s courts should not determine how ongoing political processes in South Africa should be resolved.⁵¹

Second, it claims the litigation will undermine South Africa’s own reconciliation and transformation processes: “These proceedings ... will intrude up [*sic*] and disrupt our own effort to achieve reconciliation and reconstruction.”⁵² Finally, the declaration claims that litigation will hinder foreign direct investment and thus negatively influence the South African economy:

This litigation ... will ... discourage much-needed direct foreign investment in South Africa and thus delay the achievement of our central goals. Indeed, this litigation could have a destabilizing effect on the South African economy as investment is not only a driver of growth, but also employment.⁵³

At first glance the South African government's claims seem legitimate. The *Khulumani* case does remove the question of corporate accountability from South Africa's borders. The claim is also directly related to reparations issues and could potentially impact foreign investment. However, a closer examination of the substance and evidence behind the claims leaves them wanting.

Turning first to the question of sovereignty, this is a critical flashpoint for debates over globalization and the power of corporations. Paul Gready argues that the understanding of what sovereignty entails has changed and should continue to change as borders become increasingly porous. Whereas sovereignty previously embodied a notion of authority, entailing that the state had full and unparalleled power and legitimacy within its territorial space, the concept has been challenged by the processes of globalization, whereby sovereignty might be re-imagined through the lens of responsibility.⁵⁴ This lens would require governments to act against cases that infringed on the interests of the nation as a whole, something argued by Maduna in his further two points to the court. Abandoning the implication of Maduna's invocation of sovereignty, on what general basis is there a claim to the inappropriateness of seeking justice from a foreign court? While in theory a South African court could hear the case in some form, the practical stumbling blocks to the possibility of gaining a measure of justice highlight the importance of using the more established route of the ATCA. As Richard Meeran, a renowned human rights lawyer, argues, due to the complicated nature of the case, the *jus cogens* basis of the claims, and the inequality in legal teams and financing available to a South African court, it is not practically possible to see a case of this kind through to trial in South Africa.⁵⁵

The second claim, that the litigation undermines South Africa's own reconciliation and reparations processes, has also been met with stern opposition, not least from the TRC members themselves. The mandate of the TRC clearly specified that amnesty would be granted only to those individuals or institutions that came forward, fully disclosed their actions, and satisfactorily showed that their actions were politically linked. Where amnesty was refused or perpetrators did not come forward, the threat of prosecution was raised. A number of the TRC Commissioners, including Archbishop Desmond Tutu, submitted an *amicus curiae* brief to the New York District Court in support of the litigation and in opposition to the "Maduna Declaration." The *amicus curiae* brief notes that none of the Defendants in this action sought amnesty before the TRC. It would be bizarre at best to hold that they may now find shelter from civil

liability in private litigation because their payment of damages might somehow interfere with a reconciliation process in which they refused to participate. The *Khulumani* action involves the private redress of private harms from private actors. The now-completed work of the TRC is not implicated in any way.⁵⁶

Indeed, the TRC findings were quite explicit in condemning business's involvement in the apartheid regime. Their core finding was that "[b]usiness was central to the economy that sustained the South African state during the apartheid years."⁵⁷ The TRC went further than this to highlight key instances in which business had directly co-operated with the apartheid government. For instance, "[b]usiness failed in the hearings to take responsibility for its involvement in state security initiatives specifically designed to sustain apartheid rule;"⁵⁸ and "banks that gave financial support to the apartheid state were accomplices to a criminal government that consistently violated international law."⁵⁹ In light of these findings by the TRC, the lawsuit should be considered a continuation of the reconciliation process, which promised the prosecution of any perpetrators that did not come forward or were not granted amnesty, rather than a hindrance to it.

The final claim, that the litigation will negatively affect foreign direct investment and thus the ability of South Africa to reconstruct and provide jobs to its people,⁶⁰ raises the most interesting points of debate. Supporters of the South African government position argue that the precedent set would be disastrous for international trade, should the claim be awarded to the plaintiffs. Hufbauer and Mitrokostas, of the International Institute for Economics based in Washington D.C., argue that,

[c]orporate lawyers would advise the targeted multinational corporations (MNCs) and many other firms to curtail their investments ... in mainly developing ... countries with less than perfect observance of individual and labor rights and short-comings in the realm of political and environmental norms.⁶¹

Hufbauer and Mitrokostas further argue that existing ATCA litigation could, if successful, disrupt over three hundred-thousand US jobs and two million jobs world-wide,⁶² and lead to a net reduction in global economic output of \$70 billion.⁶³ While this is a substantial amount, it is dwarfed by the current economic losses associated with the global financial crisis and is arguably a small price to pay for the potentially-increased stringency of human rights norms for business practice.

Joseph Stiglitz argues that the litigation is unlikely to adversely affect the South African economy; it could even create a climate of increased stability and confidence in the markets. According to Stiglitz, “[a]ddressing corporate misconduct brings confidence to consumers and markets, creating a more positive business climate—genuine foreign investors are attracted to conditions of stability where social justice and good political, economic and corporate governance prevail.”⁶⁴ The post-apartheid South African government boasts one of the best human rights records in the world, with a firm commitment, at least on paper, to fulfilling the basic rights of its people. Thus, even if corporations only began investing in developing countries with good human rights records, South Africa would be unlikely to suffer. Further, the pressure that such litigation might put on other African countries to ensure that their regimes do not violate human rights, in the interest of attracting foreign investment, would actually further the aims of projects such as the New Partnership for Africa’s Development.

The US government has also been a vigorous opponent of the litigation, although its opposition stems from a broader argument against the very existence of the ATCA as a legal avenue for foreign nationals. In *Doe v. Unocal*, the US Department of Justice submitted a series of *amicus curiae* briefs challenging the ATCA legislation as having commandeered and transformed into a font of causes of action permitting aliens to bring human rights claims to U.S. courts. This holds even when the disputes are wholly between foreign nationals and when the alleged injuries were incurred in a foreign country, often with no connection whatsoever to the United States.⁶⁵

The US Department of Justice further argued that ATCA jurisprudence erroneously provided a right of action to private parties to enforce non-binding UN treaties and treaties that had not been ratified.⁶⁶ The US government’s opposition to the ATCA provisions reached its apogee under the Bush administration. The Bush administration’s opposition to the ATCA statute coincides with the filing of several lawsuits against politically-powerful defendants such as major corporations, foreign government officials, and even members of the US government itself.⁶⁷ Unlike the concerns previously expressed by US administrations, which amounted to the executive reserving the right to legally challenge the justiciability of any case, the Bush administration directed its attack at the very use and existence of the ATCA legislation.⁶⁸ It remains to be seen how the Obama administration will respond to similar concerns.

The basis of the Bush administration’s attack on the ATCA statute was two-fold: First, it argued, the evolution of the ATCA through jurisprudence had been a misinterpretation of the original intentions of the legislation.

Second, and more significantly, it argued that the ATCA cases pose a threat to the foreign policy directives of the executive branch of government.⁶⁹ Essentially, the administration's primary allegation is that through its rulings in the ATCA cases, the judiciary overstepped its role by making decisions about cases of international human rights violations which could affect the foreign affairs powers of the US government.⁷⁰ Stephens argues that the current administration's opposition to the ATCA amounts to it "seeking to shield human rights abusers from accountability in US courts and to grant the executive branch the sole power to pick and choose who should be held liable in what forum."⁷¹

There has always been tension between the various strands of the US government over foreign relations. In 1936, Justice Sutherland declared "the President as the sole organ of the federal government in the field of international relations ... [having the] plenary and executive power [to decide] the important complicated, delicate and manifold problems [of foreign relations]."⁷² In the 1970s, however, Judge Douglas argued that allowing the executive branch the power to decide which cases should be dismissed on foreign policy grounds would be dangerous to the proper functioning of constitutional democracy.⁷³

The opposition of both the South African and US governments has proven to be an ever-present aspect of the legal question in this case. Notably, the primary rationale given by corporations in their appeal to the US Supreme Court rests on the question of sovereignty and the role of the judiciary in deciding matters across national boundaries. They argue that

[i]n light of the opposition to this litigation expressed by the Executive Branch, by South Africa, and by other nations⁷⁴ – because plaintiffs' suits effectively seek to overturn South Africa's post-apartheid policy of reconciliation as well as the policies of the United States and other nations – the cases should be dismissed on grounds of case-specific deference to the political branches, political question, or international comity.⁷⁵

This argument, which was not tested in court because the appeal was dismissed due to the recusals of the Supreme Court judges, goes to the central question of the relationship between the state and corporations in a globalizing world. Should future decisions under the ATCA, such as that which will be made by the district court when it hears the final case in 2009, take the line that it is not the court's role to make decisions on cases where abuses occur in foreign countries, there would be a major clawing back of the options open to those affected by the actions of transnational corporations. Allowing the political establishment of

states to decide the fate of claims against corporations creates far fewer realizable avenues of action for victims and survivors.

Conclusion

This paper has attempted to briefly sketch some of the complexities that the relationship between states and transnational corporations brings to efforts to achieve corporate accountability. The transnational corporation embodies the globalizing nature of the contemporary world, existing simultaneously within and beyond the territorial boundaries of states. Negotiating corporate accountability in this context proves particularly challenging, because the individual power of states to impose stringent requirements on corporate activities is hampered by the need for investment and the absence of an enforceable supra-territorial framework for accountability. In light of this, a number of civil society groups are attempting to use the ATCA legislation in the United States as an avenue to realize some form of accountability, though it is narrowly legalistic in its possibilities. Given that the ATCA is one of the foremost spaces that negotiates the territorial/supra-territorial nature of transnational corporations, any threat to obtaining relief from, and access to, the ATCA should be viewed with major concern.

What becomes clear in the historical review of the complicity of corporations in apartheid human rights abuses, and of the post-apartheid redress sought in this case, is the complexity of state-corporate relations. While this paper initially posited the state as territorially bound and serving public interests against the corporations' supra-territoriality and private interest, the reality of these institutions is far more nuanced. In this case, states extend their influence beyond their own territories. The South African government has attempted to influence the decision of the courts, and the United States may extend international customary law through whatever judgment comes from the case. Likewise, because corporations are, in some way, territorially bound, a decision by the court in the United States is enforceable on US operations of the companies. Even in the context of this complex relationship, what remains clear in this case is the worrying trend of states acting in support of corporations and against their own citizens' attempts to seek justice. That the lawsuit has been opposed by the US and South African governments in its sheer existence, rather than for the specific claims being made in the case, points to a worrying consensus between these states and corporations

that, where business interests may be harmed, human rights abuses can go unaddressed. ■

Notes

¹ Mark S. Mizruchi, "Berle and Means Revisited: The Governance and Power of Large U.S. Corporations," *Theory and Society* 33, no. 5 (2004): 579–617, 603.

² James Ramage, "The Growth and Moral Attitude of Corporations," *The American Law Register* (1898–1907), no. 4 (1901): 221–31, 225.

³ United Nations (UN) Commission on Human Rights: Sixty-Second Session, "Promotion and Protection of Human Rights: Interim Report of the Special Representative of the Secretary-General on the issue of Human Rights and Transnational Corporations and Other Business Enterprises" [E/CN.4/2006/97], February 22, 2006, <http://www1.umn.edu/humanrts/business/RuggieReport2006.html> (accessed November 15, 2008).

⁴ For more detailed discussions of the ATCA and its implications see Edward J. Schoen, Joseph S. Falcheck, and Margaret M. Hogan, "The Alien Tort Claims Act of 1789: Globalization of Business Requires Globalization of Law and Ethics," *Journal of Business Ethics* 62, no. 1 (2005): 41–56; Rachel Chambers, "The Unocal Settlement: Implications for the Developing Law on Corporate Complicity in Human Rights Abuses," *Global Policy Forum*, 2005, <http://www.globalpolicy.org/intljustice/atca/2005/09unocal.pdf> (accessed March 1, 2009); Ronen Shamir, "Between Self-Regulation and the Alien Tort Claims Act: On the Contested Concept of Corporate Social Responsibility," *Law and Society Review* 38, vol. 4 (2004): 635–64; Michael D. Ramsay, "Multinational Corporate Liability under the Alien Tort Claims Act: Some Structural Concerns," *Hastings International and Comparative Law* 24, no. 3 (2001): 361–80; Justin Lu, "Jurisdiction over Non-State Activity under the Alien Tort Claims Act," *Columbia Journal of Transnational Law* 35 (1997): 531–49; Jean-Marie Simon, "The Alien Tort Claims Act: Justice or Show Trials," *Boston University International Law Journal* 11 (1993); Anne-Marie Burley, "The Alien Tort Statute and the Judiciary Act of 1789: A Badge of Honor," *American Journal of International Law* 83 (1989): 461–93; Jeffrey M. Blum and Ralph G. Steinhardt, "Federal Jurisdiction over International Human Rights Claims: The Alien Tort Claims Act after *Filartiga v. Peña-Irala*," *Harvard International Law Review* 22 (1981).

⁵ Gary C. Hufbauer and Nikolas K. Mitrokostas, *Awakening the Monster: The Alien Tort Statute of 1789* (Washington, DC: Institute of International Economics, 2003).

⁶ Lucien J. Dhooze, "The Alien Tort Claims Act and the Modern Transnational Enterprise: Deconstructing the Mythology of Judicial Activism," *The Georgetown Journal of International Law* 35 (2003–2004): 12.

⁷ *Filártiga v. Peña-Irala*, 630 F.2d 876 (2d Cir. 1980).

⁸ Beth Stephens, "Upsetting Checks and Balances: The Bush Administration's Efforts to Limit Human Rights Litigation," *Harvard Human Rights Journal* 17 (2004): 169–205, 174.

⁹ *Ibid.*, 177.

¹⁰ *Sosa v. Alvarez-Machain*, 542 U.S. 692 (2004).

¹¹ For more in depth discussion of this aspect see John G. Dale, "Transnational Conflict between Peasants and Corporations in Burma: Human Rights and Discursive Ambivalence under the U.S. Alien Tort Claims Act," in *The Practice of Human Rights: Tracking Law between the Global and the Local*, eds. Mark Goodale and Sally Engle Merry (Cambridge: Cambridge University Press, 2007), 285–319.

¹² A South African NGO made up of roughly fifty-five thousand victims of apartheid gross human rights violations. "Khulumani" is a Zulu word meaning "speak out." Victims and survivors of gross human rights violations started the Khulumani Support Group as a means by which to ensure that those victims appearing before the Truth and Reconciliation Commission hearings had adequate support to speak publicly about their experiences. The organization now works at continuing the work of reconciliation in South Africa and at acting as an advocacy organization for the interests of victims of gross human rights violations, and it is providing counselling and support for its members. The eighty-seven named plaintiffs are representatives of the different categories of human rights violations that the corporations are alleged to have aided and abetted the South African state in committing.

¹³ *Khulumani et al. v. Barclays et al.*, "Original Complaint," United States District Court, Eastern District of New York, November 11, 2002, <http://www.cmht.com/pdfs/apartheid-cmpl.PDF> (accessed November 15, 2008), 160.

¹⁴ *Ibid.*, 166.

¹⁵ United General Assembly Resolution, "Treatment of People of Indian Origin in the Union of South Africa," A/RES/395 (V), December 2, 1950.

¹⁶ United Nations General Assembly Resolution, "The Policies of Apartheid of the Government of South Africa," A/RES/2396 (XXIII), December 2, 1968.

¹⁷ United Nations General Assembly Resolution, "Policies of Apartheid of the Government of South Africa: Economic Collaboration with South Africa," A/RES/31/6 H, November 9, 1976.

¹⁸ Jonathan Leape, Bo Baskin, and Stefan Underhill, *Business in the Shadow of Apartheid: U.S. Firms in South Africa* (Lexington: Lexington Books, 1986), xxv.

¹⁹ Khulumani, "Original Complaint," 68.

²⁰ *Ibid.*, 70.

²¹ *Ibid.*

²² *Ibid.*

²³ *Ibid.*, 5.

²⁴ *Ibid.*, 100.

²⁵ Ibid.

²⁶ Ibid.

²⁷ Timothy H. Smith, "Bank Loans to South Africa: The Case against 'Business as Usual,'" *Issue: A Journal of Opinion* 7, no. 1 (1977): 12-4, 13.

²⁸ Khulumani, "Original Complaint," 112-13.

²⁹ Ibid.

³⁰ Ibid.

³¹ Ibid., 125.

³² Ibid.

³³ Ibid., 132.

³⁴ Ibid., 141.

³⁵ Ibid.

³⁶ Ibid., 146.

³⁷ Ibid., 140.

³⁸ Ibid.

³⁹ Jennifer Davis, "American Committee on Africa testimony before the United States Senate Committee on Foreign Relations Subcommittee on African Affairs," September 29, 1976, cited in *Khulumani*, "Original Complaint," 145.

⁴⁰ Ruth First, Jonathan Steele, and Christabel Gurney, *The South African Connection: Western Investment in Apartheid* (London: Temple Smith, 1972), 162.

⁴¹ Khulumani, "Original Complaint," 162.

⁴² Ibid.

⁴³ Ibid., 163.

⁴⁴ Ibid., 164.

⁴⁵ Khulumani Support Group, "Judge Dismisses the so-called 'Apartheid Lawsuits,'" December 1, 2004, <http://www.brandonhamber.com/documents/legalaction-press4.htm> (accessed November 15, 2008).

⁴⁶ CNN, "Supreme Court Upholds Apartheid-Era Lawsuit," May 12, 2008, <http://money.cnn.com/2008/05/12/news/international/apartheid-lawsuit/?postversion=2008051211> (accessed November 15, 2008).

⁴⁷ *Khulumani et al. v. Barclays et al.*, "Amended Complaint," United States District Court, Southern District of New York (October 31, 2008).

⁴⁸ Nkosazana Dlamini-Zuma, "Letter to Colin Powell, U.S. Secretary of State: Litigation Against Corporations that may have Benefited from the Apartheid System," May 4, 2002, <http://www.nftc.org/default/ussabc/DAE8515.pdf> (accessed March 1, 2009).

⁴⁹ Ibid., 1.

⁵⁰ Penuell M. Maduna, "Declaration by Justice Minister Penuell Maduna on Apartheid Litigation in the United States," July 11, 2003, <http://www.info.gov.za/otherdocs/2003/apartheid.pdf> (accessed March 1, 2009), 7.

⁵¹ *Ibid.*, 11.

⁵² *Ibid.*

⁵³ *Ibid.*, 12.

⁵⁴ Paul Gready, "The *Khulumani v. Barclays* case and the Future of Human Rights in South Africa" (conference presentation, Justice for Apartheid Crimes: Corporations, States and Human Rights, Oxford Transitional Justice Research Group, Oxford University, January 30, 2009).

⁵⁵ Richard Meeran, "Domestic Barriers to Accountability for Multinational Corporations," conference presentation, Justice for Apartheid Crimes: Corporations, States and Human Rights, Oxford Transitional Justice Research Group, Oxford University, January 30, 2009.

⁵⁶ *Khulumani et al. v. Barclays et al.*, "Brief of Amici Curiae International Human Rights Organisations, TRC Commissioners, and Others in Support of the Plaintiffs," United States District Court Southern District of New York, September 29, 2004, <http://www.cmht.com/pdfs/AmicusBriefAsFiledSeptember292004.PDF> (accessed November 15, 2008), 18.

⁵⁷ Nicoli Nattrass, "The Truth and Reconciliation Commission on Business and Apartheid: A Critical Evaluation," *African Affairs* 98, no. 392 (1999): 373–91, 375.

⁵⁸ Truth and Reconciliation Commission of South Africa (TRC), *Truth and Reconciliation Commission of South Africa Report* vol. 4, chap. 2 (Cape Town, 1998), 161.

⁵⁹ Truth and Reconciliation Commission of South Africa (TRC), *Truth and Reconciliation Commission of South Africa Report* vol. 6, sect. 2, chap. 5 (Cape Town, 1998), 26.

⁶⁰ Christelle Terreblanche, "South Africa: Tutu Tackles Government Over Reparations," *Sunday Tribune Online*, January 2, 2004, <http://www.afrika.no/Detailed/4774.html> (accessed November 15, 2008).

⁶¹ Hufbauer and Mitrokostas, *Awakening*, 1.

⁶² Gary C. Hufbauer, "New Class Action Vehicle Threatens World Economy," Peterson Institute for International Economics, July 24, 2003, <http://www.peterson-institute.org/publications/newsreleases/newsrelease.cfm?id=94> (accessed March 1, 2009).

⁶³ *Ibid.*

⁶⁴ Norman Reynolds, "Khulumani's Reparations Case and the Future of Human Rights," *Pambazuka*, January 6, 2005, <http://www.globalpolicy.org/intljustice/atca/2005/0106khulumani.htm> (accessed November 15, 2008).

⁶⁵ Dhooge, "Alien Tort Claims," 9.

⁶⁶ Ibid. So, for example, the Department of Justice argues that it should not be held liable for violations of treaties such as the Convention on the Rights of the Child, which the United States has signed but not ratified.

⁶⁷ Ibid., 170.

⁶⁸ Ibid., 173.

⁶⁹ Ibid., 182.

⁷⁰ Stephens, "Upsetting Checks and Balances," 169.

⁷¹ Ibid., 173.

⁷² Ibid., 171.

⁷³ Ibid., 170.

⁷⁴ Switzerland and the United Kingdom, as the home governments of some of the defendants, have also released statements condemning the litigation.

⁷⁵ *American Isuzu Motors, Barclays Bank et al. v. Lungisile Ntsebeza, Khulumani et al.*, "Petition for a Writ of Certiorari," November 2007.

The Business of Transnational Climate Governance: Legitimate, Accountable, and Transparent?

PHILIPP PATTBURG AND OKECHUKWU ENECHI

ABSTRACT

In recent years, the number of transnational climate change governance arrangements has increased. Transnational corporations in partnership with governments, intergovernmental organizations, and non-governmental actors have established a variety of schemes that aim to govern the global climate arena. This article argues that while the effectiveness of transnational climate governance arrangements in reducing greenhouse gas emissions is hard to measure, the question of the legitimacy of these arrangements should receive greater attention. To assess the legitimacy of transnational climate governance arrangements, we analyse (1) their inclusiveness and openness, (2) their accountability and transparency mechanisms, and (3) their discursiveness. We address these questions with regard to three transnational climate governance arrangements that have gained relevance in climate governance over the last years: the Global Gas Flaring Reduction Partnership, the Carbon Disclosure Project, and the Chicago Climate Exchange. We conclude that even though at present most transnational schemes lack either proper legitimacy, accountability, or transparency, such schemes have placed a number of responsibilities on corporations, which in the long run could lead to behavioural change and contribute to successful global climate change governance.

Transnational climate governance arrangements have become a central topic of scientific debate within the larger context of agency in global environmental politics.¹ Numerous arrangements that involve companies, NGOs, and public actors are adding to the complexity of contemporary climate governance. These include private standard-setting initiatives for the carbon market (such as the Gold Standard), public-private governance networks that implement internationally-agreed outcomes including the Millennium Development Goals (such as The Renewable Energy and Energy Efficiency Partnership), public non-state networks that focus on mitigation (such as C40, a recent initiative of 40 global cities to curb their greenhouse gas emissions), and private networks that attempt to govern the climate arena through information disclosure and public awareness (such as the Carbon Disclosure Project). From these, a host of governance arrangements agree upon, implement, and monitor

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climate policies that are beyond the state in two ways. First, transnational climate governance arrangements primarily derive their authority from pragmatic sources rather than formal sources. Second, the decisions and rules emerging from transnational climate governance arrangements are not predominantly targeted at public actors (i.e., states) but attempt to influence the behaviour of private actors (i.e., companies). This empirical observation has led to attempts to typologize and conceptualize the nature of transnational climate governance in more detail.² Scholars have also begun to study the effectiveness of climate governance beyond the state. However, as we argue in this article, a complementary research effort is needed to study the implications of transnational climate governance for our understanding of democratic legitimacy, accountability, and transparency. Although the effectiveness of transnational governance is a crucial issue, we argue that questions of legitimacy are currently pivotal to wider global governance.³

The need to study the legitimacy of transnational arrangements derives from two assumptions, one empirical and the other theoretical. First, transnational arrangements are influential and have significant effects beyond their narrowly conceived effectiveness or problem-solving contribution, including normative, discursive, and material effects.⁴ They create markets through research and development of new products, seek information disclosure from companies, and share information geared towards influencing climate governance, among other roles. Transnational climate governance arrangements set rules and regulations, and companies frequently comply with these rules. For example, 1,550 companies and 385 institutional investors from different geographical regions and business sectors participated in and complied with the 2007 questionnaire (CDP6) of the Carbon Disclosure Project (CDP),⁵ which requests companies to disclose information on their carbon emissions.

The Chicago Climate Exchange (CCX), a US-based organization regulated by US commodity exchange laws, has continued to increase its sphere of influence globally despite its voluntary nature, with its membership growing across sectors and regions. The CCX has attracted membership from organizations and government agencies outside the United States, with affiliates established in Canada, Europe, and China. The Global Gas Flaring Reduction Partnership (GGFR) actively involves a number of oil companies and oil-producing countries in rule- and decision-making processes geared toward the reduction of gas flaring. According to World Bank estimates, gas flaring contributes approximately four hundred-million metric tonnes of carbon dioxide (CO₂) to the annual global CO₂ emissions.⁶

The second argument for studying transnational climate governance arrangements is based on the theoretical assumption that increased input legitimacy will also increase the output legitimacy and effectiveness of transnational governance. Given the inadequate international responses to the challenge of global climate change, understanding the conditions for successful transnational climate governance becomes imperative. Consequently, we argue that an assessment of input legitimacy is an important complement to the current focus on questions of the effectiveness of global environmental governance.⁷

In this article, we first analyse the legitimacy of transnational climate governance arrangements that have gained prominence in global environmental governance. We proceed by developing a theoretical framework to analyse the legitimacy of transnational climate governance schemes. Secondly, we briefly discuss the top fifty companies from the global *Financial Times* (FT) 500 companies across regions, sectors, and industries to map the empirical landscape of transnational climate governance. Based on this overview, we select the three most relevant transnational climate governance arrangements as case studies. Finally, we discuss the legitimacy of the case studies based on the theoretical framework and present conclusions and areas for further research.

Understanding the Legitimacy of Transnational Governance

Understanding the legitimacy of transnational governance arrangements in the area of global climate politics is not a simple task. A number of assessments build on the “input” and “output” criteria as suggested by Fritz W. Scharpf in his complex theory of democracy,⁸ while others conceptualize “throughput” criteria.⁹ However, most scholars choose “output”—with emphasis on “effectiveness”—over “input,” which centres on the quality of the decision-making processes. Some scholars have gone further to conceptualize a functional link between “input” and “output.”¹⁰ Focusing on output criteria, transnational climate governance arrangements could be analysed based on their success or effectiveness. Taking into account that transnational climate governance arrangements are functionally similar to international regimes, their success or effectiveness would be proven when they meet “the goals as set by the arrangement’s initiators and members.”¹¹ However, this perspective does not take into account the quality of the decision-making process. Hence, the success or effectiveness of transnational climate

governance is an important aspect, but not the only possible framework for its analysis. In analysing transnational governance, scholars have focused on “procedural legitimacy,” “linking decision-making procedure to effectiveness,”¹² “influence,”¹³ “participation and accountability,”¹⁴ “accountability and legitimacy,”¹⁵ “accountability, legitimacy, and effectiveness,”¹⁶ and “efficiency and effectiveness.”¹⁷

However, while the question of effectiveness of transnational climate governance is important, many arrangements are arguably still at an early stage and are thus difficult to assess, especially when it comes to quantifying the reduction of greenhouse gas (GHG) emissions. Furthermore, it is difficult to measure the hard impacts of soft disclosure-based arrangements at this stage.¹⁸ Consequently, an argument can be made that the legitimacy of transnational governance arrangements is a central component of the wider global governance debate. Although it may be too early, and too hard, to measure the effectiveness of transnational climate governance arrangements, it is at least conceivable that these arrangements produce effects and have significant consequences for global climate politics.¹⁹

Legitimacy has developed into a major perspective in transnational decision- and rule-making processes. In addition to legitimacy, accountability and transparency have also emerged as useful perspectives for the analysis of rule-making processes within transnational climate arrangements.²⁰ Legitimacy, as a concept in International Relations (IR) scholarship, has largely been attributed to acts of governments. However, the proliferation of “transnational rule-making processes,” which “now constitute contemporary global governance,”²¹ has intensified the debate about the legitimacy of decision-making processes beyond the international arena.

What is still missing is a commonly agreed-upon definition of legitimacy in transnational governance. In an attempt to provide a clearer explanation of what legitimacy entails, scholars distinguish different forms of legitimacy, such as “sociological and normative,” “input and output,” “throughput,” “internal and external,” “constitutional,” and “teleological.” One unifying feature of these explanations is the strong emphasis they place on the relationship between legitimacy and the concept of democracy. This has led to the conceptualization of “democratic legitimacy” by a number of IR and political science scholars.²²

A broad consensus exists that climate change governance has developed beyond public governance institutions to include authority beyond the state.²³ The empirical observation that governance of global climate change is not limited to, or centralized in, public governance institutions has opened space for pluralistic accounts of global climate

governance. Pluralism, as a concept, describes the interaction of political and social actors in liberal democracies, while normatively it is conceived to include the active involvement of voluntary organizations set up by individuals. In democratic pluralism, concepts such as “participation,” “inclusiveness,” “dialogue,” “discursiveness,” “deliberativeness,” “accountability,” “control,” and “transparency” are regarded as the primary sources of legitimacy. These sources of democratic legitimacy inform our analytical framework for the empirical analysis of transnational climate change governance.²⁴ We will further elaborate on the elements of (1) participation and inclusiveness, (2) control, and finally (3) discursiveness.

Participation and Inclusiveness

Participation and inclusiveness as key features of pluralism are often described as necessary to establishing the democratic legitimacy of decision-making processes that have a collective impact. Participation and inclusiveness are described as core elements of democracy and imply at least a minimum degree of participation of individuals affected by a certain decision.²⁵ One controversial question is whether transnational governance arrangements do require the same level of participation and inclusiveness as arrangements involving state actors. Although there is no consensus yet among IR scholars on the level of participation and inclusiveness required, more detailed research might be needed to provide the basis for such a benchmark. However, partial agreement exists that participation and inclusiveness are imperative for democratic legitimacy. The World Bank, for example, defines participation as a “process through which stakeholders influence and share control over ... initiatives and the decisions ... which affect them.”²⁶ The question then is how much participation and inclusiveness transnational decision-making would require in order to be legitimate. The issue of participation should arguably include the question of how much influence participants actually have on the decision-making process. As the minimum requirements for participation are context-specific and depend on the issue in question, a general formula is hard to agree upon. Within the context of our discussion, we, however, assume that participation from all sectors (government, for-profit, and civil society) is a minimum requirement for legitimate transnational climate change governance arrangements. Consequently, it is imperative to raise such questions as: Who is participating? Were the participants selected or elected? What

methods were used to identify the participants? These questions will guide the analysis of diversity and levels of participation in the decision-making process of transnational governance arrangements.

Control

Control is another fundamental principle of democratic legitimacy. It is a feature that is recognized in concepts of both constitutional and pluralistic democracy. Its basic elements are accountability and transparency. Accountability, according to Robert Keohane, is the relationship in “which an individual, group and other entity makes demands on an agent to report on his or her activities and has the ability to impose costs on the agent.”²⁷ However, he acknowledges that accountability conceptualized in this form is highly institutionalized, while other forms of accountability are more contested. Accountability, according to Peter Newell, goes beyond the “formal institutional arenas in which its most obvious manifestations are often described.”²⁸ However, concepts of accountability are easy to understand in relation to formal institutions’ bureaucratic context, but problematic in relation to informal institutions. On this account, Sander Chan and Philipp Pattberg distinguish accountability systems into public, market-based, and civic ones.²⁹ Public accountability is understood as hierarchical, whereas market-based and civic accountability are non-hierarchical. In a similar vein, Newell divides accountability into “public accountability and civil regulation.”³⁰ In public accountability, the focus is on the bureaucratic context of government, where those who are entrusted with authority and power are requested to accept responsibility and fulfil obligations. Instruments such as lobbying, protests, media coverage, and legal instruments are employed in achieving public accountability. In civil regulation, the focus lies on private organizations that do not have the formal authority to make rules or decisions but nevertheless have the power to make an impact in a given area. Several mechanisms such as shareholder activism, corporate movements, and civil society are used to ensure accountability.³¹

For analytical reasons, we distinguish between two different forms of accountability: internal accountability that links the organizational and individual members of an arrangement, and external accountability that relates them to the wider public. Furthermore, Andreas Schedler argues that the concept of accountability connotes answerability and enforcement. While answerability imposes obligations on the person

or organization entrusted with decision-making, enforcement can be understood as a right of affected stakeholders to impose sanctions on the person or organization on whose behalf the decision is being made.³²

Transparency is another concept often mentioned in the study of transnational governance. Aarti Gupta, for example, argues that transparency is a “moral imperative” that is functionally linked to accountability, legitimacy, and democratic governance.³³ Transparency is conceptualized as the “extent to which individuals affected by a decision are able to learn about the decision-making process.”³⁴ On this account, it connotes openness and accessibility in decision-making processes.

Discursiveness

Discursive democracy is described as an association which is governed by the public deliberation of its members.³⁵ Deliberation is a tool through which binding collective decisions are made. The ideal of discursiveness provides the necessary criteria for differentiating discursive and non-discursive decision-making processes. Although there seems to be a consensus on discursiveness as a basic principle of democratic legitimacy, there is no consensus on how much discursiveness is sufficient in private decision-making processes. This gap is even more prominent in the study of climate change governance due to the diverse interests involved in climate change politics. Since decision-making processes involve pluralistic concepts, diverse ideals, convictions, and preferences, it is important to carry out a careful analysis of the discursive quality. To aid in this analysis, we ask: How pluralistic is the discursive process? Is deliberation an ongoing and independent process? Are the outcomes of the deliberations perceived as fair? Do all the participants have the capacity to enter into such deliberation? How autonomous are the participants in the process? Through these questions we seek to analyse the deliberative quality of transnational governance arrangements.

Thus, participation, inclusiveness, control, and discursiveness are dimensions on which the legitimacy of transnational climate governance can be assessed. However, it is important to acknowledge the variation of transnational climate change governance in scope and ambition. As a consequence, we seek to analyse the background of each transnational governance arrangement in more detail and to ascertain the source of authorization for transnational climate governance.

FT Global 50 Companies

The FT Global 50 companies are regarded as the largest companies in the world valued according to their market capitalization.³⁶ The FT Global 50 consists of twenty American companies and nineteen European companies including Russia companies, while eleven are based in other parts of the world.³⁷ We have categorized the companies into two sectors: energy intensive and energy extensive.³⁸ The energy intensive sector includes oil and gas companies (eleven), mining, metal and general industries (six), food and beverages producers (three), pharmaceuticals and biotechnology (five), utilities (two), household goods and home construction (one), general retailers (one), and automobile industry (one).

The extensive energy sector includes banking and insurance (nine), telecommunication (four), and equipments, software and hardware industries (seven). Taken together, companies within the FT Global 50 sample participate in over fifty transnational governance arrangements. Examples include the Equator Principles (EP), the UN Global Compact, the Global Reporting Initiative (GRI), the Carbon Disclosure Project (CDP), the Global Gas Flaring Reduction Partnership (GGFR), and the Chicago Climax Exchange (CCX). While some governance arrangements are related to wider notions of sustainability, others are specifically geared toward climate governance. Among the transnational governance arrangements that are specific to climate change, three are most common in our sample: CDP, CCX, and the GGFR. The CDP is an information-based arrangement that requires companies across sectors and regions to disclose their carbon emissions to investors and the wider public. The CCX is a voluntary but legally binding market-based arrangement that trades carbon emissions, while the GGFR is a public-private partnership that is involved in capacity-building and policy-making related to global gas flaring reduction. Among the FT Global 50 companies sampled, thirty-four participate in the CDP, seven in the GGFR, and three in the CCX. In the FT Global 50 sample, there are eleven oil and gas companies, seven of which are GGFR members. All seven companies are based in Europe and North America. The CDP includes eighteen companies based in the US, thirteen companies based in Europe, and four companies based in other parts of the world.³⁹ The participation of companies in the CDP cuts across regions, sectors, and industries. The CCX has three US-based

companies from the energy extensive sector participating within the FT Global 50 sample.

A quick glance at the variation of company participation shows that companies participate more frequently in information-based transnational climate change arrangements than in involuntary, legally binding market-based arrangements. Other types of arrangements that companies frequently participate in are capacity-building and product launch arrangements. Geographically, European and North American transnational corporations (TNCs) participate more often in transnational climate change governance arrangements than companies based in other regions.

In sum, the high participation of TNCs in information and capacity building as well as product launch arrangements is mainly due to strategic and competitive considerations. Information- and disclosure-based arrangements provide companies with an opportunity to “launder” their corporate image and continue to build “good” brands, while capacity-building and product launch arrangements enable companies to make strategic investments at lower operational cost or to increase their revenue by marketing new “environmentally friendly” products. The low-level participation in market-based arrangements, which are voluntary but legally binding, can be explained by the costs involved. Energy intensive companies are reluctant to join a market-based arrangement since it might increase their operational cost and litigation risk. It is not surprising that North American and European companies participate more frequently in transnational governance arrangements, as the level of global climate change awareness and corresponding NGO pressure is higher in these two regions. After this broad overview of the fifty leading companies worldwide, we focus on the legitimacy, accountability, and transparency of three specific cases in the next sections: the GGFR, the CDP, and the CCX.

Global Gas Flare Reduction Partnership

The Global Gas Flare Reduction Partnership (GGFR) has emerged as an outcome of the World Summit on Sustainable Development (WSSD) held in Johannesburg in 2002.⁴⁰ It can be characterized as a capacity-building and policy-making arrangement involving governments of oil-producing countries as well as private and state-owned oil companies in the development and implementation of “best practices” toward reduction of carbon emissions from gas flaring and venting. The

arrangement has been established to mitigate the negative climate implications of global gas flaring and venting,⁴¹ which contribute about four hundred million metric tonnes of carbon dioxide to annual CO₂ emissions.⁴² As of November 2008, the Partnership counts fourteen oil-producing countries, ten oil companies, as well as the Organization of the Petroleum Exporting Countries (OPEC) and the World Bank among its members.⁴³ Five donor countries and the European Union (EU) are funding the arrangement. A central goal of the initiative is poverty reduction, which is to be achieved through the development of domestic utilization of natural gas. The decision and rule-making processes of the GGFR are authorized by the member countries of the Partnership. The decisions taken and the rules made by the Partnership are directed at oil companies and oil-producing countries, which are generally expected to reduce global gas flaring. A globally applicable norm for gas flaring and venting could arguably introduce some conflicts among the oil producing countries due to their diverse economic backgrounds. However, it could be argued that the beneficiaries might be the oil companies themselves, as a voluntary global norm would potentially pre-empt binding national or international regulations.

To sum up, the GGFR affects global climate change governance as it intends to decrease global gas flaring activities that will lead to significant reductions in annual GHG emissions. In addition, it has a direct impact on the participating oil and gas companies.

(1) Participation and Inclusiveness

Participants in the Partnership are drawn from the oil and gas industries. The donor countries involved in the Partnership are also oil and gas producing countries. Although member countries theoretically represent their citizens, active participation by (NGOs) and civil society organizations—which represent individuals directly affected by the day-to-day gas flare activities and have thereby acquired some level of “expertise” due to their long campaign against gas flare practices—are absent from the Partnership. Extending the constituency to include participants from outside the oil and gas sector would have allowed more diversity and helped to shape the outcome of the decision-making process positively.

As donors, Canada, Norway, the United States, the United Kingdom, France, and the European Union approve the Partnership projects and provide funding through the World Bank. In addition, it is noteworthy

that the corporate members of the Partnership are exclusively based in the donor countries.⁴⁴

However, although the Partnership is global in scope, a majority of oil-producing countries and oil companies are still not part of the initiative. One interesting observation is that oil companies operating in non-member countries are also not members of the Partnership. An example is the non-participation of Russia and Gazprom.⁴⁵ This suggests a strong link between country participation and company participation in the Partnership. The non-participation of other oil producing countries and oil and gas companies in the decision-making process has added to the participation deficit of the Partnership. Overall, participation in, and inclusiveness of the GGFR are restricted and, by and large, the Partnership has failed to attract participation from the majority of oil-producing countries and companies.

(2) Control

The donor countries provide funds for the day-to-day operations of the Partnership and hence retain control of the Partnership. However, there is an evaluation and verification routine by the Partnership through the World Bank to determine and approve global gas flaring projects. Approval of such projects is carried out by the steering committee made up of the donor countries as well as other selected member countries and chaired by the World Bank. The strong influence of the donor countries and explicit exclusion of some member countries (mainly from the Global South) in the decision-making process leads to some imbalance. The participation of the World Bank as the chair of the decision-making process notwithstanding, the donor country members are the most influential actors in the Partnership. Also, the decision-making process may well be biased in favour of the private oil and gas companies, which are all based in the donor countries. A careful analysis of the rate of gas flare published by the US National Oceanic and Atmospheric Administration (NOAA) shows a slower decrease in developing countries when compared to the reduction rate in the donor countries.⁴⁶

Since non-state actors are excluded from the decision-making process, it is difficult for the oil and gas companies to be held accountable externally. Moreover, while member governments are expected to collate gas flare information and publish it, the companies are only expected to publish voluntarily the gas flare information in their annual sustainability reports. This reporting routine of the GGFR raises serious questions about the reliability of information published by both the member countries

and companies.⁴⁷ Hence, there is no clear mechanism for external accountability in the GGFR, even though it would be required for an issue such as global climate change. The evaluation and verification procedure by the World Bank on behalf of the GGFR is an internal rather than an external control mechanism. The non-existence of clear external control mechanisms raises questions about the normative legitimacy of the decision- and rule-making process.

(3) Discursiveness

As discussed above, the internal rule-making process of the GGFR lacks inclusiveness. The discursive quality of the process is limited due to a number of factors. First, it might be difficult for developing country members that are primarily interested in poverty reduction to oppose any proposal put forward by the donor countries. This economic dependency affects their relationship with the private oil companies that are all based in the donor countries. Second, although the decision-making process is open to every member of the Partnership, the agenda is set by the steering committee, which consists of the donor countries and the World Bank. Third, the voluntary nature of the regulation makes it difficult for the outcome of the discursive process to bind every member of the Partnership at the same time. Arguably, the developing countries are the junior partners in the process, as they have neither the technology and knowledge that companies from developed countries have nor appropriate funds to secure equal participation in the discursive process. The role of OPEC in the entire discursive process is not clearly defined as its role is not mentioned in the official documents.

In sum, the openness and equal participation in the discursive process of the GGFR can be questioned. The developing country members of the Partnership may just play along to get poverty reduction funding rather than substantive reduction of gas flares. This could hamper the effective governance of global gas flaring.

Carbon Disclosure Project

The CDP is an independent non-profit organization representing, as of 2008, 385 institutional investors with an investment base of approximately fifty-seven trillion US dollars.⁴⁸ In 2003, it issued its first CDP questionnaire that asked companies to disclose their past and future

carbon emissions.⁴⁹ The CDP, to date, has issued six questionnaires to companies requiring disclosure of their carbon emissions.⁵⁰ The required disclosure stimulates information sharing about climate change and the related business risks between companies and stakeholders. The Project's goals are based on the assumption that information disclosure will motivate and facilitate meaningful dialogue among business actors, investors, and the wider public to induce corporate responses to climate change.

The CDP decision- and rule-making processes are authorized by investors. Although the individual investor did not authorize the process, institutional investors arguably represent them. The governance arrangement is directed at companies across industries and regions. Carbon emission disclosure has become imperative due to business activities that cause anthropogenic climate change. As a governance mechanism, disclosure is intended to induce behavioural change among companies such as innovation and use of "clean technologies," as well as to provide a global mechanism to monitor corporate carbon emissions independently of states. In view of this, the global public is interested in the decisions and effects of the arrangement.

The business community has, by and large, responded very positively to the CDP. Among the FT Global 50 alone, thirty-four responded to the CDP5, cutting across regions and sectors. However, the voluntary nature of the arrangement has given many of the transnational companies the flexibility to choose the region they include in their emission disclosure. For example, some transnational corporations have chosen to disclose information on their carbon emissions deriving from their activities in developed countries exclusively. Most companies place a disclaimer in their answer that the information they are disclosing does not include their activities in some developing countries. In the end, the global scope of CDP's disclosure norm has allowed companies to retain some control over the process by providing them with some flexibility in terms of their reporting.

(1) Participation and Inclusiveness

Investors are at the centre of the CDP's decision-making procedure. Although they are not represented individually, the institutional investors that make up the signatory investors and members of the Project represent them in the decision and rule-making process. The constituency is drawn in such a way that it includes investors across sectors and regions. The involvement of non-state actors such as NGOs

is not explicitly stated; however, as initiators and supporters of the idea of corporate carbon disclosure they retain some rhetorical influence in the decision-making process. In addition, the voluntary funding and support given to the CDP by some national governments have further diversified the participation to include public actors to some degree. While the content and structure of the CDP questionnaire is decided on by the institutional investors, the responding companies are only passive participants in the Project. Hence, there are two levels of participation in the governance arrangement: the responding companies and the global public are passive participants while the institutional investors take the decisions. Although the institutional investors are assumed to represent the investors, it would have been more appropriate to allow participation of every interested member of the global public in the decision- and rule-making process of the Project by making available the draft questionnaire publicly on the Internet before its final approval. The output of the arrangement (i.e. the questionnaire) is intended for global use. However, a majority of the institutional investors are based either in Europe or in North America. Institutional investors from other regions of the world are not explicitly excluded from participation. Nevertheless, their non-participation suggests that they lack the capacity to participate and thus are implicitly excluded. Hence, legitimacy could be increased by mechanisms that encourage the participation of institutional investors from other parts of the world.

(2) Control

The CDP questionnaire and reports are public and can be accessed via the Internet. The draft questionnaire is made available to all the signatory investors that make up the decision-making body; the responses from the companies are stored in a database, which is also accessible online without any restrictions. The questionnaire at the draft stage, however, is not made available for input from interested parties and the wider public. The CDP receives funding from various sources, including NGOs and some national government agencies. Making the information available on the Internet has made it easy for the individual investors that are not directly involved in the decision-making process to have access to the information.

There is no institutional control mechanism in place to monitor and verify company responses. The lack of verification and monitoring mechanisms may result in companies manipulating their responses in order to appear “good and responsible” in the eyes of the global pub-

lic. Nevertheless, the CDP allows exchange of information and, most likely, induces independent verification and monitoring of companies' responses by individuals and groups. Potentially, individuals and groups may, in the near future, use the responses to hold companies accountable for their actions with regard to global climate change. The non-existence of a control mechanism may have contributed to the CDP questionnaires' high corporate response rate. Among the FT Global 50 companies sampled, thirty-four companies responded to the CDP5, and there is every possibility that more will join in the future.

To conclude, the CDP has shown a considerable level of external accountability. Although its internal accountability might be contested, the nature of climate change politics calls for more external rather than internal accountability. At the same time, the non-existence of institutional verification and monitoring mechanisms might encourage manipulation of responses by the companies.

(3) Discursiveness

The institutional investors, so-called signatory investors, dominate the CDP decision-making process. They approve the questionnaire to be distributed to the companies for responses after input from selected stakeholders. The input is usually at an advisory level and not binding on the board. In addition, the composition of the stakeholders is not transparent. The companies that are required to respond to the questionnaire are not part of the deliberations that lead to a new questionnaire. The signatory investors that make up the decision-making body of the Project are neither elected nor selected; the only criteria are that a signatory investor should be an institutional investor and that its membership be voluntary. Arguably, the signatory investors are representing the interest of individual investors in the discursive process although they were not explicitly elected or selected to do so. Several non-state actors such as NGOs and some investor groups that have contributed to the establishment of the Project retain a strong influence on the discursive process. The question is whether the influence of other non-state actors on the discursive process has negatively affected the arrangement's autonomy or not. It could be argued that it has indeed affected the autonomy of the participants in the discursive process. Based on the influence of the NGOs and other groups behind the process, companies continue to respond to the questionnaire even when they are not involved in the discursive process. Only two companies out of the

FT Global 50 sampled participate in the discursive process as investor signatories.

In sum, the CDP decision-making process lacks discursiveness as it excludes the respondent companies. The structure of the Project provides limited room for participation of the respondent companies in the discursive process as it was deliberately set up as a mechanism through which investors could request information on corporate carbon emissions from the companies.

Chicago Climate Exchange

The CCX is a voluntary but legally binding carbon emission trading system.⁵¹ It was established in Chicago in 2003 in line with the principles of the Clean Development Mechanism and Joint Implementation established by the Kyoto Protocol to reduce GHG emissions through emissions trading. The Chicago Climate Exchange is very similar to the EU Emission Trading System in operation but different in its management and ownership structures. The reduction in carbon emissions must be made in North America and verified by an independent third party. However, the Exchange is expanding globally as its members now include government agencies from Brazil, US-based embassies, and organizations from India. Furthermore, it has established affiliates in Europe and Canada.

The decision and rule-making processes of the CCX are authorized by the members of the Exchange. The decisions affect all members (irrespective of the category of membership) and have no direct impact on non-members. However, as the CCX aims at reducing global carbon emissions, the global public has a general interest in the decision-making process, in particular about how the emission baseline is set. As of 2008, CCX has only attracted three companies from the FT Global 50 sample, all of which are energy extensive companies from the banking and software/technology sectors.

(1) Participation and Inclusiveness

The decision and rule-making processes of the CCX are open to members of the Exchange. It includes all registered members that comply with the rules and regulations of the Exchange. The membership is targeted at companies and public actors such as municipalities and universities.⁵² Members are those with direct GHG emissions and a legally binding reduction commitment. They form the organization's main decision-

making body. They are entitled to be part of the six committees of the Exchange involved in setting specific technical rules and standards. In addition to members, there are five other categories of participation that imply different levels of involvement: associate members, offset providers, aggregators, liquidity providers, and Exchange participants. Associate members are not full members of the Exchange and consequently are not entitled to the privileges accorded the members. The associate members can only serve on the committees based on certain conditions. Thus, participation in the CCX's rule-making process is limited to specific categories of membership. Other categories of the Exchange membership only have a business relationship with the Exchange and do not participate in the rule-making process.

The CCX has set out to attract more companies that have direct impact on GHG emissions, but, so far, has been unable to attract companies from the energy-intensive sector. Among the FT global companies sampled, only three companies are members of the Exchange, and they are all from the energy extensive sectors. The non-participation of companies from other regions suggests that it is better to establish such trading platforms at the regional and country level than at a global scale. The CCX has identified this problem and gone ahead to establish affiliated carbon markets in Europe, Canada, and China.⁵³

To sum up, the CCX has limited participation and inclusiveness as it has not yet succeeded in attracting members from different sectors and regions of the world. It has failed to attract membership from the energy intensive sector, which contributes substantially to global climate change. It has not done better in terms of geography, since it has failed to attract membership outside the US.

(2) Control

The members of the Exchange provide funding for the management of CCX. There is a strong internal control mechanism in place to hold members of the Exchange accountable irrespective of the membership category. However, there is no clear external accountability mechanism in place in the decision-making process of the organization. The verification and monitoring mechanism is handled by the US Financial Industry Regulatory Authority (FINRA), based on the commodity trading nature of the organization. Hence, the global public cannot independently verify and monitor the decision-making process of the Exchange.

Some categories of membership of the Exchange do not participate in the decision-making process. The establishment of the emission baseline

has been one area for which the Exchange is criticized due to lacking transparency. Since non-members, as well as several categories of its membership, do not have access to the decision-making process, it would be difficult to argue that the process is transparent enough. It would have been better to establish a mechanism that allows both members and non-members to independently verify and monitor the decision-making process. However, as a commodity exchange market, its high internal accountability is understandable.

(3) Discursiveness

The decision-making process in the CCX resembles mechanisms in other financial institutions, such as commodity and financial markets. The decision-making process is open to all members. Yet how discursive and deliberative the process is remains unclear. Even though it includes all members, the CCX directors, the advisory board, the senior management, and the standing committees, all decisions are prepared at the standing committee and management levels. The members simply cast their votes to either accept or reject decisions reached at those levels. While the members are said to be the highest decision-making body of the Exchange, they arguably do not engage in extensive discourse before they cast their votes. They usually rely on the advice of the advisory board whether or not to accept the recommendations put forward to them by the management and standing committees. The deliberative quality of the discursive process is limited by the fact that members have little time to study the recommendations put forward by the management and standing committees before casting their vote. Relying solely on the advice of the advisory board arguably cannot settle the accountability and legitimacy questions. The exclusion of other membership categories from the decision-making process shows the limited nature of the CCX's discursive process.

Conclusion

We have proposed a framework to analyse the legitimacy of transnational climate governance arrangements according to their inclusiveness, discursiveness, and control mechanisms. We have also scrutinized the legitimacy of three transnational climate governance arrangements that were most common among the climate related transnational governance schemes endorsed by FT Global 50 corporations: the Global Gas Flaring

Reduction Partnership, the Carbon Disclosure Project, and the Chicago Climate Exchange. These cases represent the most relevant examples of transnational climate change governance which involve large multinational corporations. Therefore, an analysis of their legitimacy is a complementary research agenda that adds to the current focus on effectiveness of governance.

We can therefore draw a number of conclusions. First, the inclusiveness of the transnational climate governance arrangements reviewed in this article is limited. In all cases, key stakeholders are excluded and participation is geographically imbalanced. Second, with regards to control, while the CDP shows a high level of external accountability, the CCX and GGFR show high levels of internal accountability as a result of oversight by public agencies such as FINRA and the World Bank. Third, the discursive quality of all three cases analysed in this article is rather poor, mainly as a result of limited inclusion of relevant stakeholders into the decision-making process and the structural power of certain business actors—such as institutional investors in the case of the CDP, or CCX member companies in the CCX. In sum, the three cases show substantial shortcomings in each of our analytical categories.

This result, however, should not be taken as the final word on the legitimacy of transnational climate governance arrangements as many schemes are fairly recent and will further evolve as a result of constant public scrutiny. On the other hand, these results should caution us against too optimistic an outlook on the legitimacy of global environmental governance “beyond the state.” Consequently, this conclusion also questions the optimistic assumptions observers might hold about the potential effectiveness of transnational climate governance arrangements. ■

Notes

¹ Frank Biermann, “Earth System Governance as a Crosscutting Theme of Global Change Research,” *Global Environmental Change* 17, no. 3–4 (2007): 326–37, 332.

² For a detailed discussion of the concept and definition of transnational climate governance, see Philipp Pattberg and Johannes Stripple, “Beyond the Public and Private Divide: Remapping Transnational Climate Governance in the 21st Century,” *International Environmental Agreements* 8, no. 4 (2008): 367–88. We do not claim that transnational climate governance arrangements exclude public actors, but rather that public actors are one player among others.

³ See, for example, Michael Mason, “The Governance of Transnational Environmental Harm: Addressing New Modes of Accountability/Responsibility,” *Global Environmental Politics* 8, no. 3 (2008): 8–24.

⁴ For a more detailed discussion of these analytical categories, see Klaus Dingwerth and Philipp Pattberg, "The Effects of Transnational Environmental Regimes," conference paper, workshop on Global Governance and Private Standards, Leuven, Belgium, November 4–5, 2008.

⁵ Figures are based on the CPD6 Report, 2008.

⁶ World Bank, "Learn the Facts," <http://go.worldbank.org/016TLXI7No> (accessed October 1, 2008).

⁷ Recent studies on the effectiveness of global environmental governance include Frank Biermann and Bernd Siebenhüner, *Managers of Global Change: Explaining the Influence of International Environmental Bureaucracies* (Cambridge, MA: MIT Press, forthcoming); Frank Biermann and others, "Partnerships for Sustainable Development: An Appraisal Framework," Global Governance Working Paper No. 31, October 2007, <http://www.glogov.org/images/doc/wp31.1.pdf> (accessed March 1, 2009); Klaus Dingwerth and Philipp Pattberg, "Wirkungen transnationaler Umweltregime," *Politische Vierteljahresschrift*, special issue 39 (2007): 133–56; Philipp Pattberg, "The Influence of Global Business Regulation: Beyond Good Corporate Conduct," *Business and Society Review* 111, no. 3 (2006): 241–68.

⁸ Fritz Scharpf, "Economic Integration, Democracy and the Welfare State," *Journal of European Public Policy* 4, no. 1 (1997): 18–36, 19.

⁹ Klaus Dingwerth, *The New Transnationalism: Transnational Governance and Democratic Legitimacy* (New York: Palgrave Macmillan, 2007).

¹⁰ Karin Bäckstrand, "Multi-Stakeholder Partnerships for Sustainable Development: Rethinking Legitimacy, Accountability and Effectiveness," *European Environment* 16, no. 5 (2006): 290–306.

¹¹ Marianne Beisheim and Klaus Dingwerth, "Procedural Legitimacy and Transnational Governance: Are the Good Ones Doing Better?," Working Paper, SFB-Governance Series no. 14, June 2008, <http://www.sfb-govern-ance.de/publikationen/sfbgov-wp/wp14-en/sfbgov-wp14-en.pdf> (accessed March 1, 2009).

¹² Beisheim and Dingwerth, "Procedural Legitimacy," 12.

¹³ Biermann and others, "Partnerships for Sustainable Development."

¹⁴ Thorsten Benner and others, "Multisectoral Networks in Global Governance: Towards a Pluralistic System of Accountability," *Government and Opposition* 39, no. 2 (2004): 191–210.

¹⁵ Thomas Risse, "Transnational Governance and Legitimacy," February 17, 2004, <http://userpage.fu-berlin.de/fflatasp/texte/tn-governance-benz.pdf> (accessed March 1, 2009).

¹⁶ Bäckstrand, "Multi-Stakeholder Partnerships for Sustainable Development."

¹⁷ Ans Kolk, Rob Van Tulder, and Esther Kostwinder, "Business and Partnerships for Development," *European Management Journal* 26, no. 4 (2008): 262–73.

¹⁸ Ans Kolk, David Levy, and Jonatan Pinkse, "Corporate Responses in an Emerging Climate Regime: The Institutionalization and Commensuration of Carbon Disclosure," *European Accounting Review* 17, no. 4 (2008): 719–45.

¹⁹ See Philipp Pattberg, "The Influence of Global Business Regulation: Beyond Good Corporate Conduct," *Business and Society Review* 111, no. 3 (2006): 241–68, 242. See also Liliana Andonova, Michele Betsill, and Harriet Bulkeley, "Transnational Climate Change Governance," paper prepared for the Amsterdam Conference on the Human Dimensions of Global Environmental Change, May 24–26, 2007, <http://www.2007amsterdamconference.org/Downloads/AC2007—Betsill.pdf> (accessed March 1, 2009).

²⁰ Peter Newell, "Civil Society, Corporate Accountability and Politics of Climate Change," *Global Environmental Politics* 8, no. 3 (2008): 122–53; see also Aarti Gupta, "Transparency under Scrutiny: Information Disclosure in Global Environmental Governance," *Global Environmental Politics* 8, no. 2 (2008): 1–7. In our understanding, legitimacy is a broad concept that encompasses both accountability and transparency.

²¹ Dingwerth, *The New Transnationalism*, 3.

²² David Held, *Models of Democracy* (Stanford: Stanford University Press, 2006).

²³ Pattberg and Stripple, "Beyond the Public and Private Divide"; Sverker C. Jagers and Johannes Stripple, "Climate Governance Beyond the State," *Global Governance* 9, no. 3 (2003): 385–99.

²⁴ For more detailed theoretical discussion of these elements and their relation to democratic theory, see Dingwerth and Pattberg, "Wirkungen transnationaler Umweltregime."

²⁵ Held, *Models of Democracy*.

²⁶ World Bank, *World Bank Participation Sourcebook*, available at <http://www.worldbank.org/wbi/sourcebook/sb0100.htm> (accessed July 22, 2008).

²⁷ Robert O. Keohane, "Global Governance and Democratic Accountability," Spring 2002, <http://www.lse.ac.uk/collections/LSEpublicLecturesAndEvents/pdf/20020701t153t001.pdf> (accessed March 1, 2009).

²⁸ Newell, "Civil Society," 125.

²⁹ Sander Chan and Philipp Pattberg, "Private Rule-Making and the Politics of Accountability: Analyzing Global Forest Governance," *Global Environmental Politics* 8, no. 3 (2008): 103–21.

³⁰ Newell, "Civil Society," 125.

³¹ Ibid.

³² Andreas Schedler, "Conceptualizing Accountability," in *The Self Restraining State: Power and Accountability in New Democracies*, eds. Andreas Schedler, Larry Diamond, and Marc F. Plattner (Boulder, CO: Lynne Rienner, 1999).

³³ Gupta, "Transparency under Scrutiny," 1.

³⁴ Dingwerth and Pattberg, "Wirkungen transnationaler Umweltregime," 30.

³⁵ Joshua Cohen, "Deliberation and Democratic Legitimacy," in *Debates in Contemporary Political Philosophy: An Anthology*, eds. Matavers Derek and Jon Pike (New York: Routledge, 2003).

³⁶ See Financial Times Online, "The World's Largest Companies: FT 500 (2008)," <http://www.ft.com/reports/ft5002008> (accessed March 1, 2009). Market capitalization is the total value of a company. It is derived from multiplication of total number of company's shares on issue by the current share price.

³⁷ The eleven companies based outside the United States and Europe are distributed as follows: China (seven), Japan (one), Brazil (two), and Saudi Arabia (one).

³⁸ The categories are based on the categorization used in CDP 2008 annual report.

³⁹ See CDP 2008 annual report.

⁴⁰ The data used for the GGFR empirical analysis is largely based on the information obtained from the publications of GGFR, company and country members of the partnership. The initiative was formally conceived and launched at the COP7 (Conference of Parties) held at Marrakech, Morocco in 2001 by the World Bank in collaboration with the government of Norway.

⁴¹ Gas flaring and venting is a standard procedure associated with the extraction of crude oil.

⁴² The estimated CO₂ annual emission is available on the GGFR web page of the World Bank.

⁴³ There is likelihood that the number will increase when Iraq finally formalizes its membership procedure.

⁴⁴ The country members include Algeria, Cameroon, Chad, Ecuador, Equatorial Guinea, Gabon, Indonesia, Kazakhstan, Khanty-Mansysk (Russian Federation), Nigeria, Qatar, Angola, the United States, and Norway. The World Bank and OPEC are also members. The company members include BP, Chevron, Shell, Hydro Oil, Eni, ConocoPhillips, Marathon Oil, ExxonMobil, Statoil Hydro, and Total.

⁴⁵ Gazprom is the Russian state-owned oil and gas company. In addition, companies that operate in Latin America are not members of the partnership either. None of the oil-producing countries from Latin America except Ecuador are a member of the partnership. In the Middle East, many oil-producing countries and their state-owned oil companies are not members of the partnership.

⁴⁶ NOAA publishes satellite image data of gas flaring on their web site based on data provided by GGFR members; see <http://www.ngdc.noaa.gov/dmsp/interest/gas-flares.html> (accessed March 1, 2009).

⁴⁷ The satellite image published by NOAA is in scientific technical language that may be difficult for the global public to understand. This places limitations on independent verification of the reported gas flare figures by the partnership members.

⁴⁸ The information used for the empirical analysis is sourced mainly from the publications of CDP. The figure is based on the CDP 2007 report available on the web site of the CDP. However, if more institutional investors join the initiative, there is likelihood that it will increase.

⁴⁹ See CDP annual report 2002.

⁵⁰ The CDP questionnaire is issued annually.

⁵¹ The CCX accepts emission sources and offset projects worldwide. Between 2003 and 2006, emission reduction targets were one per cent per year, below an average of baseline period 1998–2001. In phase II, the reduction period has been extended through 2010, with an additional two per cent reduction commitment for Phase I Members and a total of six per cent reduction commitment by 2010 for new members joining in Phase II. CCX includes carbon dioxide (CO₂), methane (CH₄), nitrous oxide (N₂O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF₆).

⁵² For a current membership overview, see Chicago Climate Exchange, “Members of CCX,” <http://www.chicagoclimatex.com/content.jsf?id=64> (accessed March 1, 2009).

⁵³ The CCX has established affiliations with the European Climate Exchange (ECX), the Montreal Climate Exchange (MCX), Insurance Futures Exchange Services (IFEX), and the Chinese Tianjin Climate Exchange (TCX). This arguably enables the Exchange to attract members from other regions and to expand their influence in global climate governance.

Constituting Capitalism: Corporations, Law, and Private Transnational Governance

99

A. CLAIRE CUTLER

ABSTRACT

Transnational business corporations exercise a growing but inadequately analysed influence on the development of rules that regulate local and global political economies and societies. This paper seeks to understand the increasing importance of transnational corporations and the laws governing them in global governance and in constituting the material and normative foundations of transnational capitalism. This paper posits the specificity of legal regulation under contemporary capitalism, and develops a theory of private transnational governance that draws upon a critical understanding of the nature of “private authority” in global governance. It argues that transnational corporations are crucial participants in globalizing and legitimizing increasingly privatized legal forms that modify, and even displace, public modes of governance in global trade, investment, and corporate social responsibility regimes. Private transnational governance is argued to raise acute analytical and normative concerns. This analysis advances the “commodity form” theory of law as central to understanding how private transnational governance both expands and legitimates transnational capitalism.

We reach, then, not a simple conclusion (law = class power) but a complex and contradictory one. On the one hand, it is true that the law did mediate class relations to the advantage of the rulers; not only is this so ... that the law became a superb instrument by which these rulers were able to impose new definitions of property to their even greater advantage ... On the other hand, the law mediated these class relations through legal forms, which imposed, again and again, inhibitions upon the actions of the rulers.¹

[T]he rationalization and systematization of the law in general and ... the increasing calculability of the functioning of the legal process in particular, constituted one of the most important conditions of the existence of ... capitalist enterprise, which cannot do without legal security.²

It is commonly presumed that there is a special relationship between law and capitalist business enterprise, as suggested by the above quotations from two famous students of capitalism, E. P. Thompson and Max Weber. Thompson’s conclusion that law, notwithstanding its

A. Claire Cutler, “Constituting Capitalism: Corporations, Law, and Private Transnational Governance,” *STAIR* 5, no. 1 (2009): 99–115.

failings as an instrument of oppression, sets limits to arbitrary action and thus remains an “unqualified human good,” and Weber’s faith in the rational calculability and predictability supplied by law, are echoed in contemporary views concerning the “‘elective affinity’ between economic globalization and the rule of law.”³ These views suggest that the relationship between law and capitalism is quite distinctive. This is evident in claims about the contemporary “ubiquity” of law, the “legalization of world politics,” and the “globalization of law”—all of which are regarded as symptomatic of profound transformations attending the global expansion of capitalism.⁴ Despite this concern, there is little understanding of the role that transnational business corporations and their law play in the constitution of global capitalism. Studies of corporate governance tend to focus on the internal management of corporations at the national or cross-national level, employing business models and theories of regulation. When global governance is the focus, law tends to be conflated with more general conceptions of regulation located at the state or inter-state level.⁵ Transnational corporations and the laws governing them have been under-studied in both law and politics, where the dominant tendency is to regard global governance as the preserve of states.⁶ Transnational corporations are thus conceptualized as actors that might influence, or even constrain, the global activities of states; however, they are regarded as only occasionally engaged in global governance.

In this latter regard, there has been a proliferation of empirical studies on the “private authority” and “private governance” exercised by transnational business corporations.⁷ This literature contributes to a better understanding of the plurality of sources of governance in the global political economy. However, it overlooks the role of private actors and private law in constituting the material and normative frameworks for global capitalism. It is necessary to *get inside* or *get behind* the relationships between law, capitalism, and transnational business corporations to show how private authority and law form part of the very fabric of capitalism.

This paper seeks to further analytical and theoretical understandings of the increasing importance of transnational business corporations and law in the development of private modes of global governance. Private governance modifies and even displaces public modes of governance, and thus raises significant concerns about its legitimacy. The first section provides a critical overview of efforts to analyse the significance of self-regulatory roles adopted by transnational firms, identifying important considerations of legitimacy. The analysis focuses in particular on the global governance of international trade, investment, and corporate

social responsibility (CSR). It argues that simply adding the firm to the complex of global actors engaged in global governance is insufficient. Rather, the optic must shift in order to capture the significance of transnational corporations and law in the constitution and legitimation of global capitalism. The final section advances a theory of law that captures transnational corporations and transnational law as central, constitutive forces linked to deeper structures and processes of transnational capitalism.

Private Transnational Governance

There has been a blossoming of interest, across diverse disciplines, in the expansion of corporate or private actors in governance roles and the corresponding concerns about legitimacy. The terms “transnational governance” and “private transnational governance” are used increasingly to depict the role that firms are exercising as governors.⁸ Private transnational governance takes many forms and involves many different types of actors, sectors, issues, and interests that cut across traditional political, economic, cultural, legal, disciplinary, and spatial boundaries in complementary and contradictory ways. It results in increasingly complex forms of governance. The governance activities of private actors have been identified in many areas of international and transnational economic relations and law, including, *inter alia*, financial governance and central bank independence,⁹ the law of secured financial transactions and competition law,¹⁰ the governance of accounting and auditing practices,¹¹ insurance and risk management,¹² coordination service firms and bond-rating agencies,¹³ the Internet and online commerce,¹⁴ and investor protection.¹⁵

Empirical developments associated with the globalization of law and the transnationalization of the legal field emphasize the significance of entrepreneurial lawyering and law-making by transnational law firms and private business associations,¹⁶ and the significance of private actors in disaggregating sovereignty.¹⁷ In fact, private law-making processes are regarded as transforming the fields of both public and private international law, blurring the distinction between the two and creating tensions between national and transnational orders.¹⁸ Transnational lawyers and the law are creating supra-territorial relations among people by delocalizing and denationalizing the law; they are removing its creation, interpretation, and application from the constraints of territorial

locations while simultaneously relocating and renationalizing social relations when enforcing the laws.¹⁹

These examples illustrate that private transnational governance is recognized in many areas as a significant dimension of the contemporary world order. The examples also reveal three shared characteristics: they are concerned with private actors and processes; they focus on political concerns; and they involve more than one national jurisdiction, cutting across territorial boundaries, markets, sectors, and issue-areas.²⁰ Private transnational governance may thus be defined as “the setting of collectively binding rules, through institutions that lie outside the domain of states, and where the rules apply in a transnationally integrated space.”²¹

Three areas where private transnational authority is particularly evident concern the governance of international trade, international investment, and CSR initiatives. In some cases, private actors are generating self-regulatory rules, while in others, public authorities are creating rules that benefit and empower private actors and interests. In international trade and investment, the global regulation of intellectual property rights, trade in services, and trade-related investment reveals important characteristics of private transnational governance. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Investment Measures (TRIMS), negotiated as part of the Uruguay Round of multilateral trade talks, were driven by powerful transnational business corporations and created binding legal arrangements that regulate transnationally integrated markets and networks. In the case of intellectual property, influential corporations and industry associations “played a major role in catapulting the previously arcane issue of [intellectual property] protection to the top tier of the US trade agenda” and which, once there, were decisive in establishing the parameters of the emerging legal regime and securing the interests of corporate promoters to the neglect of dissenting participants from developing countries.²² Similarly, the GATS was driven initially by major US-based service industries and their offices abroad in telecommunications, finance, and insurance, including American Express, American International Group, Citibank, and Arthur Andersen.²³ In later GATS negotiations, European services providers, in particular transnational water companies, became important players. Corporate promoters of the GATS were successful in securing their interests against the opposition of many states, including developing states, and have successfully advanced the liberalization of services in a number of areas.²⁴ The TRIMS agreement was also led by US-based transnational corporations, working with the US Council for International

Business, the Coalition of Services Industries, and the Securities Industry Association.²⁵ The outcome of these negotiations is not regarded to be as successful or as far-reaching as the TRIPS agreement or the GATS due to significant conflicts within the United States and the opposition of a number of countries, both developed and developing, who believed that the regulation of investment exceeded the purposes of the trade regime.²⁶ However, it is important to note that the TRIMS agreement is only part of a much broader international investment regime comprised of networks of international investment agreements (IIAs), bilateral investment treaties (BITs), and the investment provisions of the North American Free Trade Agreement (NAFTA), in addition to investment-related commitments made by states in the Asia Pacific Economic Co-operation (APEC) and the Organisation for Economic Co-operation and Development (OECD).²⁷ The investment regime “is intended to protect established investments abroad far into the future by locking countries into predictable regulatory frameworks” and “renders foreign investors immune from the legislative and administrative action that substantially impairs their investment interests.”²⁸ Private international commercial arbitration forms an integral part of the international investment regime, adding to the complexity of private and public regulation.²⁹

The CSR movement engages corporations and private business associations in developing codes of conduct, voluntary and “soft,” and in self-regulation of their environmental, labour, human rights, and corporate governance activities.³⁰ CSR initiatives range from private arrangements, within and among firms and industries, to global initiatives such as the Global Compact, sponsored by the United Nations.³¹ In some instances, private actors, including both corporations and civil society groups, are engaged in governance that traverses sectoral boundaries and issue areas, as in certification schemes that regulate the environmental, labour, and/or human rights activities of industries and producers.³² The notion of CSR is also extending beyond economic and corporate domains to matters of international security in the context of theorizations of the corporate *security* responsibility (CSECR) of private security companies.³³

The important point about these agreements is the legitimacy problems they raise as initiatives driven and shaped by powerful private sector interests. Most studies of private transnational governance frame legitimacy in terms of democratic legitimacy, employing criteria taken from liberal political theory and political economy concerning the legitimacy of decision-making within democratic states.³⁴ Participation, transparency, accountability, and efficacy thus figure as prominent criteria of the legitimacy of private governance, as does the provision

of public goods. These criteria are conceptualized as input legitimacy, output legitimacy, and throughput legitimacy. Input legitimacy requires participation in, and transparency of, rule-making, implementation, and enforcement. Output legitimacy requires the rule to be effective and efficient. Finally, throughput legitimacy requires that the rule be procedurally fair.³⁵ Output legitimacy is also assessed by the provision of public or collective goods. A common finding is that rule-making by corporations involves serious defects in democratic participation.³⁶ The inadequacy of participation by developing countries in the negotiation of the GATS and the TRIPS agreements, the general lack of transparency in the operations of the World Trade Organization (WTO),³⁷ and the inadequate access to participation in the WTO's dispute settlement mechanism,³⁸ are considered to be profound problems detracting from the legitimacy of the WTO regime.³⁹ As Susan Sell concludes, "[T]he shaky foundations of this global regime raise important concerns about accountability and legitimacy. The process compromised the ultimate legitimacy of the agreement. If legitimacy and mutual benefits are the ultimate yardstick for public international law, the TRIPS process fails on both counts."⁴⁰ Similarly, Elizabeth Smythe attributes the failure of WTO negotiations to develop a comprehensive agreement on investment to a "legitimacy crisis in the WTO" deriving from discontent with the "balance of benefits of agreements, its decision-making processes, and its lack of transparency, all of which fostered a mistrust on the part of many developing country members."⁴¹

If we consider the provision of public goods as the criterion of legitimacy, we must tackle the problem of private actors providing public goods.⁴² Liberal political economy posits that public goods, by their very nature, remain under-supplied in the absence of a government willing to assume the costs of supplying them. This is due to what is referred to as a "collective action problem," whereby free-riders take advantage of the benefit of a good without contributing to its provision. According to the theory, the intervention of a government is required to provide the good and ensure that all who benefit make a contribution to its provision. However, in international relations, the provision of global public goods, being "goods where benefits extend to all countries, people and generations," is particularly problematic.⁴³ First, there are practical obstacles to public goods provision as there is no global state and only rudimentary institutions of global governance to create and distribute global public goods. Second, relying on private actors to supply public goods obscures the insights of liberal political economy, which posits the absence of an appropriate incentive structure for private entities to provide public goods voluntarily.

These concerns thus raise questions about the public nature of the goods supplied by the trade regime. The TRIPS agreement advances the protection of private intellectual property rights as generating the public goods of knowledge generation, trade facilitation, and public health provision.⁴⁴ However, critics note that strong patents can conflict with the provision of public health care, as in the lack of access for many to costly medications for AIDS.⁴⁵ Moreover, to the extent that a protected property right precludes development through innovation by anyone not holding the right, one might argue that the privatization of intellectual property creates a global private good. Similarly, the GATS advances the liberalization of services as a public good, but threatens widespread privatization of basic services, including health care, education, and water.⁴⁶

Turning to the public nature of the goods generated by the investment regime, while BITS constitute only one dimension of global investment governance, they are central as the pivotal legal form that anchors the investment relationship. Their standard rationale is to provide certainty in commercial contracting and to protect the reasonable expectations of the parties to the investment agreement by ensuring the security and enforcement of investment rights. However, BITS are overwhelmingly tilted toward the encouragement and protection of foreign capital and the creation of an “investor-friendly” legal regime, which is crucial to a host state’s ability to compete for foreign investment.⁴⁷ Few of the goods generated by BITS qualify as public goods, in terms of extending across countries, to rich and poor, and across generations. Rather, many of the goods are private or “club” goods and limited in their enjoyment.⁴⁸

The legitimization of voluntary CSR responses to environmental, labour, and human rights problems on the grounds that they are providing public goods is similarly problematic. Critics argue that the goods produced by CSR initiatives are better represented as private or club goods, as CSR undertakings are part of the business strategy of transnational corporations seeking to substitute voluntary self-regulation for mandatory public regulation.⁴⁹

Efficiency and effectiveness in outcomes have also been identified as legitimating mechanisms and are linked to the centrality of experts in the creation and operation of private transnational governance. Indeed, the significance of experts in legitimating private authority has contributed immeasurably to the power of experts in transnational governance. For Tony Porter, technical accounting expertise is so significant in legitimating private transnational governance that he analyses *technical authority* as a distinct form of private transnational authority.⁵⁰ Significantly, private authority in accounting standards has not operated objectively or

neutrally, but has removed the standards from broader public scrutiny, resulting in standards that favour Anglo-Saxon financiers.⁵¹ In a similar vein, private transnational governance of secured transactions clearly favours secured creditors over borrowers, while the substantive rules and dispute settlement mechanisms of the private investment protection regime favour investment banks and multinational corporations over host states, and are insulated from national and public policy pressures.⁵² In fact, technical knowledge and specialized expertise are, by their very nature, exclusionary and inconsistent with democratic notions of participation, transparency, and accountability.

These analyses of private transnational governance identify significant problems with its democratic legitimacy. Even more importantly, they reveal that “it is necessary to go beyond the analysis of self-regulation as a set of rules,” and consider the principles from which these rules are derived.⁵³ This requires a shift in optic from an examination of the legitimacy of private transnational governance to an analysis of private transnational governance as itself a legitimating strategy for transnational capitalism. This will assist in isolating the specificity of legal regulation to contemporary capitalism.

The Commodity Form, the Legal Form, and Transnational Capitalism

Insights from the critique of capitalist political economy developed by Karl Marx⁵⁴ and from theorizations concerning the role of law in capitalist development—as developed in a fragmentary way by Marx, Antonio Gramsci,⁵⁵ and Louis Althusser⁵⁶—assist in getting *behind* or *inside* the relationship between law and transnational capitalism. Each thinker recognized that capitalism does not simply reproduce itself, but requires material, institutional, and ideological institutions to ensure its reproduction. Marx believed that law takes on specific forms in different economic systems and is integral to historical transitions from one mode of production to another.⁵⁷ Under capitalism, law provides the infrastructure for the entire system of production and exchange. Marx reasoned that in a capitalist system of production, commodities have both use-value and exchange-value, but upon entry into the market their use-value disappears as they are equalized with other commodities through their exchange-value, which is translated into monetary terms. This severs the relationship between the worker and the product of his labour, and alienates the worker by infusing the product—now a commodity—

with the appearance of independence from its producer and with a life of its own. Marx termed this process the “fetishism of commodities,” which he believed masked the exploitative social relations underlying production and the inequality between the producer of the commodity and the owner of the means of production, who reaped the surplus value generated by the sale of the commodity in the market.⁵⁸ While Marx expressed an awareness of the importance of new legal forms to the internal logic and expansions of capitalism, others have sought to isolate the role of law in commodity fetishism. Marx suggested, and others have further developed the notion, that under capitalism law takes on a form that mirrors the commodity form of capitalism.⁵⁹ Indeed, “the commodity form needs the legal form to create subjects that can realize the value of the commodity through its exchange in the market.”⁶⁰ Accordingly, the juridical and constitutional framework governing the various legal forms of private property form the foundation of capitalist society and political economy.⁶¹ This framework forms part of the material, institutional, and ideological conditions of existence for capitalism. Just as the commodity form masks the unequal social relations underlying the capitalist mode of production, law, in its fetishized form, conceals the inequalities flowing from private property rights that establish the foundation for capitalist production and exchange. Thus, the labour contract entered into between the capitalist and the worker presents their relationship as one of equality based upon consent, concealing the inequality that inheres in the very nature of private property.

However, this situation did not emerge spontaneously. Rather, as Gramsci theorized, it emerged as a result of the effort by “organic intellectuals” to successfully advance the private interests of the ruling class as societal and common interests.⁶² In doing so, they achieved the ideological acceptance by the subaltern of “the law spontaneously, freely, and not through coercion, as imposed by another class, as something external to consciousness.”⁶³ This process is described by Althusser through the “theory of interpellation,” which seeks to capture the role that ideology plays in constituting individuals as subjects who are aware of, and identify with, their own subjectivity, and who thereby participate consensually in the (re)production of capitalism.⁶⁴

Transnational corporations and transnational law may thus be conceptualized as crucial institutions engaged in creating the material and ideological conditions for capital accumulation, both locally and globally. Materially and ideologically, they contribute to the globalization of trade and investment relations as engines of capital accumulation that reach deep into the domestic jurisdictions of states, linking local political economies and societies into global economic

networks and circuits of capital. Transnational corporations and law advance disciplinary neoliberalism as the overriding “socio-economic form,” extending processes of commodification and alienation through a “politico-legal framework for the reconstitution of capital on a world scale” that integrates domestic societies and markets globally, into a “new constitutionalism.”⁶⁵

Transnational corporations contribute to the reproduction of transnational capitalism by generating legal forms that both create and legitimate capitalist productive relations on a transnational scale. Legally binding disciplines emanating from the international trade and investment regimes advance neoliberal market ideology, setting limits to local development and industrial policies according to the logic of the TRIPS, GATS, TRIMS, and BITS. These agreements articulate the “rights” side of corporate citizenship through hard rights that are enforceable by transnational corporations in courts of law. In contrast, CSR regimes formulate the “duty” side of the corporate citizen in terms of soft law, imposing only voluntary self-regulation on transnational corporations.

Private transnational governance may thus be conceptualized as a regime of global capitalist appropriation and legitimation. Its material, institutional, and ideological structures lie in the multilateral agreements governing trade, investment, and corporate responsibility discussed above. TRIPS contributes to the interpellation of the neoliberal subject through a global regime of private property rights that contributes to the material dispossession of many, including the rights of indigenous peoples to traditional knowledge, or the rights of the ill to patented medicines, or the rights of farmers to patented seeds.⁶⁶ The GATS advances the legal fetishism and commodification of services as tradeable goods, distorting reality and concealing the human dimension of services provision “by assimilating many diverse features of social life within a unified ideological category” of trade in goods.⁶⁷ A fundamental shift in ontology was required to treat services as tradeable commodities. This involved the efforts of an “epistemic community” comprised of private firms, states, and international organizations committed to the ideological framework of neo-liberal market civilization.⁶⁸ They included academics, lawyers, industry specialists, journalists, government officials, and representatives from many major transnational corporations as well as representatives from states and international organizations. Functioning as organic intellectuals, they legitimated the liberalization and privatization of services provision as common sense and as serving the common interest. In doing so, they created the ideological climate for the commodification of services provision by presenting their positions as “scientifically objective” with benefits for “the international community

as a whole.”⁶⁹ Invoking neoliberal theory and political economy, these organic intellectuals presented the deregulation of services sectors and liberalization as the way forward to prosperity and happiness.

The international investment regime interpolates transnational corporations as neoliberal subjects with enforceable legal rights against host states who are subordinated to the demands of securing and expanding global investment. In addition, bilateral investment treaties are the predominant legal forms used in transnational investment relations, and have been implicated in privatization schemes that advance market ideologies and market-oriented reforms throughout the world, deepening relations of commodification. In some cases, commodification through BITS and trade agreements has worked toward the material dispossession of essential services for many local communities, as is evident in the “water wars” in South Africa, South America, Africa, and municipalities in Europe and North America.⁷⁰ In fact, a decline in the number of BITS signed in 2008 is attributed to their increased politicization and to calls for the rights of host states to regulate environmental and social issues.⁷¹ These institutions of private transnational governance contribute to the material and discursive legitimacy of transnational capitalism, but raise significant legitimacy concerns as mechanisms of private appropriation. Finally, CSR initiatives also contribute to the interpellation of transnational corporations as neoliberal subjects by advancing voluntary self-regulation as a *Grundnorm* of private transnational governance. To the extent that these initiatives thwart the development of more meaningful regulation and function, in Gramscian terms, as *transformismo*, in diffusing and absorbing dissent, they raise particularly acute legitimacy concerns. Indeed, the tension between hard corporate rights and soft corporate duties goes to the heart of the relation between law and contemporary capitalism, which may be characterized as “late capitalist” and “postmodern.” Late capitalist and postmodern governance is predicated upon a dialectic of soft, permissive, and self-regulatory standards governing corporate responsibilities and hard disciplines governing corporate rights. This dialectic facilitates the flexible expansion of capitalism transnationally through the removal of national barriers to trade, investment, and corporate conduct.⁷²

Conclusion

Post-modern governance involves a plurality of normative orders operating nationally, internationally, and transnationally, as private or

mixed private and public legal orders, and involving flexible regulation whose bite is both hard and soft. Private transnational governance is thus a mode of regulation that is specific to the form taken by contemporary, late capitalism. It is a form of governance that links local and global political economies and societies through disciplines that cut across micro, meso, and macro levels, forming part of the fabric of capitalism as a whole. This constitutive function of corporations and their laws raises acute analytical and normative concerns. Students of private transnational governance must shift their analytical focus from the legitimacy of private regulation to include private transnational governance as a legitimating mechanism in itself. This involves an analysis of the constitution of capitalism at a deeper, ontological level where private regulation materially constitutes and normatively legitimates processes of transnational capital accumulation. Moreover, such a shift in optic should be informed by a healthy dose of scepticism about law as an unqualified human good. ■

Notes

¹ Edward P. Thompson, *Whigs and Hunters: On the Origin of the Black Act* (New York: Pantheon, 1975), 264.

² Max Weber, *Economy and Society*, eds. Guenther Roth and Claus Wittich (Berkeley: University of California Press, 1968), 883.

³ William Scheuerman, "Economic Globalization and the Rule of Law," *Constellations: An International Journal of Critical and Democratic Theory* 6, no. 1 (1999): 3–25, 3.

⁴ A. Claire Cutler, "Critical Globalization Studies and International Law under Conditions of Postmodernity and Late Capitalism," in *Critical Globalization Studies*, eds. Richard Appelbaum and William Robinson (New York and London: Routledge, 2005), 197–205; Judith Goldstein and others, eds., "Legalization and World Politics," special issue, *International Organization* 54 (2000): i–xiii and 385–703; William Twining, *Globalisation and Legal Theory* (Evanston, IL: Northwestern University Press, 2000).

⁵ Colin Crouch and Wolfgang Streek, eds., *The Political Economy of Modern Capitalism* (London: Sage Publications, 1997); Peter A. Hall and David Soskice, eds., *Varieties of Capitalism: Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001); Robert Boyer and Daniel Drache, eds., *States Against Markets: The Limits of Globalization* (London: Routledge, 1996); John Braithwaite and Peter Drahos, *Global Business Regulation* (Cambridge: Cambridge University Press, 2000); William Bratton and others, eds., *International Regulatory Competition and Coordination* (Oxford: Clarendon Press, 1996); Keith Hawkins and John Thomas, eds., *Enforcing Regulation* (Boston: Kluwer-Nijhoff, 1984).

⁶ See A. Claire Cutler, *Private Power and Global Authority: Transnational Merchant Law in the Global Political Economy* (Cambridge: Cambridge University Press, 2003),

62ff., for an analysis of the dominant tendencies to state-centrism in the disciplines of international relations and international law.

⁷ A. Claire Cutler, Virginia Haufler, and Tony Porter, eds., *Private Authority and International Affairs* (New York: SUNY, 1999); Rodney Bruce Hall and Thomas Biersteker, eds., *The Emergence of Private Authority in Global Governance* (Cambridge: Cambridge University Press, 2002); Jean-Christophe Graz and Andreas Nölke, eds., *Transnational Private Governance and Its Limits* (London and New York: Routledge, 2008); Karsten Ronit and Volker Schneider, eds., *Private Organizations in Global Politics* (London and New York: Routledge, 2000).

⁸ Marie-Laure Djelic and Kerstin Sahlin-Andersson, eds., *Transnational Governance* (Cambridge: Cambridge University Press, 2006); Hank Overbeek, Bastiaan van Apeldoorn, and Andreas Nölke, eds., *The Transnational Politics of Corporate Governance Regulation* (London and New York: Routledge, 2007); Klaus Dingwert, *The New Transnationalism: Transnational Governance and Democratic Legitimacy* (London: Palgrave Macmillan, 2007).

⁹ Martin Marcussen, "The Transnational Governance Network of Central Bankers," in Djelic and Sahlin-Andersson, *Transnational Governance*, 180–204.

¹⁰ Edward Cohen, "The Harmonization of Private Commercial Law: The Case of Secured Finance," in *Law and Legalization in Transnational Relations*, eds. Christian Brutsch and Dirk Lehmkuhl (London: Routledge, 2007), 58–80; Marie-Laure Djelic and Thibaut Kleiner, "The International Competition Network: Moving Towards Transnational Governance," in Djelic and Sahlin-Andersson, *Transnational Governance*, 287–307.

¹¹ Tony Porter, *Globalization and Finance* (Cambridge: Polity, 2005); Andreas Nölke and James Perry, "The Power of Transnational Private Governance: Financialization and the IASB," *Business and Politics* 9, no. 3 (2007): 1–25.

¹² Richard Ericson, Dean Barry, and Aaron Doyle, "The Moral Hazards of Neoliberalism: Lessons from the Private Insurance Industry," *Economy and Society* 29, no. 4 (2000): 532–58.

¹³ Timothy Sinclair, *The New Masters of Capital: American Bond Rating Agencies and the Global Economy* (Ithaca, NY: Cornell University Press, 2004).

¹⁴ Sven Bislev and Mikkel Flyverbom, "Transnational Private Governance of the Internet: the Roles of Business," in Graz and Nölke, *Private Governance*, 129–41.

¹⁵ Gus Van Harten, "Private Authority and Transnational Governance: the Contours of the International System of Investment Protection," *Review of International Political Economy* 12, no. 4 (2005): 600–23.

¹⁶ David M. Trubek and others, "Global Restructuring and the Law: Studies in the Internationalisation of the Legal Fields and Transnational Arenas," *Case Western Law Review* 44 (1994): 407–98; Yves Dezalay and Bryant Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order* (Chicago: University of Chicago Press, 1994); Glen Morgan, "Transnational Actors, Transnational Institutions, Transnational Spaces: the Role of the Law Firms in the Internationalization of Competition Regulation," in Djelic and Sahlin-Andersson, *Transnational Governance*, 139–60.

¹⁷ Anne-Marie Slaughter, "Disaggregated Sovereignty: Towards the Public Accountability of Global Governance Networks," *Government and Opposition* 39, no. 2 (2004): 159–90.

¹⁸ John Spanogle, "The Arrival of Private Law," *George Washington Journal of International Law and Economics* 25 (1991): 477–522; Ralph Steinhardt, "The Privatization of Public International Law," *George Washington Journal of International Law and Economics* 25 (1991): 523–53.

¹⁹ Boaventura de Sousa Santos, *Toward a New Legal Common Sense: Law, Globalization, and Emancipation*, 2nd ed. (London: Butterworths, 2002); A. Claire Cutler, "Transnational Law and Privatized Governance," in *Institutions, Governance, and Global Ordering*, eds. Louis Pauly and William Coleman (Vancouver: University of British Columbia Press, 2008): 144–65.

²⁰ Daniel Mügge, "Private-Public Puzzles: Inter-firm Competition and Transnational Private Regulation," *New Political Economy* 11, no. 2 (2006): 177–200.

²¹ Daniel Mügge, "Keeping Competitors Out: Industry Structure and Transnational Private Governance in Global Finance," in Graz and Nölke, *Private Governance*, 179–80.

²² Susan Sell, *Private Power, Public Law* (Cambridge: Cambridge University Press, 2002), 76, identifies the domestic coalition as the Motion Picture Association of America, International Intellectual Property Alliance, Pharmaceutical Manufacturers Association, Auto Exports Council, Intellectual Property Owners, Inc., International Anti-Counterfeiting Coalition, Semiconductor Industry Association. In 1986 the Intellectual Property Committee (IPC) was formed by corporate executives from US-based transnational corporations, including CBS, Du Pont, General Motors, Digital Equipment Corporation, FMC, Procter & Gamble, Rockwell International, and Time Warner. The IPC worked with European and Japanese corporations to articulate the terms of what became public international law in the TRIPS.

²³ Sell, *Private Power*, 167; Bernard Hoekman and Michel Kostecki, *The Political Economy of the World Trading System: The WTO and Beyond*, 2nd ed. (Oxford: Oxford University Press, 2001), 465–66.

²⁴ The TRIPS agreement is regarded as more successful in securing corporate interests than the GATS, where opposition from developing countries thwarted more comprehensive disciplines. Sell, *Private Power*, chap. 6.

²⁵ Sell, *Private Power*, 169. TRIMS addresses policies used by governments to apply performance standards such as local content, export, or technology transfer requirements.

²⁶ Sell, *Private Power*, 169–70; Hoekman and Kostecki, *Political Economy*, 202.

²⁷ See David Schneiderman, "Investment Rules and the Rule of Law," *Constellations* 8, no. 4 (2001): 521–37. IIAs and BITs protect the foreign investments of corporations against the imposition of discriminatory measures imposed by host states. BITs have proliferated at an extraordinary rate over the past two decades, numbering over 2,608 by 2007 and involving some 179 states; see United Nations Conference on Trade and Development (UNCTAD), *Recent Developments in International Investment Agreements* (2007–June 2008), IIA Monitor No. 2 (2008), UNCTAD/WEB/DIAE/IA/2008/1. These treaties create an interesting hybrid of public and private authority. As a treaty between host and investing states, a BIT is an instrument of public international law. However, a BIT also grants the investing corporations enforceable

rights under international law and contains provisions governing binding dispute resolution, creating private rights that would otherwise be unenforceable by a corporation without the intervention of a state. NAFTA, unlike the WTO regime, follows the practice of BITS and provides investing corporations with legal right to sue a host state for infringements of the agreement. See Stephen McBride, "Reconfiguring Sovereignty: NAFTA Chapter II Dispute Settlement Procedures and the Issue of Public-Private Authority," *Canadian Journal of Political Science* 39, no. 4 (2006): 1–21.

²⁸ Schneiderman, "Investment Rules," 522–23.

²⁹ A. Claire Cutler, "Global Capitalism and Liberal Myths: Dispute Resolution in Private International Trade Relations," *Millennium* 24, no. 3 (1995): 377–97.

³⁰ Virginia Haufler, *A Role for the Private Sector: Industry Self-Regulation in a Global Economy* (Washington, DC: Carnegie Endowment, 2001).

³¹ John G. Ruggie, "Reconstituting the Global Public Domain: Issues, Actors and Practices," *European Journal of International Relations* 10, no. 4 (2004): 499–531.

³² Ronnie Lipschutz with James Rowe, *Globalization, Governmentality and Global Politics: Regulation for the Rest of Us?* (London and New York: Routledge, 2005).

³³ Klaus Dieter Wolf, Nicole Deitelhoff, and Stefan Engert, "Corporate Security Responsibility: Towards a Conceptual Framework for a Comparative Research Agenda," *Cooperation and Conflict* 42, no. 3 (2007): 294–320.

³⁴ For a good discussion of legitimacy see Daniel Bodansky, "The Legitimacy of International Governance: A Coming of Age for International Environmental Law?," *American Journal of International Law* 93, no. 3 (1999): 596–624.

³⁵ Klaus Dieter Wolf, "Private Actors and the Legitimacy of Governance Beyond the State: Conceptual Outlines and Empirical Explorations," in *Governance and Democracy*, eds. Arthur Benz and Ioannis Papadopoulos (London and New York: Routledge, 2006), 200–27.

³⁶ This is the case for the private transnational governance of finance, secured transactions, underwriting, and auditing (see Cohen, "Harmonization"; Van Harten, "Private Authority"; Mügge, "Private-Public Puzzles").

³⁷ Ilan Kapoor, "Deliberative Democracy and the WTO," *Review of International Political Economy* 11, no. 3 (2004): 522–41.

³⁸ Gregory Shaffer, "Recognizing Public Goods in WTO Dispute Settlement: Who participates? Who decides? The Case of TRIPS and Pharmaceutical Patent Protection," *Journal of International Economic Law* 7, no. 2 (2004): 459–82.

³⁹ Amrita Narlikar, *The World Trade Organization* (Oxford: Oxford University Press, 2005).

⁴⁰ Sell, *Private Power*, 173.

⁴¹ Elizabeth Smythe, "Just Say No! The Negotiation of Investment Rules at the WTO," *International Journal of Political Economy* 33, no. 4 (2003): 60–83, 79.

⁴² Public goods are usually defined as goods with non-excludable benefits and non-rival consumption. Non-excludability means that it is technically, politically, or economically infeasible to exclude someone from consuming the good. Non-

rivalry means that one person's consumption of the good does not detract from its availability to others. See Inge Kaul and others, eds., *Providing Global Public Goods: Managing Globalization* (New York: Oxford University Press, 2003), 21.

⁴³ Inge Kaul and Ronald Mendoza, "Advancing the Concept of Public Goods," in Kaul and others, *Global Public Goods*, 95.

⁴⁴ Shaffer, "Recognizing Public Goods," 460.

⁴⁵ *Ibid.*, 463.

⁴⁶ Christoph Scherrer, "GATS: Long-Term Strategy for the Commodification of Education," *Review of International Political Economy* 12, no. 3 (2005): 484–510; Andrew Lang, "Beyond Formal Obligation: The Trade Regime and the Making of Political Priorities," *Leiden Journal of International Law* 18, no. 3 (2005): 403–24.

⁴⁷ Zachary Elkins, Andrew Guzman, and Beth Simmons, "Competing for Capital: The Diffusion of Bilateral Investment Treaties 1960–2000," University of California Berkeley Public Law Research Paper No. 578961.

⁴⁸ A club good is a good that is excludable but non-rivalrous.

⁴⁹ See A. Claire Cutler, "Problematising Corporate Social Responsibility under Conditions of Late Capitalism and Postmodernity," in *Authority in the Global Political Economy*, eds. Martin Nettesheim and Volker Rittberger (Houndsmills, Basingstoke: Palgrave Macmillan, 2008), 189–216. See also James Rowe, "Corporate Social Responsibility as Business Strategy," in Lipschutz and Rowe, *Globalization*, 130–70.

⁵⁰ Tony Porter, "Private Authority, Technical Authority, and the Globalization of Accounting Standards," *Business and Politics* 7, no. 3 (2005): 1–30, 2. The legitimating role of expertise and specialized or technical knowledge has been evident in all of the sectors and issue-areas reviewed in this paper.

⁵¹ Nölke and Perry, "Power of Governance," 19.

⁵² Van Harten, "Private Authority"; Cohen, "Harmonization." Others have also questioned the undemocratic nature of technical authority. The "first-mover advantage" of experts, whereby the first people or organizations to be able to influence the regulatory process are able to construct the rules to their own advantage, works against democratic legitimacy when framed in terms of participation and representation; see Marie-Laure Djelic and Kerstin Sahlin-Andersson, "Institutional Dynamics in a Re-Ordering World," in Djelic and Sahlin-Andersson, *Transnational Governance*, 375–97, 396. The development of food safety standards and environmental standards has been criticized for lacking in transparency and for inadequate opportunity for public participation as has the regulation of coordination service firms, rating agencies, accounting, and law firms; see Bodansky, "International Governance," 619; Nölke and Perry, "Power of Governance." The International Standards Organization (ISO) is also criticized for being dominated by corporate interests and delegations from industrialized countries, "to the practical exclusion of the less-developed countries"; see Naomi Roht-Arriaza, "Shifting the Point of Regulation: The International Organization for Standardization and Global Lawmaking on Trade and the Environment," *Ecology Law Quarterly* 22, no. 3 (2005): 479–539.

⁵³ Paul Haslam, "Is Corporate Social Responsibility a Constructivist Regime? Evidence from Latin America," *Global Society* 21, no. 2 (2007): 269–96, 270.

⁵⁴ Karl Marx, *Capital: A Critique of Political Economy*, vol. 1, trans. Ben Fowkes (London: Penguin, 1976).

⁵⁵ Antonio Gramsci, *Selections from the Prison Notebooks of Antonio Gramsci*, eds. Quintin Hoare and Geoffrey Nowell Smith (New York: International Publishers, 1971).

⁵⁶ Louis Althusser, "Ideology and Ideological State Apparatuses: Notes Towards an Investigation," in *Lenin and Philosophy*, trans. Ben Brewster (London: New Left Books, 1971), 127–86.

⁵⁷ Marx, *Capital*, chap. 1.

⁵⁸ Marx, *Capital*, 163–64.

⁵⁹ Evgeni Pashukanis, *Law and Marxism: A General Theory* (London: Pluto Press, 1978); Isaac Balbus, "Commodity Form and Legal Form: An Essay on the 'Relative Autonomy' of the Law," *Law & Society Review* 11, no. 3 (1977): 571–88; China Miéville, *Between Equal Rights: A Marxist Theory of International Law* (Leiden and Boston: Brill, 2005); A. Claire Cutler, "Toward a Radical Political Economy Critique of Transnational Economic Law," in *International Law on the Left: Revisiting Marxist Legacies*, ed. Susan Marks (Cambridge: Cambridge University Press, 2008), 199–219.

⁶⁰ Ruth Fletcher, "Legal Forms and Reproductive Norms," *Social & Legal Studies* 12, no. 2 (2003): 217–41, 221.

⁶¹ Ernest Mandel, *Introduction to Capital by Karl Marx*.

⁶² Gramsci, *Prison Notebooks*, 6–22.

⁶³ *Ibid.*, 263.

⁶⁴ Althusser, "Ideology," 127–86.

⁶⁵ Stephen Gill, *Power and Resistance in the New World Order* (New York: Palgrave Macmillan, 2003).

⁶⁶ David Harvey, *The New Imperialism* (New York: Oxford University Press, 2003).

⁶⁷ Jane Kelsey, "Legal Fetishism and the Contradictions of the GATS," *Globalisation, Societies and Education* 1, no. 3 (2003): 267–80, 276.

⁶⁸ William J. Drake and Kalypso Nicolaidis, "Ideas, Interests and Institutionalization: 'Trade in Services' and the Uruguay Round," *International Organization* 46, no. 1 (1992): 37–100, 39.

⁶⁹ *Ibid.*, 39.

⁷⁰ Ann-Christin Holland, *The Water Business: Corporations versus People* (London: Zed Books, 2005).

⁷¹ UNCTAD, *Recent Developments*, 5.

⁷² Harvey, *New Imperialism*; Cutler, "Problematizing Corporate Social Responsibility."

The Global Financial Crisis and its Impact on Transnational Corporations

AN INTERVIEW WITH JOHN GAPPER

John Gapper is the associate editor and chief business commentator for the Financial Times, writing a weekly column on business trends. He is the co-author of All That Glitters, an account of the collapse of Barings in 1995. In February of 2009, he spoke with STAIR editor David Louk and advisory committee member Ginger Turner about the recent global financial crisis and its impact on the role of transnational corporations in global governance.

STAIR: Are we witnessing a paradigm shift in the power of the state in regulating the private sector, or is this merely part of a regular cycle? Do you think the recent bailouts have shifted power and authority away from firms and toward governments, and if so, what implications does this have for the balance of power in global governance going forward?

John Gapper (JG): I do think it's a paradigm shift. I'm sure it is not a permanent one, but it is an important one, in that the cycle has moved toward growing authority for private corporations. I would date this from the late 1970s–1980s, with the election of Thatcher and Reagan. Further, it was a period when the US Federal Reserve imposed tight controls on inflation and created a stable marketplace with increasing deregulation. Not only did private corporations and private managers become more powerful and successful compared to public enterprise, there was also a sense that they had greater authority. Many thought it was best to leave to the private sector the functioning not only of private enterprise itself but also of aspects of the public sector.

So yes, I think there has been a significant paradigm shift. There has been a general collapse of confidence in the competence of the private sector, particularly the financial sector, and there is a feeling that the private sector needs to be more tightly regulated and controlled. This is a significant shift and we will see its implications for quite a long period of time. Inevitably, the cycle will swing back, but we're in a decade-long period of reconsidering the boundary between private and public sector enterprises.

Q: *In some of your recent articles (“Earthquake Insurance should cost a lot,” “King’s men must put themselves together again”), you emphasize that while*

private companies should be made to pay for their losses, regulation is not a panacea. If private companies must pay more for the negative externalities they create, does that mean government must have a larger enforcement role?

JG: I believe it is to everyone's benefit if private sector companies pay for the negative externalities they produce. If they take risks and collapse they should be allowed to do that. Furthermore, we should be extremely careful about mixing private and public ownership. In the cases in which we have seen that, such as the mortgage lenders in the US (Fannie Mae and Freddie Mac), they were quasi-public, quasi-private organizations, and that mixture was not ideal. They over-expanded and took risks, knowing they could rely on government backing. That said, we are clearly in a rather extraordinary set of circumstances; the instincts of many people, myself included, was that it was correct to let Lehman Brothers collapse, but we are in a situation where a distressingly large number of financial institutions have built themselves into such large and interconnected systems that we simply cannot allow them to collapse.

There are several reasons for this: First, the banking systems cannot be allowed to flounder because they are so critical to the functioning of economies. Second, all these individual financial institutions were in effect "too big to fail" because they were so interconnected with complex securities markets. So, we're in a very unhappy situation where governments, in effect, have very little choice but to step in; then the question is, what do you do now? Most people have probably come to the same conclusion, which is that governments need to step in, provide public capital and recapitalize these institutions, but then they need to get out as soon as possible, because governments are bad owners of financial companies. That's where we are at present, but how you do this is very complicated, and it is still being done on the fly.

Q: Despite the transnational nature of many large firms, the nationalized bailouts highlight the fact that states may remain the point of last resort for firms. Who suffers the most from cross-border spill-over from the nationalization of banks?

JG: The places that clearly appear to be the worst sufferers are the countries where international banks have expanded and formed an integral and dominant part of the local banking system, even though these banks were not from those countries. This includes many Eastern Europe countries, Asian markets, and other emerging markets where the relatively underdeveloped capital system and local banking system

were effectively taken over, or pushed aside, by large international institutions. The effect of local, nationalized bailouts is that politicians are pouring taxpayers' money into these institutions so that they will reduce their balance sheets. They want them to become more stable in their foundations and to sell their assets to raise capital. All of this will diminish their international operations. You can already see these effects rather severely in Eastern Europe. Although this is a global problem, the national solution is being sold by a patchwork of national interventions, and that's creating enormous strain and uncertainty.

Q: Given that several countries' banking systems have weathered the financial crisis well in comparison to the Anglo-American banks, do you think aspects of those systems will be exported to other countries in the future?

JG: A couple of national banking systems are perceived to have done pretty well. For example, India's banking system has done comparatively well because the former central bank governor was pretty restrictive in not allowing them to trade in derivatives. Another example is Canada. Canada is the more interesting example, because Canada's banks are fairly international for a G7 country, and yet they fared better, no question. They were more traditional commercial banks with relatively limited investment banking arms and were relatively tightly regulated. People may well look to the Canadian model in particular. This might be a stretch, but it is interesting to see that some of the more successful banks have been those of the former commonwealth countries rather than Britain itself. HSBC has survived relatively well, as have the Canadian banks, whereas the British banks (Northern Rock, RBS, Lloyds, and HBOS) have done rather badly. Many people are asking a lot of questions about the hegemony of the Anglo-American model of banking that appeared to be ascendant for a long time.

Q: In 2006, you wrote about the market pressure for TNCs to go green ("Companies see the gains in going green"). With the financial downturn, will companies continue to make progress on environmentally-friendly and human rights-friendly initiatives, or will they have to cut innovative programmes as they struggle to meet their bottom-lines?

JG: You can still see a number of companies that are infrastructure-based, like General Electric (GE), for whom there remains a considerable market opportunity in energy efficiency programmes and the smart grid programme. With GE building smart grids and working on infrastructure in the United States, in some sense there is even more of

an opportunity now, because there will be new infrastructure spending related to stimulus packages. Some of that is being labelled as “green spending,” and this will be a revenue opportunity. Companies that were relying on consumers paying a premium for green, sustainable, and organic products may have greater difficulty, because it’s unclear whether consumers will still pay the premium or instead save money. It depends where you are and whether your company sells to consumers, other businesses, or is one that relies on government spending in terms of determining what your attitude about this is going to be.

Q: As large TNCs replace smaller independent firms, they have come to employ larger and larger segments of societies. These firms’ bankruptcies and relocations have significant implications for the state. We saw that, for instance, with the threats of layoffs and trickle-down effects if US auto firms were to have failed. In what ways are states increasingly held captive by the survival or failure of their largest firms?

JG: There have been a whole set of issues to do with companies that are “too big to fail,” and a related set of realizations about states and national governments. This is not just a question of large banks but also of the car companies, which are also large employers. We’ve seen large complex global effects from the failure of the Detroit car companies; GM not only wants a bailout from the US government, but its regional operations in the UK and Asia also need help from local governments, and in a sense some of these large TNCs are passing around the begging bowl to different national governments. One thing national governments are discovering, and this relates to the issue of Western banks in emerging markets, is that you cannot rely on the home state of those companies being as sympathetic to their overseas operations. You’re left responsible for those local operations. One thing governments are discovering is that when these TNCs get into trouble, they are effectively a collection of national enterprises.

Q: Several articles in this issue of STAIR suggest that TNCs are acquiring a greater agenda-setting and rule-making role, especially in relation to issues like climate change governance. How desirable do you think this trend is, and how legitimate are TNCs as agenda-setting actors? What problems or complications might arise?

JG: In a pure sense, one could say that the agenda-setting on issues such as climate change should be set by democratically elected governments and not corporations. However, greater participation by TNCs is the unintended consequence of protests against TNCs in the 1990s.

People protested that they were not respecting human rights or labor standards in their factories and that they were being environmentally irresponsible, and the response of TNCs was to take a lot of those issues more seriously.

Frankly, people can't complain that TNCs are being irresponsible and then when they start being responsible complain that they are somehow usurping the role of national governments. The reality is these institutions exist, and if they are being asked to behave "responsibly," then they will inevitably start setting standards; clearly Western corporations, in effect, set standards for labour in their factories and those of their suppliers that are higher than local regulatory standards would otherwise be. Companies like Nike are forced to impose higher labour standards on suppliers than their suppliers would be required by their own national governments. They have become agenda-setters because people demanded that they set those agendas. I don't see a way out of this.

Q: Do you view the fact that firms are agenda-setters as a generally positive trend? Given the fact that firms might have standards that are not aligned with the preferences of civil society, what possible fora exist for these actors to discuss and resolve their differences and competing interests over these issues?

JG: There clearly can be competing interests, and inevitably with something like labour standards there will inherently be competing interests between people who are employed and the employers, between capital and labour; Karl Marx said this, and nothing much has changed. This is also true about environmental standards, where an individual corporation has a shareholder incentive to exploit resources, whereas it is in the collective interest of society to have these resources preserved. I am not sure what forum is best for settling these interests, but it certainly is true that TNCs, because of enforcement, are taking these things much more seriously, and many of the large TNCs have quite sophisticated consultation mechanisms for involving civil society groups. I don't see this as being a resolvable issue though, because competing interests will always remain.

Q: The concept of "global governance" has achieved increasing prominence in recent years; it suggests a multi-actor, multi-level, process of decision-making. How might TNCs contribute to this multi-tiered decision-making structure?

JG: By and large, TNCs clearly have some incentive to warm to the idea of global governance, certainly the idea of global regulation, because one of

the extreme difficulties they face in doing business in different countries is competing regulatory standards and different safety standards. Clearly, if you are a US company, you face that problem both within the US (among different states) and internationally. So from their point of view, having a single market with a single regulatory structure and, to the extent that one can, relatively few currencies, would be a good thing because it would reduce their costs.

Having said that, it would depend on what form of regulation it was. I think they will be simultaneously attracted to the idea and wary of it, because the idea of a single, powerful global regulator might not be exactly what they want, so clearly they will angle for their own interests. In practice, I'm not sure how much choice they will get, because much of the push toward global governance now is to close a set of loopholes that TNCs exploited. For example, Wall Street would move fluidly to the jurisdiction with more favourable tax advantages or regulatory advantages. It would move its credit derivatives operations out of New York and into London, which was seen to be a friendlier regulatory climate. Now, TNCs will have more restrictions placed on them, and therefore I'm not sure how much they are going to be asked to be part of rule-making and decision-making process. I think they are going to be told what to do.

Q: To what degree do you think the development of a restrictive global regulatory framework governing the actions of TNCs is a result of the financial crisis? Was the development of global governance in this area an inevitability of globalization or more of a reaction to current conditions?

JG: The financial crisis has made a difference in two ways: first, the general trajectory was in the direction of more liberalization within individual countries. This has now changed as a result of the financial crisis toward greater regulation away from liberalization. Second, in the past there was a sense, almost as part of that liberalization process, that individual countries were more likely to compete in what you might term "a race to the bottom," i.e. competitively reducing rules and liberalizing tax regimes. Both of these effects have been effectively altered and governments perceive the risks of competitive liberalization much more heavily, for it has affected their finances very badly. Ireland is a good example—it was a competitive liberalizer and is now facing extreme fiscal problems. I think the world has changed and we're not only going to see a switch away from liberalization toward re-regulation, but we are also going to see a switch toward more integrated global governance and away from regulatory competition. Global governance will be a more restrictive affair. ■

Deal or No Deal? Social Responsibility and Corporate Decision-Making: A Review of McKinsey's Global Impact Report

TAYLOR ST. JOHN

Two recent reports, from McKinsey & Co.¹ and Goldman Sachs Research,² aim to measure if and how environmental, social, and governance (ESG) norms change corporate practices. The reports base their analysis of ESG norms on the United Nations Global Compact (GC), the most prominent example of a multi-stakeholder partnership designed to align corporate practices with agreed-upon ESG norms. The GC has been subject to intense criticism that, since it is voluntary and unmonitored, it enables corporations to “blue-wash”³ their dirty brands and free-ride on the good deeds of others.⁴

These critiques often miss that the innovation of the GC lies in its recognition of reality: the GC is not regulation, nor does it pretend to be a regulator, or even a certifier of corporate behaviour. As Therien and Pouliot argued, it “relies on persuasion and the example of good practice rather than hierarchy or coercion.”⁵ The power of the GC is discursive, not direct, and its influence relies on what Martha Finnemore and Kathryn Sikkink described as the norm life cycle of “emergence,” “cascade,” and “internalization.”⁶ The GC is premised on an implicit recognition that no authority would be able to monitor all global corporate behaviour, which sets the stage for the GC to be an explicit plea to the ethics of signatory corporations.

Launching pleas at corporations initially seems a laughably weak strategy, but I follow Kratochwil⁷ and others to argue that it would be foolish to overlook the power of norms and promises in creating changes in corporate practice. Traditionally, norms and obligations have entered into discussions of corporate governance only in the way Milton Friedman argued, specifically that “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits.”⁸ However, I argue that strong norms of social obligation are emerging in contemporary business, a phenomenon illustrated most vividly by corporations themselves declaring they have

social responsibilities other than increasing profits. With projects like the GC, social responsibility is becoming a key discourse in the international business community—but is it effective? Is the GC changing the way leaders of signatory corporations perceive social obligations and changing the way they act to be in accordance with those obligations?

The McKinsey report answers “yes” to that question, and provides evidence that the GC is creating meaningful changes in the way corporate executives perceive duties other than profit-making. After interviewing four hundred executives in signatory companies, McKinsey found that “more than 9 out of 10 corporate leaders are doing more than they did 5 years ago (about the time when most companies signed the GC) to incorporate environmental, social, and political issues into their firms’ core strategies” (5). McKinsey used the language of obligation in their report, not “suggesting” social responsibility but “explaining why businesses *must* confront” social and environmental duties. The report speaks of “what could be a profound mindset shift” as executives realize underlying tensions in business models focused exclusively on short-term profits and the importance of investing in the “intangible arena” of environmental, social, and governance norms.

The Goldman Sachs report also provides evidence that the diffusion of ESG norms brought about by the GC is having an impact on corporate practice. The report introduces a framework for identifying “sustainable advantage,” or well-run firms that actively manage their ESG obligations. The report then argues internalization and early action on ESG norms gives firms a strategic advantage and can help make them the “best positioned to succeed given the issues arising from a rapidly changing, globalizing world.”

Neither of the reports hides the reality that “enlightened self-interest” drives most of the adaptation to ESG norms. Nor do the reports hide that Goldman Sachs and McKinsey are themselves powerful enough as agents of diffusion to create the very reality they describe. These two corporations are among the most powerful organizations in the world when power is measured in constitutive terms and the “strategic advice” they suggest has repeatedly become reality as the suggested norms have cascaded and been internalized by corporations. Therefore, I view these two corporate reports as helping to create and strengthen the perceived social obligation and the norms that they claim to measure. Similar to the Global Compact itself, the McKinsey and Goldman Sachs reports deploy only their discursive power to spread ESG norms among corporations—and now it is time to recognize that this discursive construction of social obligation is a powerful step towards more responsible corporate decision-making.

Deal or No Deal? Social Responsibility and Corporate Decision-Making: A Response

DANIEL HEMEL

Taylor St. John argues that the Goldman Sachs GS SUSTAIN “focus list,” along with a recent survey of business practices by the consultancy McKinsey & Co., is “helping to create and strengthen” norms of corporate social and environmental responsibility. She suggests the Goldman and McKinsey reports are “powerful step[s] towards more responsible corporate decision-making.” I examine one of these two documents—the GS SUSTAIN report—in greater detail to evaluate St. John’s claim. GS SUSTAIN is a list of twenty-one stocks in “mature industries” and twenty-three in “emergent industries” that (according to Goldman Sachs) meet environmental, social, and governance (ESG) standards and are (putatively) poised for long-term growth. But these standards are neither transparent nor terribly stringent. As Daniel Drezner writes, “sham standards...act to relieve or redirect any domestic or civil society pressure for significant global regulations.”⁹⁰ If the Goldman Sachs ESG standards have this hypothesized effect, then they are one step toward and two steps back from responsible corporate decision-making.

Ironically, the Goldman Sachs report—which assesses companies based on transparency (as well as other dimensions)—is not itself an exemplar of transparency. Goldman Sachs gives companies scores in five categories (corporate governance, leadership, relations with employees, relations with “stakeholders,” and environment) but does not publish the statistics that go into these calculations. Thus, the global mining company BHP Billiton makes it onto Goldman Sachs’s list and lands in the top quartile for relations with employees, even though, as Goldman Sachs notes, BHP’s operations are marked by “high fatalities and fatality rate” (a potential investor might reasonably ask: “how high?” The report does not answer this question). Indeed, even from the scant information that is available, it seems that some of the companies on GS SUSTAIN are not performing particularly well in ESG areas. For example, the list includes the steelmaker Voestalpine, which ranks in the bottom quartile of mining and steel firms for environmental responsibility (according to Goldman Sachs’s own analysis). Less than half of the twenty-one “mature industry” stocks rank in the top quartile in Goldman Sachs’s own environmental assessment.

More disturbingly, Goldman's ESG scores do not include human rights components for more than half of the covered industries because, according to the report, "we do not believe that sufficient quantifiable and comparable data exists." Thus Nestlé makes the cut (and gets an overall ESG score in the top quartile) even as the International Labor Rights Forum accuses it of being one of the "five worst companies for the right to associate," and even as Nestlé combats accusations that some of its chocolate comes from farms that used child slave labour (Nestlé denies the charges).¹⁰

St. John rightly notes that the Goldman Sachs report does not "hid[e] the reality that 'enlightened self-interest' drives most of the adaptation to ESG norms." On its first page, the Goldman Sachs report trumpets the fact that its ESG picks have outperformed stocks in similar industries by 25 per cent over the previous two years. The report came out before the 2008 stock market meltdown, and Goldman Sachs has not released information on its picks' performance in recent months. But the question is not whether the GS SUSTAIN strategy advances investors' self-interest; the question is whether the strategy is *enlightened*. As long as it leaves the public in the dark about its methodology and about the human rights records of the stocks on the list, GS SUSTAIN does not deserve civil society's support.

Deal or No Deal? Social Responsibility and Corporate Decision-Making: A Rejoinder

TAYLOR ST. JOHN

In his response to my piece, Daniel Hemel draws attention to many of the shortcomings of the GS SUSTAIN "focus list" and its constituent companies. While I am the first to admit the mediocrity and indeed impotence of many social responsibility initiatives, I think his critique of the report's methodology and silence on human rights point out realities that are indeed problematic, but not necessarily unique to the report. The more serious problem raised by Hemel with the GS Report and others like it is "sham standards"; yet even these, while deeply troubling, do not negate the power of norms in changing behaviour.

First, he notes that the report does not disclose (let alone defend) its methodology, which is inexcusable for academic literature. However, in many business settings, it is looked upon as “best practice” and Hemel fails to take account of the reality that Goldman Sachs Research—or McKinsey for that matter—are in the business of selling their knowledge. These reports advertise their expertise, and remind readers frequently in the text that their insight is “proprietary information” protected by all manner of intellectual property rights. The GS SUSTAIN list is meant to demonstrate to potential investors that Goldman Sachs has a special, more robust way of picking winners than the competition; therefore, they should not be expected to willingly give up the trade secret that is their methodology.

Hemel also draws attention to the silence of the Goldman Sachs report on human rights. This is a serious flaw in the methodology, since human rights are the first two principles in the Global Compact. However, it is not as though the authors of this report simply failed to incorporate existing indicators—reliable, quantifiable (or at least ordinal) indicators of human rights on a sub-national level are simply not available. To its credit, the Goldman report seems eager to drop the term “human rights” in a bullet-point format describing BHP Billiton with “good human rights”—but this only makes one wonder if the debate is settled enough that consensus exists as to what “good human rights” even means.

Although I implicitly admitted that self-regulation is a corporate strategy to prevent “real” regulation in my piece, that doesn’t make Hemel’s point about sham standards ring any less true or any less worrying. Hemel points to what could be termed “false social consciousness”—a self-satisfied sense of having done right that mitigates social guilt and thus neuters or prevents effort for real social change. This line of thinking is almost as damaging to corporate social responsibility debates as the false consciousness argument put forward by an earlier political economist hankering for change, and I believe it must ultimately be rejected in favour of viewing social consciousness as a cumulative “awareness builds back on awareness and into a habit” process. If we can agree that “false” consciousness is better than no consciousness, the question becomes: what tools are available to build awareness and change corporate practices? A realistic and honest, if humbling, answer to that question is to recognize that “superior self-governance” may be one of the strongest tools available to all who want more responsible and accountable corporations. While I still have a hard time accepting the idea of putting my hope for social change in the power of corporate promises, the notion that reports like GS SUSTAIN help to build corporate

awareness and strengthen norms of responsible, sustainable behaviour is much easier to accept, and perhaps even an encouraging way forward. ■

127

Notes

¹ Jeremy Oppenheim and others, "Shaping the New Rules of Competition: UN Global Compact Participant Mirror," McKinsey and Company, July 2007, <http://www.unglobalcompact.org/docs/summit2007/mckinsey—embargoed—until020707.pdf> (accessed March 1, 2009).

² Anthony Ling and others, "Introducing GS SUSTAIN," Goldman Sachs Group, Global Investment Research, June 22, 2007, <http://www.unglobalcompact.org/docs/summit2007/gS—ESG—embargoed—until030707pdf.pdf> (accessed March 1, 2009).

³ "Blue-washing" frequently refers to corporations disingenuously using the UN to bolster the legitimacy of their brand worldwide.

⁴ Ann Zammit, *Development at Risk: Rethinking UN-Business Partnerships* (Geneva: South Centre and UNRISD, 2003).

⁵ Jean-Philippe Thérien and Vincent Pouliot, "Global Compact: Shifting the Politics of International Development," *Global Governance* 12, no. 1 (2006): 55–75.

⁶ Martha Finnemore and Kathryn Sikkink, "International Norms and Political Change," *International Organization* 52, no. 4 (1998): 887–917.

⁷ Friedrich V. Kratochwil, *Rules, Norms, and Decisions: On the Conditions of Practical and Legal Reasoning in International Relations and Domestic Affairs* (Cambridge: Cambridge University Press, 1989).

⁸ Milton Friedman, "The Social Responsibility of Business is to Increase its Profits," *The New York Times Magazine*, September 13, 1970.

⁹ Daniel W. Drezner, *All Politics Is Global: Explaining International Regulatory Regimes* (Princeton: Princeton University Press, 2007), 81.

¹⁰ International Labor Rights Forum, "Working for Scrooge: 5 Worst Companies for the Right to Associate," Washington, DC, December 10, 2008, <http://www.labor-rights.org/files/WorkingForScrooge.pdf>; Deborah Orr, "Slave Chocolate?," *Forbes.com*, April 24, 2006, <http://www.forbes.com/global/2006/0424/024.html> (both accessed March 1, 2009).

Bottom-Line Activism: A Review of Oxfam's Better Returns for a Better World Project

DANIEL HEMEL

Late last year, Oxfam released the first installment of its “Better Returns for a Better World” project. The twelve-page discussion paper, produced in conjunction with a for-profit asset manager, aims to offer “an analytical framework” for thinking about the relationship between private-sector investment and the development agenda.¹ The Oxfam project is still at an early stage, so it would be premature to criticize the effort. But so far, Oxfam has yet to ask—much less answer—the key question for socially responsible investors: what works?

Oxfam cites four ways in which socially responsible investors can “exert influence” over companies directly: divestment, shareholder resolutions, research, and investor-non-governmental organization (NGO) coalitions.² But these strategies reflect two diametrically opposing logics—“insider” activism and “outsider” activism—with no effort at reconciliation.

This review offers a critique of two of Oxfam's influence strategies: shareholder resolutions and divestment (I bracket the two others—research and investor-NGO coalitions—because they are necessary components of both shareholder activism and divestment). I will argue that, to date, most shareholder-resolution and divestment initiatives have represented “weak” rather than “strong” socially responsible investment (SRI) strategies (see Table 1). A socially *conscious* investor might sleep better at night if she knows that she voted for a shareholder resolution related to climate change at the ExxonMobil annual meeting (even if the resolution failed). By the same token, such a socially *conscious* investor might sleep better at night after selling her stock in Wal-Mart (even if the sale had no discernible effect on Wal-Mart's share price). But a socially *responsible* investor (i.e., one who monitors his *impact* on social and environmental *outcomes*) should not be satisfied with strategies that map onto the top line (Box A and Box B) of the Table 1 matrix. Rather, a socially *responsible* investor should strive for *bottom line* (Box C and Box D) actions.

Table 1: A Typology of SRI Strategies

	Insider	Outsider
Weak	A. Shareholder Resolution Voting	B. Divestment
Strong	C. Corporate Aid	D. Short-Selling

Shareholder resolutions are proposals presented at a publicly traded company's annual meeting; large public pension funds and private SRI-oriented asset managers often use these resolutions to promote social and environmental objectives. Shareholder resolutions represent an "insider" strategy because they use a company's own corporate governance procedures to influence behaviour. According to a review of the empirical literature on shareholder activism, "to date, unsuccessful resolutions have been the norm."³

Divestment refers to the strategy of selling (and refusing to buy) shares of "socially irresponsible" companies. Divestment is an "outsider" strategy because it aims to influence companies through *non-ownership* of their stock (whereas "insider" strategies aim to influence companies through *ownership* of their stock). While activists hope that divestment will depress share prices and therefore motivate changes to corporate policies, econometric analysis finds scant evidence that divestment initiatives have affected the stock market.⁴

These empirical results should not be surprising. When "corporate raiders" such as Carl Icahn and activist hedge funds such as Trian identify a poorly managed firm, they do not just cast their votes on shareholder resolutions. Rather, they aggressively acquire *more* shares of stock to increase their voting power and compel the company to change. When speculators want to drive down the price of a stock, they do not just divest their existing stake. Rather, they *short-sell* shares in large volumes.⁵ Shareholder resolutions and divestment initiatives are unlikely to succeed because they are weak variants of strong strategies.

Herein lies the contradiction: a strong insider approach involves taking a large long position on a stock, while a strong outsider approach involves taking a large short position on a stock; they are mutually exclusive strategies. Both of these strong strategies have their drawbacks.

Whereas socially *conscious* investors want to keep their hands clean of companies with checkered records, the “corporate raid” approach involves getting one’s hands dirty. Likewise, whereas divestment might help investors sleep soundly at night, short-selling will keep them wide-awake: it is a high-risk strategy that exposes investors to heavy losses in the event that share prices rise rather than fall.

If SRI is a tool for investors to ease their conscience, then perhaps the top-of-the-matrix strategies—shareholder resolution voting and divestment—will suffice. If SRI is a tool to change corporate behaviour (and in so doing, to change the world), the bottom-line strategies of “corporate raiding” and “short-selling” may be better suited to that goal.

Bottom-Line Activism: A Response

TAYLOR ST. JOHN

The aggressive socially *responsible* investment (SRI) strategies outlined by Daniel Hemel in “Bottom-Line Activism” are certainly novel and represent a welcome hybrid of activist investing with social activism. This response will not question the efficacy of the proposed “strong” SRI strategies. If enacted, socially-minded investors would almost surely get the attention of the corporate managers and other owners. This response raises two issues which precede efficacy as a concern: the logic and the feasibility of the proposed SRI strategies.

Hemel cites approvingly the tactics of the so-called “barbarians at the gate” that have been lambasted for ripping apart companies, causing layoffs, and creating poisonous corporate environments, because he recognizes that corporate raiders create dramatic change by acquiring large stakes of companies. I agree that nothing would be so deliciously ironic as to remake the hostile takeover into a SRI strategy, but unfortunately, Hemel has overlooked the one essential reason why corporate raids and short-selling succeed—because they are (at least expected to be) profitable. He claims that insider and outsider activism are diametrically opposed, but this is a false binary; profit drives both the “insider” strategy of corporate raiding and the “outsider” strategy of short-selling.

The logic of profit is at work from the instant that rumours of a takeover create speculation, trading, and volatility. Rumours of activist investors taking interest in a company usually cause relatively extreme movements both

directions; rumours of a social activist investor taking interest would likely only drive the stock price down. Other investors would dump their shares because the company is likely to be less competitive and less profitable in the future if activist shareholders are going to force more socially responsible practices onto the company.

If this scenario were to play out, the socially responsible investors would have consciously destroyed their own capital, and regardless of their success or failure as social activists, they have utterly failed as investors. Failing as an investor is not an option if shareholder activism is to be a sustainable force for social change.

The feasibility of Hemel's argument also rests on questionable assumptions about the SRI community. He does not mention the enormous collective action problem that must be resolved before a 'strong' SRI strategy could even be contemplated. Socially responsible investors are incredibly diverse in views and exceptionally diffuse. In addition, even the leading socially responsible investors, such as California Public Employees' Retirement System (CALPERS), are not high-risk investors. They were not designed to take on the risk inherent in launching a take-over bid, which tends to trigger poison pills or defensive action by management to avoid the takeover or, worse yet, protracted legal battles. Even short selling is resisted by many socially responsible investors, not because of any inherent risk but because of its unpopular, capital-destroying premise—a practice the Securities and Exchange Commission temporarily banned recently because of its destructive capabilities.⁶

Even if the logic and feasibility issues were solved, the dramatic, risky action called for by Hemel makes the difference between socially conscious and socially responsible investing resemble the distinction between a separatist movement and its armed wing (the part that usually discredits the rest and escalates the conflict). If these are the choices faced by investors, I'll follow the 'weak' strategies offered in the Oxfam paper, and be content as merely a socially conscious investor.

Bottom-Line Activism: A Rejoinder

DANIEL HEMEL

I do not expect that socially *responsible* investors will adopt the "strong" socially responsible investment (SRI) strategies that I describe in "Bottom-Line Activism" anytime soon. Taylor St. John rightly notes

(and I acknowledge above) that these strategies entail financial risks that institutional investors will not rush to embrace. However, by imagining what a “strong” SRI strategy would look like, we can generate two insights into the “weak” strategies that the SRI community has adopted so far. First, the two “weak” strategies work at cross-purposes: shareholder resolutions require a critical mass of socially conscious stockholders to pass, and divestment dilutes that critical mass. Second, “weak” SRI strategies should lose the “R.” If the strategies are not designed to have an impact on actual events, then in what sense are they responsible?

Admittedly, there are ways in which “weak” SRI strategies can have a real-world impact: for example, a high-profile divestment might draw media attention to a specific company’s practices. However, SRI asset managers who keep their research “proprietary” do little to disseminate information on human rights violations or environmental degradation. Unfortunately, the focus of the SRI community to date has been on keeping a clean conscience, not building a better world. ■

Notes

¹ Rory Sullivan and Helena Viñes Fiestas, *Responsible Investment: A Force for Poverty Alleviation. Framing the Debate* (Oxford: Oxfam GB, 2008).

² More specifically, with regard to divestment, Oxfam cites the example of Norway’s Global Pension Fund, which has sold its stakes in companies such as Wal-Mart and Boeing that “do not meet its social and environmental criteria.” With regard to shareholder resolutions, Oxfam cites the fact that investors in more than fifty US stocks have filed shareholder resolutions to set greenhouse-gas emissions reduction targets. With regard to research, Oxfam cites (co-author) Insight Investment, which has presented executives with reports on the social impact of their companies’ supply-chain practices; several companies have changed their practices as a result. Finally, Oxfam cites its own involvement in an investor-NGO coalition that persuaded pharmaceutical manufacturer GlaxoSmithKline to expand access to HIV and AIDS drugs in the developing world. See *ibid.*, 6.

³ Matthew Haigh and James Hazelton, “Financial Markets: A Tool for Social Responsibility?,” *Journal of Business Ethics* 52, no. 1 (2004): 59–71.

⁴ Siew Hong Teoh, Ivo Welch, and C. Paul Wazzan, “The Effect of Socially Activist Investment Policies on the Financial Market: Evidence from the South African Boycott,” *Journal of Business* 72, no. 1 (1999): 35–89.

⁵ Outright market manipulation is banned in the US under Section 9 of the Securities Exchange Act of 1934, though short-selling is not.

⁶ Kara Scannell and others, “SEC Issues Temporary Ban Against Short Selling,” *The Wall Street Journal*, September 19, 2008.

Karl P. Sauvant, ed. *The Rise of Transnational Corporations from Emerging Markets: Threat or Opportunity?*

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TAYLOR ST. JOHN (St Antony's College, University of Oxford)

For a phenomenon that effortlessly grabs headlines (e.g., Dubai Ports World acquiring US ports, Lenovo buying IBM, Tata buying Corus), investment *from* emerging markets receives little coverage in academic literature. This new volume edited by Karl Sauvant addresses this gap with seventeen chapters from prominent academics and policymakers; together, the chapters document the changes in investment patterns and then open discussion about important questions that accompany these new flows of foreign direct investment (FDI).

The first eight chapters are largely descriptive and chart the changes in investment patterns, while the last six chapters focus on policy implications for both host and home countries. Generally, the chapters in the second half of the book are more analysis-driven and broach the difficult, more interesting issues about FDI and its impacts on host and home countries. On the whole, the book is fabulously heavy with well-researched description, but dismayingly light on sustained critical engagement or contributors willing to challenge dominant orthodoxies.

Perhaps this reluctance to examine critically is linked to the long and impressive list of contributors, which unfortunately seems to create a climate of appeasement that stifles debate rather than stimulates it. It is, in fact, the most famous contributors that bring down the quality of this volume. In particular, the chapters by Jeffrey Sachs (chapter two) and Joseph Stiglitz (chapter fifteen) are not specific to FDI, are not relevant to the rest of the book, and are loaded with problematic, sweeping statements. For example, Sachs casually notes the "increasing presence of China in Africa" and comments "as someone interested in African development, I think this is good" (17). Few of their assertions are defended (or even defensible) with evidence, and indeed Stiglitz's chapter has—in an act of stunningly poor scholarship—only a single

reference, to his own book. The contributions of John Dunning (chapter eight) and Alan Rugman (chapter six) are at least on the topic of FDI from emerging markets; however, compared to their past contributions to this field, their chapters are disappointing amalgamations of quantitative data that, for the most part, lack incisive analysis.

In other contexts these four scholars have produced rigorous and innovative research, but in this volume they all undergird their work with a troubling attitude towards history. The idea that history has ended and we are now just watching convergence to a state of total economic integration is present in all four chapters mentioned above, and stated most pointedly by Sachs: “[M]y essential point is that the ‘tricks of the trade’ of technology-based, market-led development are now known everywhere, and they are basically being implemented everywhere” (16). Dunning also presents the history of investment as something that began shortly after World War II, and can be divided neatly by the year 1980 into two distinct periods: pre-globalization and post-globalization (171). This short historical memory seems endemic to the study of investment in this volume and might explain why later contributors, most notably Edward Graham, puzzle over why developing countries might be sceptical of FDI (306).

Graham, however, like other contributors to the second and third sections of the book (and unlike the four chapters mentioned above), does provide an interesting, empirically-driven analysis of the new policy problems associated with FDI from emerging markets. These later contributors follow in the spirit of Sauvant’s opening chapter, when he frames the issue addressed by the book as a noble-minded challenge for host countries in the developed world: they need to see the rise of transnational corporations from emerging markets not as a threat but as an opportunity, as an additional avenue to integrate emerging markets fully into the world economy (10).

If anyone is qualified to issue such a challenge to investment policymakers, it is Karl Sauvant, who has been publishing and working at the top of this field since 1973. Sauvant’s message is directed at policymakers, and later chapters support that message by making a convincing case for serious self-reflection by developed, traditionally capital-exporting countries. First and foremost is the issue of hypocrisy: in her excellent chapter, Andrea Goldstein argues that “it is clear that most arguments deployed in Western countries to block foreign acquisitions, especially by emerging-market TNCs, are specious, and more often than not, they amount to a not-so-veiled protectionism” (196). Theodore Moran points out that developed country literature on FDI has been driven by a preoccupation with the workers left behind (Perot’s “great

sucking sound" destroying the supply of good jobs at home). Although Moran's analysis is focused on identifying the policies that developing countries should adopt towards FDI, his conclusion, that supporting national champions and keeping firms at home are not viable options for strengthening the local job base, is just as relevant for policymakers in the developed world (292).

The contributors also focus on policy-making challenges from the perspective of developing countries. Edward Graham's nuanced chapter approaches the increasingly important but extremely understudied realm of international investment agreements (IIAs). In particular, he presents a case to developing countries that an international investment regime might be in their interests (300), yet he recalls the negative experiences of developing countries with international agreements (e.g., TRIPS) in the recent past and in this way understands the reluctance of leaders to sign agreements with the potential to bring similar damages. Moran also examines the impacts of IIAs, and asks how actual foreign greenfield investment can be distinguished from capital "round-tripping" or actions by domestic investors to secure special privileges associated with inward (foreign) investment. This echoes the critical question posed earlier by John Cantwell and Helena Barnard: is outward FDI from developing countries just institutionalized capital flight?

This question is never answered conclusively (nor is it likely that it could be), but it is followed up by Steven Globerman and Daniel Shapiro, who analyse the impact of FDI on home (sending) countries. Their evidence, supported by the findings of Moran and Graham, is that investment does generally bring desirable results to the home country. However, Globerman and Shapiro also put the amount of FDI from developing countries into perspective, and therefore argue that, even if it is just institutionalized capital flight, not enough is leaving to "adversely affect domestic capital formation and macroeconomic stability in emerging markets ... In this regard, it is appropriate to highlight the fact that OFDI [outward FDI], to date, has been highly concentrated among a small number of countries. Equally relevant, OFDI from emerging markets has also been highly concentrated among a relatively small number of TNCs. This concentration serves as a caution against generalizing our findings and conclusions to all emerging markets" (231). Lorraine Eden echoes these warnings against assuming that all emerging markets exhibit similar trade and FDI patterns in her summary chapter, which is an extremely curious reflection given the tendency of the book to take a macro view (336).

Those explicit warnings against overgeneralization are welcome contributions to the book, but a warning against over-classifying the

empirical world or believing too much in analytic categories is not in the book, and particularly after the latest financial crisis, would have given the volume a longer shelf life. After the spectacular failure of corporate governance among many firms, particularly financial firms, in Organisation for Economic Co-operation and Development (OECD) countries and a relatively robust showing during the current downturn among banks in BRIC countries, the concerns of Rainer Geiger's chapter on emerging market corporate governance look not only misplaced, but contradictory to reality. Instead of comparing the behaviour of firms in non-OECD countries to the OECD principles, a more accurate comparison would have been with the actual behaviour of firms in OECD countries. The latest crisis merely illustrated why the label "emerging market TNC" should not necessarily generate any more regulatory caution than "OECD TNC."

Carrie Hall's chapter on a similar subject is much more attuned to empirical realities and highlights the need for new paradigms in investment. She works to dispel predominant assumptions of developing country firms as inexperienced and short-sighted, and argues that the "Global Compact experience shows that the leading emerging-market TNCs provide some of the most effective and comprehensive examples of corporate responsibility" (216). Yet, as she points out in one of her empirical cases, perhaps strategic and socially progressive thinking by emerging market firms is not so new at all: "In 1912, the founders of the London School of Economics were invited to India by Tata to prepare a Memorandum of health for the company, which led to the institution of an eight-hour work day later that year" (219). Indeed, perhaps even the academic study of FDI from developing countries is not as new as this volume makes it seem; after all, the University of Oxford's Sanjaya Lall wrote *The New Multinationals: The Spread of Third World Enterprises* over twenty-five years ago, in 1983. The reality that firms from what are today called "emerging markets" have been doing business across nations for centuries is important and puts the current phenomenon of increasing capital flows from developed countries in perspective. This phenomenon is not evidence of an inevitable convergence of every nation on identical policies of full capital liberalization, but is instead merely evidence of one more mutation in an ever-changing relationship between mutually constituted "developed" and "developing" countries. ■

Notes

¹ Brazil, Russia, India and China.

Robert Paarlberg. *Starved for Science: How Biotechnology is Kept out of Africa.*

137

Cambridge, MA: Harvard University Press, 2008. 256 pp. £18.95 (pbk).
ISBN 0674029739.

SALIEM FAKIR (World Wide Fund for Nature-South Africa)

In his book *The Shock of the Old: Technology and Global History Since 1900* (2008), David Edgerton made a striking observation: when use-based histories of technology are written, it is inevitable that in the name of progress, the new is always more advanced than the old and that “often histories are written as if no alternative could or did not exist.”¹ In these histories, there is an air of inevitability which always seems to accompany narratives that tell how a technology has single-handedly changed the world. Robert Paarlberg commits the same sin of implying inevitability with absolute confidence that alternatives or older agricultural sciences must give way to the power of the new.

Paarlberg traps himself in a strange and circular logic—first he says that others should not speak on behalf of Africans, and then he nominates himself as a spokesperson for the technology-fix saviours. With his advocacy, he does the very thing that he derides other European and North American non-governmental organizations and consumer lobby groups of doing.

The truth is that those who have ‘expert authority’ (and they are definitely outsiders) are in power. Epistemic communities of scientists, generally operating at the international level, are able to create the very systems of classification and terms of the debate that define agricultural policy in many African nations. Hence, Africa’s relation to both pro-genetically modified (GM) and anti-GM lobbies is asymmetric and vulnerable to pressure. These vulnerabilities are exacerbated by both a lack of institutional capacity to manage the influx of outsider pressure and a lack of economic strength in most nations. With a structural situation as asymmetrical as the one between international institutions and African nations, confident international bureaucrats are often very successful in pushing their agenda.

Yet this asymmetry and concomitant vulnerability is exploited by many groups with varying interests and policy positions; this makes Africa the collateral damage of ideological wars being fought elsewhere over agricultural policy. Paarlberg criticizes this description as an oversimplification and parodies it with an old trope—that there is good

science and bad science and that good science must triumph. In this case, good science—GM-based crops—have been demonized by selfish Europeans who do not have to worry about food security, as their domestic farmers produce enough to serve their populations. Europeans are denying Africans their right to progress and well-being by restricting access to GM-based crops.

Paarlberg goes on to call European policy on genetic modification hypocritical, since the European Union's member states and citizens happily use GM-based medicines but not GM-based foods, in part because the benefits of modifying foods are not tangible and are rather seen as unnatural interference with tradition. Paarlberg spreads the blame even wider when he castigates international agencies like the United Nations Environmental Programme, the Consultative Group on Agricultural Research, the World Bank, and others for buckling to European pressure when they should be promoting the virtues of GM based crops.

Africa, however, is an extremely large continent with an enormous diversity of ecologies, climates, soils, people, cultures, languages, and political traditions. Paarlberg seems to blithely ignore these differences, putting his proposed solution at the same great peril as all single-minded proponents of technology-fix solutions. One technology-fix that Paarlberg willingly punts is genetically-engineered drought resistant crops. He is sure these will bring a happy end to Africa's woes. Despite his apparent certainty, Paarlberg fails to demonstrate why GM-based crops alone are the solution to Africa's food security problems. He dismisses more traditional alternatives without consideration of the risk involved in massive changes to agricultural practices.

If anything, small-scale farming, reliance on traditional methods and use of local varieties are the only sources of independence and autonomy protecting African food supplies. While traditional practices may not be successful compared to the levels of yields and income in Europe and North America, they at least provide something farmers and nations can produce and claim as their own. Perhaps this should be the starting point for a more intensified promotion of science.

Even more important for food security and standard of living arguments is the reality that African farmers do not have insurance, cannot carry high debt, and have few public support structures in cases of crop failure. However, Paarlberg is not concerned with the consequences of failure, since he thinks GM-crops will leap-frog Africans into the future with a widespread technological uptake analogous to that of the now-ubiquitous cell phone. There is clearly something to the point that useful technologies can quickly spread to people all over the continent with great success, but we should not get ahead of ourselves. Agriculture

is far more complicated and far more risky than putting up cellphone towers and selling airtime.

Paarlberg admits as much when he notes that a purely science-based intensification of productivity is insufficient. The problem of agriculture is wider: infrastructure, land-reform, access to markets, favourable trade policy, and financing are necessary keys to widespread agricultural success. Paarlberg sees the social complexities that threaten his technology-as-panacea answer, but he does not seem to take them seriously. It is as though he wants to believe in a simpler reality, as if his persistence that agricultural production will receive a boost if new biotechnologies are applied in Africa on a wider scale will create a new reality.

South Africa is always presented as an exemplary country following sound policies and as an example to the rest of the continent. Yet in this book, the case study on South Africa exemplifies how Paarlberg glosses over the complexity of a nation's agricultural political economy. In South Africa, a stark division exists between white commercial farmers and small-scale and large-scale emerging black farmers. Indeed, large-scale commercial farming, well established in South Africa, is more amenable to the adoption of GM-based crops. South Africa has the largest number of hectares of GM crops under plough in Africa—fifty per cent of the country's maize, seventy per cent of its soya, and ninety per cent of its cotton is GM. In 2007, the amount of land that was planted with GM crops was thirty per cent. Though a resounding success, the conditions of agriculture in South Africa stand in contrast to the rest of Africa, and a one-size-fits-all policy simply does not apply.

Paarlberg echoes local South African pro-GM bodies, which mock the idea that African farmers must be left freely to choose from what the market offers—both GM and non-GM seeds. This mockery prevents Paarlberg from asking a very important question: why do big GM corporations spend inordinate amounts of money gaining the support of public officials, influential scientists, and other figures behind their pro-GM campaigns? It is obvious that these corporations are buying off the market. Paarlberg mistakenly thinks there is an "open-air market," where ideas and technologies are shared and discussed freely. He dedicates pages and pages to the anti-GM lobby, but says little about the massive commercial interest vested in the success of GM.

The win for GM crops is not about food, food security, or raising standards of living, but about the future of the biotechnology industry. If the biotech industry does not win this campaign, it stands to lose investor interest, which will threaten or even destroy shareholder value. Therefore, the heart of the African agricultural and food problem relates

to larger problems of local and global political economy. Agriculture is not isolated, but rather deeply enmeshed in power, money, and influence. These forces work in tandem with each other and direct the agriculture policy debates that impact so many human lives. Amartya Sen's work on food security and famines must be a prerequisite for reading Paarlberg or any other book on the GM debate. ■

Notes

¹ David Edgerton, *The Shock of the Old: Technology and Global History since 1900* (New York: Oxford University Press, 2006).

Narcís Serra and Joseph E. Stiglitz, eds. *The Washington Consensus Reconsidered: Towards a New Global Governance.*

Oxford: Oxford University Press, 2008. 384 pp. £18.99 (pbk),
£50.00 (hbk).
ISBN 0199534098.

MATT STONE (St Antony's College, University of Oxford)

The global economy is broken. The intellectual edifice of neoclassical economics—with its overtones of *homo economicus*, efficient markets, and the wisdom of crowds—has been so degraded by the series of events since August 2008 that many are left wondering what remains.

The consequences of the collapse for developing countries are stark. Whereas a year ago riots over high food prices in Haiti toppled the government, now low prices are pushing rice producers in Southeast Asia to consider cartelizing their output. Many states, not least Pakistan and Ukraine, have gone to the International Monetary Fund for budgetary support. Developing world banks have gone under and many currencies have fallen against the US dollar as foreign investors flee to safety. If there were a time to bring to bear the collective wisdom of development scholars on the global South's mostly exogenous macroeconomic problems, this would be it.

Unfortunately, this collection of papers compiled by Joseph Stiglitz and Narcís Serra, respectively academics at Columbia University, New York, and the Centre for International Relations and Development Studies in Barcelona, Spain, is not the answer many will be looking for. In fact, *The Washington Consensus Reconsidered* was never intended to address the global upheaval that now consumes our attention, and the timing of its publication was an unfortunate by-product of the slow-moving bureaucracy of academic publishing. All of the papers in this volume were prepared for the Universal Forum of Cultures, which took place in Barcelona in September 2004, and address portions of the development debate that have been superseded by recent events. The book feels four years too late.

The volume brings together a number of noteworthy scholars, including Stiglitz, Serra, Dani Rodrik, John Williamson, Paul Krugman, and Jose Antonio Ocampo, but lacks a coherent sense of direction. This is a book searching for an identity. Williamson contributes a passionate

defence of his original coining of the term “Washington Consensus” in 1989, reminding the reader that the term implied the overturning of “the intellectual apartheid that had so long assumed that citizens of the Third World behaved quite differently than those of the First World” (16). Compare that with Alice Amsden’s plea that “[t]he more freedom developing countries have to brainstorm their own economic policies, the faster they will grow,” which seems to suggest that a policy free-for-all is positively associated with economic growth (95). Stiglitz’s two solo contributions are underwhelming rehashes of his previous articles and books: two out of every three citations in both are of his own work.

However, some individual contributions, including Williamson’s, are well worth a read. Guillermo Calvo and Ernesto Talvi’s discussion of the collapse of financial flows to Argentina and Chile in 1998 is informative and germane to current economic troubles, as is Daniel Cohen’s article on international finance. Deepak Nayyar’s investigation of international migration suggests that a broader opening of global labour markets (i.e., developed world immigration reform) would unlock important economic gains. Dani Rodrik’s contribution on growth strategies offers the policymaker or development practitioner a way forward for the formulation of pro-growth policies.

Indeed, there are three broad conclusions that one might tease out of this volume. First, the two sectors in which liberalization may be most beneficial to the developing world, agriculture and labour, are the ones the developed countries have been most unwilling to reform. Second, trade liberalization can be beneficial if implemented properly. That is, on an individual-country level, export liberalization should precede import liberalization. Third, capital account liberalization, which was pushed by both the United States and the European Union, not least France, in the 1990s, and which was not included in the original Washington Consensus as Williamson defined it, has probably done more harm than good as it cedes policy autonomy to bond and foreign exchange markets that hardly understand the countries whose currencies and debt they trade. Alas, these are all important lessons but conform closely to the spirit of the original Washington Consensus.

Transnational firms, an important constituency in influencing global economic policy, would consider these lessons something of a mixed bag. Surely, a less restricted international labour market would be beneficial to international business, allowing talent and ability to relocate to where it can be most amply rewarded. However, global value chains will hardly migrate to countries that are open for exporting but remain relatively closed to imports. Similarly, the re-introduction of capital controls in developing economies would hinder the ability of some transnational

firms to operate properly. A semi-liberalized capital account in which “sticky” foreign direct investment is favoured over speculative portfolio capital flows would be more likely to offer the best of both worlds: an attractive investment climate without the risk-laden volatility of global finance.

There is a confluence of interests between transnational firms and pro-growth policy-making in that investment, foreign or domestic, can lead to job creation and rising levels of income. Yet it is not the job of national policymakers to favour the interests of international capital over democratic publics unless those interests are perfectly aligned. During the 1990s, many proponents of the Washington Consensus lost sight of the broader operational goal of ending poverty, instead seeking to defend the interests of transnational, mostly Western, firms operating in poor countries. For this, the Washington Consensus as representative of asymmetric power relations between the developed and developing worlds—not the market-based economic philosophy that underpins the term—rightly deserves criticism. But the vilification is overdone, and more importantly, harmful to proper policy-making.

Indeed, one comes away from this book with the sense that the term “Washington Consensus” has become a politicised catchall for every policy implemented by the developed world (or the international financial institutions) that in some way hurt the developing one, a political punching bag that unfairly masks an underlying economic logic which mostly works. As Rodrik reminds the reader:

[T]here are indeed some broad principles which all successful countries have adhered to. Hence, all high performing economies have managed to maintain macroeconomic stability; they have relied on market forces to varying extents and sought to integrate into the world economy; they have protected property rights of investors and entrepreneurs to some extent and enforced contracts; they have ensured adequate standards of prudential regulation and avoided financial crises; they have maintained productive dynamism and encouraged economic diversification; and perhaps a few others. (359)

That the developed world could hardly claim to have fulfilled these principles in recent years is problematic for advocates of globalization. Alas, it is the integrative process of globalization that has lifted more people out of poverty in the last quarter century than during any other period in history. To forget that lesson in the midst of the current economic crisis would be a greater detriment to pro-poor, pro-growth policy-making than any of the Washington Consensus recommendations ever were. ■

Andrew Crane, Dirk Matten, and Jeremy Moon, eds.
*Corporations and Citizenship: Business, Value Creation,
 and Society.*

Cambridge: Cambridge University Press, 2008. 264 pp.
 £18.99 (pbk), £50.00 (hbk). ISBN 0521612837.

ADAM GROVES (One World UK)

The corporations of the twenty-first century increasingly defy conventional economic theory by taking a prominent role in politics. This book represents a thought-provoking attempt to understand the corporation's political and social interactions from a political perspective. Employing the concept of citizenship as a framework for analysis, in the first part of the book the authors explore the three dimensions to business-society relations: the role of corporations as citizens; the ways in which corporations can act as governments; and the ways in which corporate activity can function as an arena for citizenship. The authors do not presume that corporations *are* citizens or that they should *have* citizenship, but rather that their identity or actions can be considered *similar* to citizens, and further, that analysing corporations through this lens reveals a political dimension to many of their social and economic interactions.

Whilst noting that there are good reasons to exclude corporations from the purview of citizenship, the authors make a strong case for their inclusion in chapter two. On a material level, it is shown that they are often rendered *de facto* citizens due to the legal status and entitlements granted to them; on a metaphorical level, they often portray human or social characteristics; and if political participation is understood as a central factor in being a citizen, then the civic nature of the corporation becomes even more pronounced.

In chapter three, corporations' capacity to define, administer, and guarantee citizenship is examined. Governance roles have shifted to corporations following the institutional failure of governments, ideological and political shifts which have seen traditional functions deliberately transferred, and globalization, which has seen an increasing number of activities taking place beyond the influence of the state. In particular, Crane, Matten, and Moon recognize corporations' increasing administrative role in the governance of citizenship, whilst exposing key factors which compromise their capacity to *replace* governments.

The concept of citizenship is applied at various levels in chapter four to analyse the relationship between corporations and their stakeholders,

including suppliers, employees, consumers, and shareholders. In this sense, the citizenship perspective not only serves as a tool to frame the complexity of a firm's relationships with its stakeholders; it can also provide rich theoretical lessons for the governance of the firm.

Building on the discussion in chapters one to four, the second part of the book amounts to an argument that strongly favours the inclusion of corporations in citizenship theorizing, because corporations are *transformative of the institution of citizenship itself*. This analysis should stimulate much debate about the political role—and responsibilities—of the firm in contemporary society. Chapter five explores how citizenship identities have been reflected, enabled and inhibited by the activities of corporations. Unfortunately, in seeking to explore the impact of the institution specifically, the book is unable to fully examine the aggregate effects of industries or the market.

Chapter six provides a fascinating discussion as to how the concept of ecological citizenship might be used to reinvigorate debates on corporate power and responsibility. Corporations have played a significant role in reconfiguring citizenship identities through the export of western liberal citizenship. Indigenous communities and cultures are undermined through processes such as the imposition of liberal property rights, which reframe and subjugate traditional knowledge systems. This analysis has the potential to open a vital conceptual space for exploring and reframing corporate responsibilities to some of the world's pressing problems, including climate change, deforestation, and decline in biodiversity.

In chapter seven, the authors explore how the notion of citizenship has been transformed by globalization. Corporations have, in many ways, weakened notions of citizenship as the drivers of globalization and the concomitant deterritorialization of the state—the central reference point for citizenship. Yet simultaneously, the civil actions, global boycotts and transnational protests which have arisen in response to this process might be seen as constituting a new cosmopolitan arena for citizenship which enriches the concept. Corporations have in turn sought to respond to the dynamic by emphasizing their own “global corporate citizenship,” even whilst seeking to limit the responsibilities and implications this entails.

While the results of Crane, Matten, and Moon's analysis are constrained by important caveats, the study points towards potentially powerful ways of examining corporations' roles and responsibilities in contemporary society. As the authors themselves note, this is not to say that the concept of citizenship necessarily provides a more powerful framework than other alternatives, but that corporations cannot be ignored within the domain of citizenship, because they are transformative of the concept itself. ■



Sovereignty and Secessionist Movements: Prospects and Challenges

Abstracts due August 1, 2009

Papers due November 1, 2009

Recent events in Kosova, South Ossetia, and Abkhazia have drawn the attention of the international community to secessionist movements, refocusing interest on cases such as Tibet and Somaliland. The increased activity of secessionist movements has revitalized intellectual debate over the changing meaning of sovereignty, self-determination, state-building, recognition, and security concerns. As the international political community strives to come to terms with these issues, the academic community is faced with the challenge of identifying the possible implications of these developments.

St Antony's International Review (STAIR) invites academics, policymakers, and practitioners to engage in an inter-disciplinary discussion of this theme. We seek to publish empirical, theoretical, and policy-oriented articles, and case studies that cover a variety of issue areas including secession, self-determination, and recognition.

Articles could consider, but are not limited to, the following questions:

- What criteria have been used to justify secession?
- How do secession movements challenge our understanding of state sovereignty and self-determination?
- What role does the international community play in recognizing secession entities?
- What are the implications of recognizing secessionist movements?
- Can the international community diffuse secessionist claims by ensuring the fair treatment of minorities and by encouraging participation in transnational organizations?
- What is the economic feasibility of secessionist entities?
- Are there common patterns involving secessionist movements in different geopolitical areas?
- What does the future hold for secessionist movements?

STAIR welcomes abstracts and idea proposals up to 500 words in length. In conjunction with this general call for papers, *STAIR* also seeks to publish book reviews of works that adhere to the stated theme. Please submit proposals to stairsecession@gmail.com.

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