



CRS Report for Congress

Codes of Conduct for Multinational Corporations: An Overview

James K. Jackson
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade

Summary

The U.S. economy is growing increasingly interconnected with other economies around the world, a phenomenon often referred to as globalization. As U.S. businesses expand globally, however, various groups across the social and economic spectrum are growing concerned over the economic, social, and political impact of this activity. Over the past 15 years, multinational corporations and nations have adopted voluntary, legally enforceable, and industry-specific codes of conduct to address many of these concerns. Congress will continue to play a pivotal role in addressing the large number of issues regarding internationally applied corporate codes of conduct that remain to be negotiated. This report will be updated as events warrant.

Background

Over the last decade, international flows of capital have skyrocketed. International flows in dollars, for instance, now total over \$1.9 trillion *per day*, or nearly as much as the total *annual* amount of U.S. exports and imports of goods and services. These flows are the prime mover behind exchange rates and global flows of goods and services. One part of these flows is foreign direct investment, or investment in businesses and real estate. On a cumulative basis, direct investment now totals over \$10 trillion world-wide, about 20% of which is associated with the overseas investment of U.S. firms, the largest share held by the firms of any nation. This type of investment spans all countries, industrial sectors, industries, and economic activities and has become a major conduit for goods, capital, and technology between the developed and the developing economies. Foreign direct investment has become a much needed source of funds for capital formation in developing countries and foreign investment accounts for important shares of employment, sales, income, and R&D spending in developing countries.¹

The United States is the largest recipient of foreign direct investment and is the largest overseas investor in the world, owning over \$2.1 trillion in direct investment

¹ *World Investment Report 2006*, New York, United Nations, 2006. pp. 1-38.

abroad, or almost twice as much abroad as British investors, the next most active overseas investors. This international expansion of business activity and overseas presence, however, often leads to a clash of cultures and values. In addition, conflicts are rising within the United States and within other developed countries over what role these global corporations should play in their respective home countries and over whose interests the corporations should serve. Traditionally, corporations have served the economic interests of a narrow group of shareholders by maximizing the return to the shareholders, or by maximizing the overall profits of the firm. Now, a broader group of “stakeholders,” including customers, employees, financiers, suppliers, communities, and society at large, is pressing for comprehensive codes of conduct that recognize their interests.

Defining codes of conduct is difficult, because such codes encompass a broad range of issues and myriad types of official and corporate activities that have defied attempts to reach a common agreement on the composition and nature of the codes. One way to view codes of conduct is by grouping them into three main categories: (1) externally generated codes of conduct that are developed by governments or international organizations, (2) corporate codes of conduct that represent an individual companies’ ethical standards, and (3) industry-specific codes. These categories often overlap and some codes that initially were adopted voluntarily by companies or industries have been incorporated into law by governments. Since Congressional activities relate most specifically to the first type of codes, or externally generated codes of conduct, they receive the greatest emphasis in this report. Congress has periodically considered issues related to corporate codes of conduct. In the 106th Congress, for instance, the House considered a measure (H.R. 4596) that would have required U.S. firms to adopt a Corporate Code of Conduct that covered a wide range of workers rights and environmental issues, similar to the set of “model business practices” the Clinton Administration proposed in March 1995.² Similarly, the Senate approved and the President signed on December 2, 1999, the Convention on Child Labor,³ which addresses various issues related to children in the workforce.⁴ The 106th Congress also considered a number of measures that addressed issues of child labor and the importation of goods produced with child, sweatshop, and prison labor. In the 108th and 109th Congresses, Congress considered various measures to protect children affected by poverty and natural disasters from trafficking and to protect children and minors from abusive labor practices.

External Codes of Conduct

Since the 1970s, public and private expectations of multinational corporate behavior have grown commensurate with the boom in foreign investment. This change in expectations, however, has not resulted in a clear-cut set of directions for governments or businesses to follow to develop codes of conduct. At times, purely voluntary codes have evolved into codes that were adopted as national legislation. For instance, in 1977, the United States adopted the Sullivan Principles and the Foreign Corrupt Practices Act

² Administration’s Draft Business Principles. *Inside U.S. Trade*, March 31, 1995.

³ Convention (No. 182) Concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labor, Geneva, June 17, 1999, entered into force November 19, 2000.

⁴ For additional information, see CRS Report RS20445, *Child Labor and the International Labor Organization (ILO)*, by Lois McHugh.

(FCPA).⁵ Initially, the Sullivan Principles provided a voluntary set of standards for firms to follow to pressure the apartheid government of South Africa to improve the living conditions of black workers, their families, and their communities. In 1986, Congress adopted the Sullivan Principles as law.⁶ The FCPA followed a series of congressional hearings and legal actions against numerous U.S. corporations,⁷ and specified legal standards and penalties that were meant to prevent U.S. firms from bribing foreign officials in order to gain economic advantages.

While there appears to be a general consensus in the United States and abroad that favors international standards governing corporate businesses practices, attempts to reach an agreement on specific standards have proven to be less promising. In some cases, these efforts have fostered competition among countries for investment projects, have highlighted the remaining differences in national policies regarding foreign investment, and have created differences in the goals and objectives of negotiations between the developed and the developing nations. Most developed economies favor international rules, or codes of conduct, that could promote a “level playing field,” or an environment in which investment decisions are based solely on competitive market factors. Developing economies, however, often view such efforts as attempts by the developed countries to promote rules and codes of conduct that effectively allow them to hoard foreign investments for themselves and to deny the developing countries the means to compete internationally for new investment projects.

These and other differences have spurred nations and international organizations to adopt various approaches in order to promote international rules on foreign investment. One approach has been to negotiate legally binding agreements, whether they are narrowly or broadly cast, that impose a set of standards on multinational firms and that bring a large number of countries into compliance simultaneously. For example, after the United States adopted the FCPA, it supported efforts within the OECD to adopt the Convention on Bribery, which focuses on a narrow set of issues related to bribing public officials. Since the Convention entered into force on February 15, 1999, 34 countries⁸, including the United States,⁹ have passed national legislation implementing the Convention.

A similar approach that failed to gain agreement was a comprehensive agreement on foreign investment, known as the Multilateral Agreement on Investment (MAI). The MAI was expected to be a broad, legally binding, multi-faceted agreement that would have established an international set of rules on a wide range of foreign investment issues. Support for the agreement eroded over the course of the negotiations, which focused on provisions that proved to be too divisive to resolve. In addition, citizen and consumer groups opposed the proposed agreement, in part because they viewed it as too favorable

⁵ P.L. 95-213, Title I; 91 Stat. 1494, December 19, 1977. See also CRS Report RL30079, *Foreign Corrupt Practices Act*, by Michael V. Seitzinger.

⁶ Although adopted informally in 1977, the Principles were incorporated as Sec. 208, Title II of the Comprehensive Anti-Apartheid Act of 1986 (P.L. 99-440, October 2, 1986) as amended.

⁷ CRS Report RL30079, *Foreign Corrupt Practices Act*, by Michael V Seitzinger.

⁸ See [<http://www.oecd.org/pdf/M00017000/M00017037.pdf>].

⁹ P.L. 105-366, November 10, 1998.

to multinational corporations, and because of their concerns regarding what they believed would be the social, economic, and political impact of the agreement.¹⁰

In lieu of negotiating comprehensive multilateral agreements, many countries have resorted to adopting narrowly focused bilateral investment treaties that contain codes of conduct. Often, these codes resemble a general set of investment-related provisions and incorporate “best practices,” rather than a legally binding agreement. According to the United Nations, 174 countries had concluded about 2,100 bilateral investment treaties by 2001. Nearly as many of these treaties were concluded among developing countries as between developed and developing countries.¹¹ Often these treaties are accompanied by some form of codes of conduct that are negotiated to cover a particular investment and tend to be highly specific to a company, project, or location.

Other Agreements. Some nations have used other types of multilateral treaties to promote codes of conduct for multinational firms. One type of agreement attempts to bring greater conformity in the treatment of foreign investment by prescribing changes in national laws governing foreign investment as one component of a broader arrangement that is geared toward economic cooperation and integration, such as the treaties that established the European Community and the North American Free Trade Agreement. There are other, legally non-binding, arrangements which cover only foreign investment, the most prominent of which are the OECD Code of Liberalization of Capital Movements (covering both long- and short-term capital movements) and the Code of Liberalization of Current Invisible Operations (covering cross-border trade in services). In addition, the OECD has issued a basic statement on foreign investment, The Declaration on International Investment and Multinational Enterprises, which is a general statement of policy regarding the rights and responsibilities of foreign investors. The World Trade Organization (WTO) also supports the concept of a common set of rules on international corporate investment.

As part of the 1994 Uruguay Round on multilateral trade negotiations, the WTO adopted the agreement on Trade-Related Investment Measures (TRIMs) which: recognized that certain investment measures restrict and distort trade; required signatory countries to apply national treatment; and required countries to provide a framework for reducing restrictions on foreign investment. In 1996, the WTO established a working group on investment, which has been studying the issue of investment rules, including technical regulations and standards that govern trade and investment. The Doha Declaration set out the goal of addressing foreign investment issues following the conclusion of the Fifth Ministerial in Cancun in September 2003. So far, these efforts have not succeeded in achieving the stated goal of developing a “multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment.”¹²

¹⁰ For additional information, see CRS Report 98-569, *The Multilateral Agreement on Investment: A Brief Analysis of the Current Status*, by James K. Jackson.

¹¹ World Investment Report, 2002, p. 8.

¹² [http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#tradeinvestment]

Corporate and Industry-Specific Codes of Conduct

A broad range of factors are influencing firms to adopt codes of conduct. Some firms see it as enlightened self-interest, while others see it as a necessary part of risk management.¹³ Corporate codes of conduct and industry-specific codes now exist in one form or another among most large multinational corporations and among most of the developed countries. A recent study by the OECD concluded that most corporate codes tend to be highly specific and to deal with the idiosyncracies of a particular company, project, or location.¹⁴ Industry-specific corporate codes dealing with environment and labor issues appear to be the most common and most U.S. manufacturers and retailers in the apparel industry have adopted corporate codes that prohibit using child, sweatshop, or prison labor. U.S. companies in such diverse industries as footwear, personal care products, photographic equipment and supplies, stationary products, hardware products, restaurants, and electronics and computers have adopted corporate codes of conduct.

Multinational corporations generally support the concept of codes of conduct that standardize rules of corporate behavior across a broad range of countries and industries. While the motivation behind adopting corporate codes of conduct can be quite complex, multinational firms generally adopt codes of conduct because they believe they represent good business practices. Generally, multinational corporations desire national treatment as a basis for any investment agreement, but are concerned that standards negotiated in one agreement could be applied to their worldwide operations, regardless of the disparity in economic conditions between locations, local customs, jurisprudence, or differences in local business practices. Some firms also argue that codes which allow foreign groups to submit complaints to U.S. regulatory bodies concerning the overseas operations of the subsidiaries of U.S. firms could be used as a competitive tool to damage the worldwide reputations of U.S. firms.

Industry-specific codes of conduct are as varied and as extensive as the multitude of industries they cover. Labor and environmental issues, however, are the two most frequently covered areas in the codes, regardless of industry. Environmental standards often comprise commitments from firms to be open to the concerns of the communities in which they locate. The most common labor codes include commitments for firms to provide a reasonable working environment, provisions against discrimination and a commitment to obey laws regarding child labor and compensation. Concerns over child and sweatshop labor, in particular, have spurred some public groups to take action on their own. The Workers Rights Coalition,¹⁵ an alliance of 67 universities and colleges, pressured Nike and Reebok to investigate allegations of sweatshop labor conditions in a Mexican apparel factory.

¹³ A Stitch in Time, *The Economist*, Special Report on Corporate Social Responsibility, January 19, 2008. P. 12.

¹⁴ Gordon, Kathryn, and Maiko Miyake. Deciphering Codes of Corporate Conduct: A Review of Their Contents, OECD Working Papers on International Investment, Number 992. OECD, October 1999. pp. 5-7.

¹⁵ For additional information see the organization's website, [<http://www.workersrights.org/>].

Concerns of Stakeholders

While traditional economic theory holds that corporations strive to maximize their profits to benefit the stockholders, a broad group of “stakeholders” is pressing to have their interests represented as well. These stakeholders argue that corporations have responsibilities beyond the narrow scope of their legal charters, or that they should abide by a “social contract” that reflects society’s changing social and cultural mores. The size of the group of stakeholders and the social responsibilities they expect vary with the size of the firm, the industrial sector it is involved in, and its products and operations. This group of stakeholders and the associated social responsibilities also become vastly larger for firms that operate in more than one country and can include issues beyond the common areas of workers rights, environmental concerns, and business production or financing operations. At times, the issues sought by stakeholders in one country can clash with those sought by stakeholders in another country, for instance when workers in developed countries push for job security, health care and other benefits, and environmental issues, while workers in developing countries push for more local jobs and local managers, worker training and education, technology transfers, and higher levels of local production.

Issues for Congress

Governments, corporations, and the public generally support the concept of corporate codes of conduct. The complexity of the issue and the diversity of foreign investments, however, make it difficult in practice to negotiate international agreements with legally binding codes of conduct and likely will present Congress with at least two large, competing groups of interests. These groups basically represent the difference between economic efficiency as represented by corporations and equity, or social justice, as represented by a broad coalition of social and public groups. Generally, economic analysis indicates that legally binding codes of conduct that eliminate market-distorting activities promote market efficiency and, thereby, provide positive net benefits to consumers and to the economy as a whole. In most cases, however, there is a mismatch between those who benefit from greater market efficiency and those who bare the costs of economic adjustment. As a result, those who bare the highest costs are likely to be the most vocally opposed and to voice that opposition to Congress, whereas those who benefit are less likely to be motivated to express their support due to the perceived limited value of the benefits.

There is no clear cut method for determining the most equitable distribution within the economy of the costs and benefits associated with international investment. A broad coalition of public and social groups increasingly have come to view negatively the global spread of economic activity and to argue that voluntary corporate codes of conduct accomplish little. Beyond a narrow set of issues, there is less agreement on how Congress should proceed. Numerous labor and environment-related measures that garner support within the United States are opposed abroad, often by the very countries and groups the measures are intended to help. Moreover, if consumer and labor groups grow uneasy about their own economic well-being as a result of a slow-down in the rate of growth of the U.S. economy, they may well urge Congress to adopt more restrictive measures concerning the labor and environmental impact associated with imports and foreign investment as a means of protecting domestic U.S. jobs.