The Evolution of Corporate Responsibility: From Unbridled Markets to Mature Capitalism

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Introduction

I want to begin by thanking the CCECP for inviting me to speak in this august setting, on a subject close to the hearts of many individuals who are associated with the Centre's work. I would also like to say how valuable and important is the work of the Centre and its supporters. I believe that you and your colleagues are at the cutting edge of strategic thinking in the business community and will light a path for Canadian corporations as they enter the 21st century.

I do not plan to say much about The North-South Institute — some background information is available for those who would like it. I would say that I'm delighted that two of the brightest and best of my Institute colleagues are here today: Gail Whiteman, who is heading up our research on corporate responsibility; and Joanna Kerr, who for the past seven years has spearheaded our work on gender equality. I'd like to add that I'm pleased so many students are present as well as members of the Ontario Council for International Co-operation.

Earlier this year, The North-South Institute released its annual flagship publication entitled the **Canadian Development Report.** The theme of this year's report was "Canadian Corporations and Social Responsibility." I and my colleagues have spoken extensively over the past six months about the report's principal findings and messages in the report across Canada, mostly to the business community and to business students in universities. In my remarks today, while I will be drawing on some of the insights we gained and some of the feedback we have received, I do not plan to go over what we say in the report in detail. Rather, I want to address some of the larger issues raised by the report.

In other words, I wish to step back and ask — why is the subject of corporate responsibility important today? Is it simply an ethical and moral question, the imperative of "doing good while doing well"? That is certainly a critical, and perhaps an eternal, dimension, of the issue. But we can also view corporate responsibility as part of the story of societal evolution, given the globalization of markets and the spread of capitalism to developing countries in all corners of the world.

Today, I will argue that:

- increasing corporate responsibility is part of the evolution of market-based societies from an unbridled to a mature capitalism;
- that that the driving force behind this evolution is the quest for social equity and justice, and environmental sustainability;
- and that while there is typically a tension between the forces of social justice and the entrepreneurial, individualistic forces of the market, in the long run they must work together, if market capitalism is to survive.

There is nothing deterministic or inevitable about this story — there is no guarantee that we will always and everywhere see a steady evolution from unbridled markets to mature capitalism. In this century, we have seen revolution, not evolution, as market capitalism was overthrown in large parts of the world. Over the past decade, many of those same parts of the world have undergone counter-revolutions as they attempted to once again to embrace market-based economies and societies again. But as we can see in Russia, the return transition back to democratic capitalism can be very fragile and fraught with all sorts of dangers and inequities: there is also the real possibility of reversal. And with the Asian crisis, we have seen that even the most dynamic countries can experience severe setbacks in the progress toward development of market-based societies.

Corporate responsibility and accountability are fundamental building-blocks of market-based societies: without them, markets would not function. Without corporate responsibility, you have unbridled markets and the makings of considerable discontent, perhaps revolution. The more developed and sophisticated is corporate responsibility, the more mature and stable does market capitalism become.

I want to suggest that corporate responsibility and accountability evolve through five stages: financial, economic, environmental, social, and political. There is a certain degree of chronology in this ordering; financial responsibility tends to occur before economic responsibility, and so on. But it is a very loose chronology, as we shall see. However, I want to emphasize that at each step of the way, non-market institutions — often, but not always, governments — play a crucial role in shaping the rules of the game and ensuring that corporations and market actors are accountable as well as responsible. I also want to suggest that as corporate responsibility evolves and broadens, markets inevitably become accountable to a larger body of stakeholders with whom corporations have a relationship.

The story I am about to tell is highly stylized — in half an hour it is impossible to go into detail and it is necessary to take a few liberties and shortcuts with history, for which I ask your forbearance.

The First Phase: Financial Responsibility

With the establishment of the joint-stock corporation sometime during the 17th century, and the rise of corporations with widely-held shares in the following two centuries, there arose a need to assure the stockholders that corporate managements were in fact acting in their best interests. In order to get this assurance, institutions and mechanisms needed to be created to ascertain the actual financial position of the corporation. These institutions had to be independent of management, otherwise management could easily manipulate information or conceal the truth from their stockholders. Of course I am referring here first and foremost to the auditing profession, to accounting standards and principles, and the laws and statutes that codify "generally accepted accounting principles."

As stock exchanges became established, there also had to be all sorts of rules and regulations governing how shares and other financial instruments were traded in such markets. Securities commissions were established by governments to ensure that parties to financial transactions abided by the rules of the game. And, of course, as commercial banks became established deposit-taking institutions, there had to be rules governing their behaviour to prevent fraudulent or illicit use of depositors' savings.

Without such institutions and rules, it is doubtful whether the "bourgeoisie" — Karl Marx's term for the middle class — would have become the major economic and political force in market-based societies by the 19th century. These institutions and rules enabled smaller investors to allocate their savings with some confidence in the banks and companies to which they were entrusting their money.

Today, in Canada, the United States, and the industrialized countries, we take corporate financial responsibility for granted. But the international financial crisis that broke out earlier this last year in Asia and spread to most parts of the developing world clearly revealed a lack of corporate financial responsibility in many emerging markets. Inadequate supervision, and poor or nonexistent regulations of banks allowed billions of dollars to be misused and misallocated.

In many developing countries, generally accepted accounting principles are often conspicuous by their absence. I have argued elsewhere that poor governance was not the only, nor even the principal, cause of the Asian crisis. But it certainly was and is a problem that needs to be remedied if countries in Asia, and other emerging markets, are to function transparently and equitably as well as efficiently. Put differently, financial responsibility and accountability are crucial if a viable middle class is to grow and challenge the supremacy of the elites in such countries, who often manipulate markets to increase their own personal wealth.

As a footnote, I would also add that there is little room for complacency about financial accountability even in the advanced industrial countries. Every so often there are instances reported in the press reports instances of insider trading in stock markets. Also, there is a total lack of supervision of the international activities of banks and other investors. If I were to give you my complete account of the Asian financial crisis, I would reserve considerable criticism for the behaviour of commercial banks, which did much to trigger the crisis and which should pay a heavy penalty for their behaviour. Finally, the

near-meltdown of some hedge funds has drawn attention to the fact that there needs to be regulation of these highly-leveraged firms, as George Soros, himself a hedge-fund operator, has recently said.

The Second Phase: Economic Responsibility

Even if corporations are financially responsible, and are maximizing returns for their shareholders, they may be doing so unfairly at the expense of other firms and their shareholders. They could do this by monopolizing business through buyouts, mergers, collusion, and other unfair practices involving price-rigging and market manipulation.

Adam Smith, the founder of modern economics, was acutely critical of such practices, and of the natural tendency of firms to resort to them. "People of the same trade seldom meet together," he said in **The Wealth of Nations,** "even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."

As Adam Smith well knew, markets work in everyone's best interests when there is competition. To ensure adequate competition, during the first half of the 20th century the industrialized countries enacted anti-trust or anti-combines legislation that made collusive behaviour a criminal act. More recently, such legislation has given way to a broader "competition policy". As we have seen with the bank merger proposals in Canada and the Microsoft case in the United States, the question of what constitutes "adequate" competition in the marketplace continues to preoccupy policymakers in the late 20th century, as they grapple with the issue of how the public interest is best served.

Corporations that are economically responsible will refrain from predatory behaviour in the markets, but government legislation and institutions are generally required to lay out the rules of the game and ensure that they are observed. Another example is bankruptcy law. Borrowers occasionally get into trouble and the purpose of bankruptcy legislation gives borrowers who are in difficulty some measure of protection from their creditors. In the process, it allocates part of the cost to the creditors. The underlying logic is that, it takes two parties to agree to a bad loan, and that creditors must beware before lending any money by sharing the risk.

Another footnote: I would point out that while many developed countries have well-established bankruptcy machinery, this is not the case in most developing countries, as we have seen in Indonesia and Thailand. But we also lack mechanisms to mediate differences between lenders and borrowers in different countries. The prevailing assumption is that creditors can claim 100 cents on the dollar and that debtors cannot seek relief. This puts an unfair and undue burden on developing-country debtors. It also encourages creditor banks in the industrial countries to take greater risks than they should when in lending money to overseas clients abroad. It is also a prescription for recurring international debt crises.

The Third Phase: Environmental Responsibility

Corporations may be financially and economically responsible, but degrade the natural environment in the course of business. Because the environment is not "priced" into the market system, it does not cost a firm to pollute the air, soil, or water. Hence, unbridled markets are apt to generate considerable pollution, reduce biodiversity, deplete the stock of natural resources, and undermine the sustainability of ecological systems.

It was well into the second half of the 20th century before industrial societies began to take environmental impact into account in their natural resource management and economic policies. A watershed event was the first UN Conference on the Environment held in Stockholm in 1972. Subsequently, most governments typically took a leading role by establishing environmental protection legislation and agencies. The earliest forms of intervention were of the "command and control" variety: environmental standards weare written into the law, and the enforcement agency would then go around checking to ensure compliance by firms. This has often proved difficult or costly to administer. More recently, "market-friendly" incentive systems have evolved such as pollution taxes, and tradable emissions permits. It should be said however, that recently, huge cuts in the budgets of environmental agencies everywhere have undermined their ability to monitor and enforce environmental regulations.

In the developing world, environmental laws and agencies are often conspicuous by their absence or lack of enforcement. This presents companies contemplating the global market with a quandary: should they take advantage of the lower environmental standards in developing countries and reap higher profits, or should they "export" the higher environmental standards they are required by under law to practice at home?

For their part, many corporations have advocated self-regulation rather than government regulation. Self-regulation would also seem to fill the void created by the absence or weakness of environmental regulation in developing countries. To this end, industry associations have established environmental codes of conduct. For example, in the mining sector, where environmental standards are an important issue, for example, the Mining Association of Canada, the Ontario Mining Association and The International Council on Metals and the Environment ask members to endorse environmental codes.

Do such codes influence make a difference to behaviour? In **the Canadian Development Report** we found that only 13 percent of exploration properties and 26 percent of production properties in developing countries are owned by Canadian companies subscribing to these codes. In other words, the existence of the codes seems irrelevant for the vast majority of corporations operating abroad. We also found that junior mining companies and those involved in exploration tend to be less environmentally conscientious than the majors and the production companies.

Some companies, for example Noranda and Placer Dome, have developed in-depth policies to govern their activities and behaviour. For example, Placer Dome has recently formulated a "sustainability policy" setting out the firm's objectives. These are laudable as far as they go, and distinguish Placer Dome as being far ahead of most of its peers. However, even with such enlightened policy initiatives, there is scope for strengthening

what is meant by "sustainability", by enhancing the firm's incentive structure and corporate commitment to sustainability, and to strengthen its relations with the broader community. And, while self-regulation is better than no regulation, without an independent mechanism to verify and enforce standards, its value is strictly limited. The key, moreover, is that firms have to find ways of **operationalizing** these codes so that they become part of their everyday practice.

The Fourth Phase: Social Responsibility

Environmental responsibility is challenging enough. But when we get to the next two phases—, social and political responsibility—, things become really complicated. These are issues of the late 20th century and, indeed, the 21st century.

A corporation can exhibit financial, economic, and environmental responsibility, but it can also be less than a model corporate citizen in its treatment of employees, customers, suppliers, and the community. Such corporations may uphold the letter of the law, but not go a millimetre beyond. Take employee relations: the difference is between a socially responsible firm that adopts human resource development and equity policies (paying particular attention to the needs of women, minority groups, and the disabled, for example) and one that does not. Similarly, a firm that gives something back to the community by supporting health, education, or civic amenities shows some degree of social responsibility; while a firm that does not, however, is being subsidized by taxpayers who have to support such community infrastructure. Socially responsible corporations, more generally, also tend to be more generous in their donations to charitable or not-for-profit organizations.

In our **Canadian Development Report 1998,** we stated that the five major banks are among Canada's leaders in corporate social responsibility. That is because of their history of progressive employment equity and generous community donations. I sincerely hope that the record levels of profits just announced by members of this fabled group will enable the banks to sustain and increase their reputation for such generosity!

As with environmental responsibility, the issue of social responsibility has become particularly acute as a result of the globalization of markets over the last two decades, and particularly with increasing investment in or trade with the developing countries. And the same kinds of challenges arise for corporations doing business in those countries. Perhaps the most important question here is that of labour or workplace standards. Developing countries often do not have the legislation or the machinery to enforce compliance on working conditions to ensure the protection of workers' health and safety. Sometimes, the creation of employment of any kind has greater priority than ensuring safe, healthy, and humane working conditions for workers.

As with environmental responsibility, Canadian and other industrial-country firms face a dilemma: should they do business in countries where working conditions are poor, or should they try to import higher workplace standards from their home countries, sacrificing potential profit margins in the process? For example, should Canadian firms

doing business with developing countries (either as investors, or as importers of goods) care about whether or not they are employing school-age children, and their working conditions? Firms like Nike obviously did not care: but both their reputation and their market share suffered seriously as a result.

Self-regulation and voluntary codes of conduct can obviously play a role in matters concerning social responsibility. In our report, we highlighted the "International Code of Ethics for Canadian Business" endorsed by a group of 13 Canadian companies led by Canadian Occidental Petroleum in 1997. The code articulated principles of conduct concerning community participation, environmental protection, human rights, bribery, and employee rights in international business activities. While such codes represent a welcome step forward, because they are voluntary they usually do not call for any monitoring or verification: they merely represent a statement of "best intentions". Without independent monitoring, there is no guarantee that companies that sign codes actually practice what they preach. I'll come back to the example of Canadian Occidental in a minute.

International institutions can also play a crucial role in defining the standards and helping to enforce them, particularly in the specific case of labour standards. This issue of labour standards has recently been the subject of considerable international discussion. In June this year, at a conference in Geneva convened by the International Labour Organization, the oldest agency of the United Nations, an important "Declaration of Principles" was adopted. It recognized that all members of the ILO (virtually every country in the world whether or not they have ratified the various Conventions on labour rights) have an obligation to respect, promote, and realize four fundamental or "core" labour rights:

- freedom of association and the right to collective bargaining;
- elimination of all forms of forced labour;
- abolition of child labour; and
- elimination of discrimination in employment.

I want to point out that consensus on this historic declaration was achieved under the leadership of Canada's Ambassador to the ILO, Mark Moher. The 174 member countries of the ILO, which is governed by representatives of business and labour as well as governments, committed themselves to following up on this declaration. If the ILO , which for some time has been one of the weaker parts of the UN family, is to succeed make a difference in elevating labour standards around the world, it will need the active support of corporations, as well as the support of labour unions and governments around the world.

Non-government organizations also play a vital role in enhancing social responsibility. Our report refers to the valuable work done by a coalition of NGOs headed by the Taskforce on Churches and Corporate Responsibility. This group has just released a

series of benchmarks with which to evaluate corporate environmental and social responsibility.

The Fifth Phase: Political Responsibility

In our **Canadian Development Report 1998**, the North-South Institute was very critical of the "Team Canada" missions mounted from time to time by the Liberal Government, sometimes to countries where human rights are abused and democracy is virtually nonexistent. We said that Canada was trading away its values, its integrity, and its credibility on issues such as human rights in order to clinch a few business deals, many of which were already committed. We felt that the costs of this kind of diplomacy — sacrificing the interests of people who were struggling for their freedom and for basic rights we take for granted — far exceeded the benefits accruing to a few firms. Political responsibility is the most difficult of the challenges facing corporations in the global marketplace. A firm can be a good corporate citizen in the way it deals with its shareholders, the environment, its employees, and the communities in which it operates, yet operate in a climate of be surrounded by human rights violations committed by the host governments of foreign countries in which it does business.

As we all know too well, despotic governments around the world suppress basic elementary freedoms (of speech, association, and religion); imprison political opponents with no due process; torture and summarily execute those who dare to protest; and in general, resort to all kinds of atrocities with impunity. Should foreign firms care? Shouldn't business, after all, stay out of politics? In any case, what can they do?

It is my belief that human rights, basic freedoms, and democracy are not only precious in their own right,; but they are also good for business. Or, to put it differently, countries in which there is no respect for people or for basic freedoms are not places in which property rights can be guaranteed, or in which business can thrive for long.

The issue of corporate political responsibility emerged dramatically in the 1980s over the apartheid regime in South Africa. However, even there, economic sanctions against South Africa were not universally respected by corporations, even if their home countries supported the sanctions, and despite the stigma associated with doing business with South Africa. In other places, for example Pinochet's Chile, Suharto's Indonesia, Burma or China, the foreign business community pays little attention there was or hardly any attention at all is paid by the foreign business community to human rights abuses or political atrocities. Indeed, it is quite evident that foreign businesses have actively courted the favour of such regimes in order to get in on the local market.

Recently, Prime Minister Chrétien visited Malaysia and China and he surprised many Canadians by speaking out against human-rights abuses in both countries. While this was a welcome change of direction for those of us who had criticized Team Canada, there were also some members of the business community who were definitely not pleased. They claimed that Canadian business interests in both the two countries would be undermined.

It may in fact be true that Canadian businesses will lose ground, along with businesses from other countries whose leaders speak out. The question I have for those who are unhappy about this is this: Do you want to gain a competitive edge in such markets by being from a country that has deliberately chosen to keep quiet about abuses and atrocities? I suspect the answer from most Canadian firms would be a definite "NO".

I would also argue that trade with and investment in repressive regimes do not automatically lead to improvements in human rights or greater political freedoms. Indeed, the evidence suggests that repressive regimes often draw economic and political sustenance from foreign trade and investment. For example, oil companies that did business with Nigeria under the Abacha regime strengthened the hand of the dictators, because the military rulers control oil revenues. Ironically, Canadian Occidental, the company that led the 1997 initiative to establish an international business ethics code, was soon thereafter involved in offshore exploration in Nigeria. They claimed there was no conflict with its ethics code, which calls for the support and protection of human rights. (There is an escape clause in the code, which refers to actions "within our sphere of influence.".)

My conclusion is that corporations have a two-fold political responsibility: on the positive side, to support and promote human rights and freedoms;, and on the negative side, to avoid contributing to human rights abuses. The former is achievable within the "sphere of influence" of firms if they uphold local laws and their own codes of ethics codes. But the latter will take a degree of political awareness and sophistication that many firms do not have or even want, since it will require weighing the indirect effects of doing business in despotic or corrupt regimes.

National governments and multilateral organizations can help by clearly articulating a frame of reference, or the "rules of the game.". About a year ago, 29 industrial country members of the Organization for Economic Co-operation and Development (OECD) signed a Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The Convention adopts a "soft law" approach: — it recommends action by national governments, but does not legally bind them to it. Nonetheless, such rules help to strengthen the hands of those companies who are unwilling or refuse to participate in bribery and corruption.

At the national level, the federal government, through the Department of Foreign Affairs and International Trade, already engages in a regular evaluation of the human rights performance of other countries. However, there is almost no use made of this material to help guide Canadian firms contemplating business in developing countries where the human rights record is patchy. Our report recommends that the Government should publish its evaluations. And I believe that, on the basis of this intelligence, the Department of Foreign Affairs and International Trade should engage in dialogue with Canadian firms to help them determine whether their activities would strengthen the hands of dictators and corrupt governments or weaken human rights.

Likewise, I feel we can incorporate social and environmental responsibility into the policies and financing practices of the Export Development Corporation, our export credit agency. EDC is in fact currently undergoing a review of its environmental policy framework.

A Brief Conclusion

Let me try to pull some of the principle strands of my talk together. Markets have shown great staying-power — because markets exhibit considerable dynamism and efficiency. Modern capitalism was born three centuries ago and it still seems to be growing. Globalization is here to stay: the key question is how can the benefits and costs of global markets be equitably shared?

Failure to answer this question clearly and satisfactorily will cause social tensions, environmental degradation, and political upheavals. In looking at the five phases of corporate responsibility, I have suggested that the notion of a corporation's **stakeholders** has gradually widened. Until quite recently, the only stakeholders that were accepted as being important were the stockholders. According to Milton Friedman, who wrote the gospel on this older view, the only important corporate responsibility was "to maximize profit, without deception or fraud, while adhering to the rules of the game."

But in my remarks I have emphasized that the "rules of the game" are never neutral and are never etched in stone. The rules in which markets and firms operate always generate more benefits (or costs) for some than others. It has also gradually dawned on us that others besides the shareholders have a real stake in business, and they should therefore also have a voice in how business operates. And as Thomas d'Aquino, head of the Canadian Business Council on National Issues, stated recently, the acceptance of the rule of law, outlawing of corrupt practices, respect for workers' rights, protection of children, and so on, are "good for business and most business people recognize this." I would add environmental stewardship to this list.

Corporations are legal persons. But it is ultimately the human personalities within corporations — particularly their top management — that must ultimately imbue their businesses with ethical philosophies and practices.

Good intentions are not enough, however. If corporate responsibility is going to make a difference, it will have to translate into corporate **accountability.** Codes of conduct and self-regulation can only go so far. I have also suggested that institutions have a vital role in making markets and market actors function equitably. To make corporations fully accountable to all their stakeholders, we will need the active engagement of governments, international organizations, and members of civil society. Many important initiatives have been launched over the last few years, but our major challenges still lie ahead.

Those of us in this room, who are committed to promoting ethical business practices in Canada and around the world, might challenge our corporate colleagues with these questions: "What kind of world do you want to live in? What kind of world do you want

your children to live in? Is your corporation acting resolutely for the good, or is it content merely to be a passive witness of evil, or worse still, an accomplice?"

Thank you.