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**“Monitoring Normative Compliance in the Globalized Economy”**

**Peter Gourevitch**

**UCSD**

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Many issues in globalization involve “monitoring” of private actions by firms. This has become particularly the case in issues of trade, human rights, environment and social issues of child labor, family farming, and the like. We have a rich literature on accountability ( for example, the “democratic deficit” concerning the European Union and WTO, (Scharpf) that focuses on governments. Similarly, the rich literature on sanctions, monitoring and verification (arms control, cease fires, trade barriers (Martin) has focused on the behavior of governments and their (non) compliance with various treaties.

A more recent agenda deals with monitoring behavior of private actors through non formal non governmental channels. Firms are asked to adhere to a standards about wages ( the living wage) , working conditions (sweatshops)\_, child labor, the environment ( sustainable development), food purity and safety. Many of these standards have not been legislated. They exist because of social movements (Tarrow, MacAdam, Davis) pushing for them: NGOs which generate demand for certain goals. With those standards comes the issue of compliance: the task of measuring the degree to which firms actually adhere to the standards.

Evaluating compliance to social norms is a key part of what David Baron calls private politics: the assertion of a rule by private actors, rather than a rule passing through the formal procedures of the state. NGOs take this route because they have not succeeded in getting the political process to adopt or enforce rules. Many have lost confidence in the regulatory approach: even if

they win a legislative battle, they feel the regulators will be captured. Politics is slow. So they engage in political process which puts pressure on firms to comply with various norms: they make protests in stores, organize boycotts, launch shareholder protests, complain in the press, and so on.

The major pressure on firms to comply comes from consumers. These techniques are most effective on well known brands with a clientele that can afford to switch or abandon the product; Starbucks coffee, Nike shoes, Home Depot and the rainforest, organic food, soccer balls. The techniques have more trouble against non brand names, against items deeply embedded down the value chain, or where consumers are unwilling to switch --- as with Wal Mart, whose low income customers want the product. There the campaign has to be more broad gauge and political.

For the consumer, the concerned citizen, the public in general, the problem of social concern turns on verification. If a company agrees to comply with a norm articulated by an NGO, how does the consumer know if compliance actually takes place? Starbucks seeks to charge consumers a premium to raise funds to paying a living wage to small growers, and uses the Fair Trade label on its coffee bags to confirm this. How do we know that the beans in that bag are actually grown according to the conditions promised? In all of these goals, consumers face a challenge of evaluation: how do we know the products we buy comply with any of these standards?

A whole structure has emerged to set standards, demand compliance, and monitor. Many organizations claim to be doing all of these things. The

consumer's dilemma is in judging how good a job they are doing. The fair trade coffee label is supposed to signal that some of the profit will flow to the small growers in the coops that produce them. The Fair Trade organization says it certifies this. . What makes the label credible to consumers? (

( And what is credible enough: a bit of on the fly research: one Starbucks I visited had few bags of Fair trade coffee, the one in DuPont Circle had mostly fair trade coffee and the coffee you buy at the counter for a drink is generally not Fair Trade coffee. Only 1% of Starbucks sales are Fair Trade coffee, yet they have a high reputation as CSR firm. When I asked my class why, they said they were a good employer, with benefits, decent treatment).

The companies and the Verifiers ( or Vigilantes as Elliot and Freeman call them) need each other: The companies fear economic cost of violating a standard: a consumer boycott, or difficulty in capital markets unhappy with controversy, or trouble with shareholder, or trouble with employees committed to the goals. Indeed the more committed firms are to social values, the more vulnerable they maybe; employees and customers hold them to the pledges; in one case, a court supported a law suit against a firm about false advertising for not meeting a stated goal, though there was no law on that CSR standard. Firms are building market segments with CSR strategy --- Baron thinks this should not be called CSR, but a marketing strategy. And the owners or managers of the firm may believe in the values.

Assuming the firm, whatever its motives, seeks to convey that it has indeed meet a CSR objective of some kind, how does it gain credibility for doing

so? It needs a verification of some kind. Historians have interpreted the origins of the US Food and Drug Administration as a response by US farmers to European claims of diseased meat, so the USDA approval would pass European import restrictions (Kolko). French wine growers rely on government regulation to protect their vintage. In many issues areas , though, firms fight against that degree of “legalization” and regulation. (Goldstein, Kahler, Slaughter IO volume, on legalization). Thus the firms who fight against state action, are left with a need: for a Verifier.

Enter the NGOs. These organizations offer a “private bonding” solution to the verification problem ( Coase, Grief, Milgrom -Weingast paper, Akerlof). They arrange a structure which generates standards, and verification of compliance, and , via the market place of enforcement. These operate outside the formal state arena, though the shadow of the state may play a role. They are non - profits (Henry Hansmann).

The NGOs perform several functions:

Standard setting: Determining the norms to be attained: what levels of compliance are acceptable? Some are for social goals, like fair trade coffee. Others arise out of the performance needs of modern manufacture and trade: standards among manufactured goods, all the more important because of the growth of supply chains and networks: Boeing has to know its suppliers are using specified bolts that bind the engine to the wing, for example. ISO (International Standards Organization) is the most famous of these. Underwriters Laboratory is another --- it tests equipment for safety and performance. We note the shadow

of the state here: UL is a private organization, but many governments require purchasing from only UL certified places.

Managerial tools: a related set of organizations develops managerial tools for tracking various kind of standards. These are procedures and accounting methods designed to show that some process is at work, a kind of check list. Six Sigma, or various accounting groups.

Standard setting and compliance are different, analytically. One determines a norm, the other whether the norm is actually met. But the two can blur in that the weaker the norm, the easier it is to comply with it. So there will be considerably lobbying at the standard stage over the level to be set.

Standard setting is thus part of the political puzzle. If it is in public law arena, we know the institutions that set the standard. If it is in the private bonding arena, what institutions set the standard? That becomes part of the struggle – the terrain of determining valid institutional settings, and thus institution formation is itself an object of contestation. IN this regard the private arena is like the anarchy of international relations, where institutional formation is part of the game . (see lake Powell volume, introduction, chapters by Gourevitch, Frieden, Rogowski).

Verification: Once the standard is set, how do we verify compliance? A number of organizational forms can be found:

1.      Governmental bodies: (Outside the sphere of private monitoring ) These observed standards created by public authorities, legislature or their delegated regulatory authorities or civil service .

Examples in the US are: Food and Drug Administration that examines testing for drugs. City and county restaurant inspections. Agriculture Department that verifies organic and other food labeling. Europe of course has a counter part organizations , at the local, national and European level. These are the strongest Verifiers in that they can mobilize the full authority of the law and public resources. They are vulnerable , though, to regulatory capture, where standards and monitoring are deflected by lobbies which influence the regulator

The focus of this paper lies on the other side of the line: where state action stops, where the norms, standards and verification lie outside the realm of formal public authority. This can be a blurry line: the shadow of the state lies behind all private bonding mechanisms--- people comply to avoid state action. And at times, states may create a de facto enforcement by saying they will only purchase items that have been certified --- this the case with public procurement for Underwriters Laboratory items. Some localities have made compliance with Green Building Council standards a requirement for any public moneys going into construction. The UN Global Compact was spawned by an international association of sovereign states, to set norms for private actors (corporations) has no formal authority and demands no formal compliance.

b. Professional associations: Doctors, accountants , lawyers. Moving in a step from formal state authority, are the professional associations that monitor individuals compliance with standards determined by the associations. The state delegates authority to them, with limited supervision. Technical expertise puts them beyond easy reach of elected officials.

c. Profit making bodies: several for profits organizations offer services of verification: Price Waterhouse offers CSR monitoring compliance for a fee.

d. non profit NGOs. These are organizations of varying size and structure which provide monitoring. of law in that monitoring is delegated by the state. FLO-Cert is one of the most well known of these. It was spawned by the Fair Trade Labeling Organization ( a standard setter) , a movement in coffee to harmonize the verification process across many countries: so here the standard setter and norm promoter are organizationally separate from the verifier. (Levi and Linton, Tim Fox, Hiscox, French book.

These organizations vary widely. Some are large, institutionally well developed. Some are quite small and informal. At the opposite end of the FLO-Cert structure are what we could call the “Tupperware Model” of verification: inspection based on face to face contact in all segments of the process. In Rain Forest “teas” the retailer in the US visits personally the producers in the rain forest, through visits organized by the distributor and the standard setter. This reflects the “know your producer” ideas of the “buy local” of “slow food” movement. (Michael Pollen, the Omnivore’ s Dilemma, Bioneers).

The range of organizations between these two poles (highly institutionalized ones like UL and ISO, to substantial institutions like FLO-Cert, and to personalized networks as with Rain Forest teas) lies a very wide range. The dimension noted here (institutionalization ) is but one of many.

What features of Verifiers makes them effective , or ineffective.? What characteristics would raise (lower) our confidence that they provide accurate

verification of norm compliance, that the bag of coffee really has beans produced under specific conditions and the money goes to the targeted producers? Here I explore a range of criteria. The research goal is to generate a metric: classifying Verifiers along an Efficacy Ranking. Providing information about these dimensions would allow higher or lower ratings of effectiveness .

### 1. Autonomy from “Target” of monitoring:

Third party independence is a common criteria of reliability. To the extent the verifier is dependent on the object of verification, our confidence would go down. We wish to see conflicts of interest. Does the Verifier have any incentive to be lenient in inspections, because of how it gets its funding, or control issues? How do we measure independence?

- a. sources of money: does the Target provide all, some or none of the money that sustains the Verifier?
- b. Control of governance: Who sits on the board of the Verifier? How much autonomy from the Target?
- c. Who pays the fees for inspection of the Target's production sites?

### 2) Organizational Strength/Capacity :

What capacity as an organization does the Verifier have in carrying out its task: trained staff, decently paid, good education. This criteria will make the personal contact processes (the Tupperware model) rank low, and favors large organizations with big staff, like UL . Will this distort in some serious way

- size of staff
- training of staff: what kind of
- educational level of staff
- amount of back up: accounting, finance, law?

### 3) Monitoring practices:

How is the verification carried ? Many of these dimensions will overlap with the degree of third party autonomy, others with organizational capacity.

- How many inspections, how often in the field?
- Are visits unannounced, or do they have to be cleared with the Target?
- How do they select inspection sites?
- How do they interact with the Target?:  
Do they need permission?
- What relationship between inspector and target? If the inspector is a local, what relationship with the target—are they from

the same community?

4) Sources of information:

how do they get information?:

- visits to the field, documentation?
- do they collect complaints from employees and others? ; do they

allow

employees to be privately interviewed without the boss.

--are they free of the target in information gathering?

--nature of information, do you need an informant, a whistle blower,

or

“eye ball’ inspection.

We observe again that many aspects of this dimension interact with “third party autonomy” and “organizational capacity.”

5) Standards vs. Monitoring

- Who sets the standard? How is that related to Monitoring activity?
- Is the Monitor separate from the standard setter?
- Is there a conflict of interest between Standard setters and verifying? Or a convergence?

6) Evaluations:

- Do they ever find violations?
- What do they do with the violations information?
- How do they measure compliance with the Standard
- How do they follow up deviation from standard?

7) Sanctions

- Are there any sanction on the target?
- Who administers a sanction : what other organization  
( It is not likely that the Monitor is the Sanctionner  
That would be the Standard setter, or the lobby group?

8) Transparency of Monitoring organization

- Does it easily provide the information for the above?
- Can you learn about 1-6 from their Website, How? Calling?
  - Does it tell you about Money, board control, process, staff
- Is it transparent about what it does, how, findings/  
?

9. “Shadow of the state”:

- does the organization rely on Government info
- on Government rules of information provision?
- does it need government support to get target to give information?

Evaluating organizations on these dimensions will help construct a way of comparing them, to see what features make them more or less effective, and more or less credible.

In all of these dimensions, it might be important to develop some kind of metric about the targets. Some will be very uncooperative and have ample resources to resist. Others will be less so. The degree of cooperation will certainly influence the kind of organization it takes to Verify.

The verification of normative standards surely differs as well from the verification of commercial ones. The maker of appliances wants the credential of safety conferred by UL. The lack of safety ( does thing explode, burn, decompose) may be easier to measure, and clearer in commercial impact. This is a key element of ISO standards: purchasers want to be sure parts really do fit as they need; the subcontractor or supplier want the credential that their parts fit. They both need a Verifier (Ackerlof). As the supply chain lengthens, greater degrees of vertical disintegration, increase the need. (Berger, Weil) Very big and powerful elements of the system, may have internal mechanisms of mutual surveillance, and thus less need for an external “private bonding” organization. But those firms who want to enter the system will find it useful to have an organization able to confer credentials. At some level, the firm (target) and the NGO (verifier) need each other. Where that is so, the system can grow.

For social standards, that is more likely to be true for some markets than others. Many of the cases of active NGOs and Verifiers turn on branded consumer goods, with affluent, educated markets for the product: coffee, organic

food, rain forest items, trees for housing, clothing items. The leverage to press for compliance comes from the willingness of those consumers to buy certified items and avoid those which are not. It comes from the willingness of some activists to boycott, demonstrate, picket, write letters, go to shareholder meetings. The Verifiers can get to verify if the Target wants the credential, the label, or the avoidance of bad publicity.

Many firms do not face this vulnerability: big oil companies, as the consumers seem less willing to differentiate. Wal Mart's customers are very price sensitive, and not willing to abandon the firm for competitors. As a result, the many critics of Wal Mart have used other methods: zoning debates about opening new stores; studies that charge Wal Mart with offloading wages onto taxpayers by not providing medical coverage and a "living wage, so the employees go on welfare. Wal Mart is fighting back with a broad campaign of PR but also targeting and talking to key groups. ( See Baron , Stanford Case studies and the many books on Wal Mart).

In complex value chains, key decisions are often quite far down the value chain, and often easier for the firm to escape. With the famous Kathy Lee Gifford case, that did not work, as the linkage could be made. But with many products, value chain complexity blurs some kinds of accountability.

In some way, firms generate their own vulnerability and need for verification. The more they seek a market that shares CSR values, the more exposed they are to accusations of violating them. A court case found a firm in

violation of its own advertising, or statements to shareholders. Companies which don't claim to be CSR are less vulnerable to private action charges of violations.

So the Verifiers have grown up around certain “yuppie” products or those which attract student or other activists. Where the products are less branded and less important to this clientele, the system is not well developed. Some pressure comes from developing countries: they want safe and clean firms. Firms want to be certified as safe and clean: the UN Global Compact comprises a way of linking firms to governments around a set of standards. At present, compliance is voluntary and self-reporting. The firms are accountable to the extent there is negative publicity on whether there is gap between reality and their self reporting. That can be a serious vulnerability or a shallow one. Self verification has been strongly criticized in the literature. If norms declaration lead to verification, there are many steps to be taken .

As norms and verification grow, it is possible that organizations will develop that specialize in this activity and start to spread the over head costs of a large structure among several products--- the kind of thing that is happening in manufacturer, where several product rivals share a single manufacture who gets the full efficiency of large volume but is able to modify for the needs of each consumer.(Berger). Some thing like this may be happening with several organizations in the CSR world( Verité, AccountAbility).

The intersection of these CSR issues, Verification and governments is central to the process. Can private bonding solve the problem as many NGO activists suggest, in a “win –win” world where the verifiers and targets need each

other? The Rocky Mountain Institute people have a stance like this: voluntary engagement will change the system –( Lovin, Hawken, *Natural Capitalism*) Or is this so far the low hanging fruit: the system has grown where activists are strongest. What happens to firms in an industry that don't sell the labeled item? Even Starbucks sells only 1 % of its total coffee as Fair trade; when then about all the other brands. And what about the many products outside the interest or reach of the activists? It is hard to imagine the tough work can be done without government rules. And that brings us to the full measure of globalization: governments, national and supra national, international agencies, cross border.(Ruggie on UN Global Compact).

Here a comparison of governments and structures would be enlightening: are the Europeans more devoted to these issues, and if so why? ; a difference in values, in political institutions, or self interest ( is the hostility to genetically modified foods a form of protectionism, like tainted beef in the 19<sup>th</sup> century). Tiberghien on GMOs). .

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