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Keynote Address at the "Critical Global Business Issues: When Theory Meets Practice" International Law Symposium Held at Santa Clara University School of Law

February 6-7, 2015

Richard Boucher

Good afternoon, ladies and gentlemen. I'm very excited to be here with you today. I want to thank Anna Han and her team at the law journal -- Lara Bahr, Jessica Mawrence, and Ralitza Dineva -- for bringing us together to talk over one of the critical issues facing us in a globalized world: the use and expansion of corporate guidelines and practices. You all have an important role in this process and I'm glad to be able to learn from you at this Symposium.

What I'd like to do today is to put your efforts into a broader context of global governance: the demands by an exploding middle-class for fairness and efficiency.

So, let's start in that center of world commerce and good governance: Trenton, New Jersey. In Trenton, there is a bridge that's over 100 years old now. A big sign on the side says: "Trenton makes; the World Takes." Now, the world doesn't work that way anymore, but much of our trade and investment policy, as well as statistics, still rest on that 100-year-old premise: I make something, you buy it. You make something; I buy it. We offer each other reciprocal tariff concessions and we trade finished goods. Simple.

However, that's not the way the world works now. Now, we make things together in value chains, which are being cut up into smaller and smaller tasks. We each find our niche. Here are a few of these chains: for the iPhone, for Nutella --that nutty chocolate goop-- and for Zara clothing. There are multiple levels to the operation, multiple corporate entities, each with a different identity: subsidiaries, joint ventures, franchises, contract manufacturers, suppliers, farmers. They are linked with finance, with investment, with data, with technical specs, and with management, as well as through the buying and selling of the product repeatedly as it crosses borders multiple times during the production chain, sometimes electronically as design and data, sometimes physically as raw materials or intermediate goods.

This world differs radically from the Trenton model. Most of the money, as Stan Shih told us in his smiley curve, is earned by organizing the process, designing the product, and, in the end, by marketing it and servicing it. Physical production is the low value part of the curve. So, China, the manufacturing hub of the universe, makes something like $10 or $15 off a $600 iPhone. They are the low-value center of the process but they're looking to move up.

For this production to work smoothly and efficiently there needs to be standards and rules. These codes of conduct spread around the world in a whole variety of ways.

First, the organizers of the value chains define much of the process, and normally require the same data, personnel, anti-bribery, accounting, safety, environmental, and other rules that apply to their central office. Corporations spread values through their value chains.

Second, international bodies and organizations specify the standards of behavior that apply to those who want to be part of these chains.

For example, the IMF and World Bank apply accountability and anti-corruption rules to their loans for infrastructure. And the UN Convention against Corruption has created a universal expectation, although without strict enforcement, for efforts against bribery.

The OECD, where I worked for four years, has been at the forefront of this effort. Let me cite several of their most significant codes of conduct:

- The OECD's Anti-Bribery Convention, pushed by the US after the Foreign Corrupt Practice Act, is now 15 years old. There are 41 signatories -- 7 more countries than the number of members of the OECD. The participants go through three phases of reviews --law, implementation and enforcement-- resulting in periodic news stories about who is serious and who isn't. We're serious. Few others are. Peer pressures push each member to do better. The members are now exploring a fourth phase of review to focus on detection, enforcement and corporate liability issues.
    - It's worth noting that the December 2014 OECD anti-bribery report identified senior management as a major source of bribes, many paid to state enterprises. Bribes are not just incidental payments by some rogue operator in a distant outpost. As Transparency International constantly insists: its tone at the top that matters.
- The OECD also has the only international corporate social responsibility code -- the Guidelines for Multinational Enterprises. These underwent a major update over the last few years. Companies, governments and civil society organizations agreed to introduce a new requirement for supply chain responsibility--so that companies need to make efforts to see that your supplier follow your same codes of conduct. As an offshoot, in 2010, the OECD produced a Due Diligence Guidance for Conflict Minerals, adopted by the governments of the Great Lakes region in Africa and endorsed by the regulations implementing the Dodd Frank Act.
- Then there are the OECD Principles of Corporate Governance. A few years ago, I spoke at the 20th anniversary for the Shanghai Stock Exchange. My staff and I discussed how tough I should be about state enterprises and their lousy governance. We decided to be clear, but diplomatic. Then, the head of the Chinese Securities Commission stood up and read them the riot act: you state enterprises are going to have to

show more responsibility to your shareholders, you need to hire real out-side directors, you're going to have to stop insider trading and sweet-heart loans, etc, etc etc. I was elated.

  - These are all standard principles for us and for the OECD. And now, the OECD is in the process of extending its guidelines on Corporate Governance of State-owned enterprises. The goal is to treat state enterprises fairly, but to expect them to compete as business, not arms of the state.

- Who will adopt these guidelines? It's hard to predict, but more and more the G-20 are promoting or requiring these guidelines and encouraging the major developing countries to adopt them. In addition, state enter-prises and other corporations from major developing countries find themselves required to implement these rules when they list on the world's stock exchanges or establish offices overseas.

There are other movements that spread good standards of conduct and practices. New style trade negotiations --the Trans Pacific Partnership and the Transatlantic Trade and Investment Partnership will go beyond tariffs and investment liberalization to deal with state enterprises and with the behind the border requirements that can make value chains clunky or break down.

When a production process crosses borders multiple times, tariffs add up as do delays from bureaucracy, corruption or unusual legal or licensing requirements. So, many countries are voluntarily adopting international guidelines in order to attract the investment and jobs that come with a place on the value chain. Look at what Costa Rica has done in terms of education, infrastructure and practices to gain investment; they're now moving to join the OECD whole hog. Others, in Southeast Asia for example, are adopting investment codes based on OECD guidelines as they open up. The story of angel investors in Israel is also instructive: the Israeli authorities copied their system and rules explicitly from the practices of Silicon Valley so that investors would find a familiar environment. Using international rules has two benefits: first to make your environment compatible with investors' expectations and second to train your companies to follow practices that make it easier to invest beyond your borders when they're ready. China is starting to see this advantage, too.

There are also consumer pressures, even boycotts, for better corporate codes of conduct --think Nike shoes from Vietnam or the pressures on Foxconn and Apple over the treatment of workers. And NGOs are often at the forefront of pushing accountability, as in the Extractive Industries Transparency Initiative.

All these efforts to expand corporate rules against bribery and secrecy and to promote social responsibility, better corporate governance, good environmental and labor practices smooth the path for value-chained production. They provide a more efficient and predictable world for everyone -- in developing and developed countries alike -- to try to find their niche in the chain and prosper. They also respond to worldwide demand for transparency and fairness.

One of the distinctive trends of our current world --beyond the messy turmoil and myriad threats on TV-- is the growth of the middle class. The middle class has grown with investment and trade. Depending on how you define "middle class" you can say there are about 2 billion people in the global middle class now and there will be about 5 billion by 2030. I tend to go with a definition that Uri Dadush of Carnegie came up with: how many people in the world can buy a car? His estimates show that under this definition the middle class is much bigger than others think.

These people have enormous buying power. Today there are 17 trillion dollar economies in the world; but we'll see more than 20 by 2020 and by 2030, at least 35 economies with over a trillion dollars in GDP.

So will these middle-classes consumers just buy more shoes and electronics? No, as a matter of fact, the middle class is revolting. Look around the world: they're demanding opportunities, fairness, and transparency. If they think the system is rigged against them, they demand change. They're a force at the ballot box and in the streets. So we see anti-corruption movements sweeping through China and India. Prime Minister Modi gets elected in India by promising clean and efficient government. The Arab spring had many middle class roots; educated youth, small businessmen, and entrepreneurs, starting with a fruit seller in Tunisia, demanded a fair shake, unshackled by the corruption and favoritism of crony regimes. Even Occupy Wall Street and the Tea Party have something in common with each other and with these movements: they both demand a more level playing field in what they see as a rigged system. The middle class is demanding a fair allocation of the services and benefits controlled by governments.

So these middle-class demands for better, cleaner governance go hand in hand with the corporate responsibilities that flow with value chains. Better standards of conduct are spreading, but it's neither automatic nor inevitable. Some countries have reached efficiency <u>without</u> significant corruption. Others have made it to efficiency <u>with</u> corruption; China and some Southeast Asian countries, for example. While many others are plagued with inefficiency <u>and</u> corruption. One of my Indonesian friends says the only thing worse than organized corruption is disorganized corruption; where you pay your bribe but still don't get the service. Let's hope total breakdown is just a transitional phase towards paying no bribes and getting good services.

Governance matters on a corporate and national scale. In fact the greatest sources of instability in the world these days are ungoverned or poorly governed spaces: places like Somalia or South Sudan, Afghanistan or Iraq. Look at these maps of governance and corruption --green is good and redder is more bad. You can readily see that the red areas are also the areas of greatest turmoil and instability in the world.

The key to future stability is providing governance and government services in these spaces. Our violent opposition --the Islamic State, the Taliban, Hamas -- know this and provide rough justice, rough security, a rough economy, and basic services to people who've been exploited and denied decent services and security. The violent groups take care of widows and orphans. I'm afraid we haven't been very successful in recent years in helping with better governance in ungoverned spaces, but a few examples, like Colombia and Georgia, do stand out.

We all have a role in spreading better governance, better corporate social responsibility, and better practices. Governments and companies have to deliver, especially for the growing middle class for whom opportunities, fairness and justice are fundamental desires. Clear rules applied fairly. That's your job, that's our job, whether in a law office, a corporate legal staff, management, international bodies, academics, or government. The developing middle class expect it. They demand it so that they can work, trade, invest, and operate in a safe environment, to take advantage of the opportunities that new production processes and products can provide. Failure leads to revolution. Success leads to better lives.

So, I'm glad you're doing the work to spread guidelines and practices. I'm excited that you're holding this conference and that you invited me. Thanks for being here and thank you for listening.