AIDING, TRADING OR ABETTING?

THE FUTURE OF TRADE, AID AND SECURITY

PROMOTING CONFLICT-SENSITIVE BUSINESS
FOSTERING RESPONSIBLE BUSINESS
IN FRAGILE STATES
1. INTRODUCTION

The liberalization of global trade and investment has led to an unprecedented upsurge in foreign direct investment (FDI) worldwide. Nearly all international trade is conducted by companies and facilitated by financial institutions; the market actors. Their investment choices and conduct can have a crucial impact on security in the developing world.

At its best, increased business investment in fragile states has been positively correlated with reduced conflict risk: raising economic growth and living standards. However, investment has not everywhere delivered on its much-vaunted promises of improved growth, opportunity and prosperity. Indeed, in some cases, it has caused quite the opposite.

There are five major ways in which companies and financial institutions exploiting and trading natural resources have been associated with violent conflict:

1. Companies have helped violent factions raise money through the sale of conflict resources such as diamonds and timber;

2. Companies have contributed to the likelihood of conflict, however unintentionally, where the income from natural resources has reinforced the power of predatory states, or has disproportionately benefited narrow social or political groups;

3. Poor corporate conduct in countries with weak regulation and limited enforcement has generated grievances over environmental damage and limited investment in host communities;

4. Financial institutions have facilitated the flows of illegal revenues from corrupt officials and conflict economies; and

5. International companies have been the focal points of local grievances over perceived foreign domination, particularly if that company is perceived as interfering in the domestic affairs of a country.

One of the most striking examples of business complicity in violent conflict is the activities of the French national oil company Elf Aquitaine, which financed both sides in the 1997 civil war in Republic of Congo (Congo-Brazzaville). Elf Aquitaine used its assets and influence to provide Sassou Nguesso, the final victor, with military assistance from Angola in return for the future rights to Congo’s substantial oil reserves. At the same time, Elf executives also organized an oil-backed loan (mortgaging future oil production at high interest rates for upfront money) for Sassou’s opponent President Pascal Lissouba, with which he could purchase arms. Elf’s so-called ‘Africa System’ was thus partially responsible for a civil war where systematic rape was prevalent, thousands died and hundreds of thousands more were displaced.

There can be little doubt that market actors investing in fragile states routinely engage in self-regarding, even predatory economic activities. But to focus only on the behaviour of market actors is to mistake the symptom for the disease. Market actors do not exist in a vacuum but in a web of incentives and risks that define the market context. Changing the behaviour of market actors means changing their perception of value, and, ultimately, this means changing the opportunity structure in which they operate. Here, poor governance at the national level is compounded by a deficit of global governance. In the stark words of one analyst, “governance has not kept pace with globalization.”
2. THE SPECTRUM OF POLICY RESPONSES: SELECTIVE AND INEFFECTIVE

The current regulatory landscape is a diverse and uneven patchwork of issue-driven initiatives. For example, UN commodity sanctions, the Kimberley Process and EU efforts to regulate the trade in illegal timber were undertaken in response to specific instances of violent conflict, particularly in Sierra Leone and Liberia, in which the unregulated trade in lucrative commodities was identified as a barrier to conflict resolution. By contrast, the current focus on transparency of natural resource revenues, although informed by specific conflicts, has also been shaped by parallel international efforts to tackle the debt crisis, reduce aid dependency and promote ‘good’ governance.

Often, discussions of regulatory responses to conflict-promoting business activities are cast in terms of a ‘voluntary versus mandatory’ dichotomy. While the distinction is analytically useful, the dichotomy is not. It obscures a number of promising hybrid initiatives which combine market inducements with legal sanction, such as the Kimberley Process, which though voluntary, has binding effects throughout the diamond trade. More important, however, where the objective is to change the incentives that enable conflict-promoting business activity, then what matters is not whether the approach is voluntary or mandatory, but whether it can effect positive change.

Although voluntary codes do suffer from self-selection and weak enforcement, they have provided important guidance and even a market niche for progressive companies seeking to improve business practice in challenging environments. By the same token, while mandatory regulation is essential to the creation of a level playing field, and to addressing the worst conduct, it cannot remedy the many conflict-promoting, yet still legal, market activities. Because different market actors have varying sensitivities to risk and opportunity, so too their receptivity to different forms of regulation is highly variable. For this reason, efforts to promote conflict-sensitive business need to take advantage of the full spectrum of regulatory options.

IN FRAGILE STATES, TRANSACTIONS BETWEEN EXTRACTIVE COMPANIES AND UNACCOUNTABLE HOST GOVERNMENTS ARE WIDELY ACCOMPANIED BY BRIbery OF PUBLIC OFFICIALS, MONEY-LAUNDERING, TAX EVASION AND OUTRIGHT THEFT.
3. TOOLS: VOLUNTARY CODES AND INDUSTRY SELF-REGULATION

That one can even speak of progressive companies today signifies an important change. Pressed by advocacy groups, shareholder protests and UN efforts, an increasing number of extractive companies, particularly large multinationals, are embracing the notion of good corporate citizenship. Positive community relations and environmental protection embodied in various codes of conduct have already become standard elements of today’s corporate social responsibility agenda. While these codes remain mostly aspirational benchmarks, a few companies have committed resources and personnel to match them with meaningful implementation.

Other forms of voluntary company self-regulation are multi-stakeholder initiatives, such as the Voluntary Principles on Security and Human Rights, the UN Global Compact’s Dialogue on Private Sector Actors in Conflict Zones, and the Extractive Industry Transparency Initiative. These initiatives have the advantage of providing sustained engagement of key stakeholders with companies that have helped to build confidence, legitimacy and consensus, and to target attention to practical and policy challenges.

A final type is the OECD Guidelines for Multinational Enterprises. While designed as a mechanism to promote transparent and responsible investment by OECD-member companies, the Guidelines now extend to address human rights concerns. Companies are now being challenged to address wider problems of business in weak governance zones, including those that intersect with violent conflict. An advantage of the Guidelines is their extraterritorial reach and their inclusion of a mechanism for dealing with non-compliance complaints.

However, voluntary initiatives suffer several weaknesses, the most apparent of which is the partial, self-selective nature of self-regulation. Smaller companies, state-owned enterprises in non-OECD countries, and independent rogue actors are often insulated against ‘naming and shaming’ and hence have few incentives to sign on. Second, industry self-regulation has led to a proliferation of voluntary codes, none of which have global reach and authority. Third, self-regulation often lacks transparent reporting, clear performance criteria and reliable monitoring mechanisms. Fourth, voluntary efforts to do good by individual companies may be undercut not just by other less scrupulous companies, but by host governments unconcerned or unable to address issues of corruption, criminality and conflict.
4. TOOLS: MANDATORY REGULATION

Given the many inherent shortcomings of industry self-regulation, there is a strong case for more robust forms of legal regulation, at both the national and international level. A common set of authoritative and legally enforceable rules would accomplish several things:

1. Rigorous sanctions would make accountability of economic actors meaningful and curtail the current climate of impunity;

2. Common rules would reduce the collective action problems that currently impede the extension of improved corporate conduct to the broader set of market actors, while also injecting clarity and predictability into what is currently an unwieldy array of voluntary codes;

3. Rules with global coverage would end the current jurisdictional double-standard that allows companies to conduct themselves abroad in ways that would never be permitted at home; and

4. An international legal framework for responsible business conduct abroad would make companies less vulnerable to retaliation by unaccountable host-country partners, and perhaps, increase their leverage to promote host-country accountability.

The strengthening of mandatory regulation does not, however, rely exclusively on the creation of a full-blown international regime. As several studies have recently demonstrated, there is a range of existing and emerging international norms and national legal instruments that may be employed to deter undesirable activity and hold economic actors accountable for misconduct in fragile states, and that also provide the blocks for building a more coherent global framework. Here the challenge lies in extending their coverage and strengthening their enforcement.

UN Security Council sanctions have helped to curtail some of the most egregious sorts of economic activities that fuel instability and violence. While Security Council enthusiasm for using targeted sanctions has diminished in recent years, UN sanctions nonetheless remain one of the most potent forms of regulation available. However, the progress achieved through targeted sanctions owes more to the creation of expert panels and monitoring mechanisms, and the deterrent effect of their practice of ‘naming and shaming’ sanctions violators, than it does to robust sanctions enforcement among UN member states.¹

Under current international law, there are few provisions that directly address economic activities that profit from or promote conflict. While designed for other purposes, anti-corruption and anti-bribery measures offer a second area in which existing regulatory mechanisms could be better deployed against conflict-promoting business activities. In fragile states, transactions between extractive companies and unaccountable host governments are widely accompanied by bribery of public officials, money-laundering, tax evasion and outright theft.² Many of these are recognized as crimes, duly codified in domestic law and in a number of international conventions.³ However, despite several prominent national court cases and a growing number of legal investigations of alleged corporate wrongdoing, convictions have been rare.⁴

Because of the laws of war and international human rights law have been extensively codified and enjoy broad international consensus, they may provide a more reliable basis for concerted action. The Rome Statute of the International Criminal Court, for example, defines pillage, plunder and spoliation as actionable war crimes. While company officials have been prosecuted under these provisions in the past, the
narrow scope and high legal thresholds of these offences will continue to make prosecutions of this sort rare.

Companies can, however, be held accountable where they are complicit in the perpetration by others of war crimes, crimes against humanity, and other grave violations of human rights such as torture, forced detention and slavery. As yet, while there have been no international criminal prosecutions against economic actors for aiding and abetting war crimes and crimes against humanity, both the International Criminal Court and the Special Court of Sierra Leone have signalled that such prosecutions are within their remit.

Holding companies liable for actions that aid and abet violations of international criminal and human rights law is also within the power of national governments. Several criminal and civil cases are now pending in France, Belgium, the Netherlands and the U.S. that seek to prosecute individual businessmen and large multinational corporations for complicity in offences committed by others abroad. These suits have signalled to companies operating in fragile states that they face expensive and reputation-battering court cases if they fail to exercise prudence in their operational and investment decisions. Paradoxically, more robust legal sanction may have the effect of enhancing the appeal of voluntary codes.

Ultimately, the effectiveness of legal forms of regulation should not be judged by the number of convictions. If an increased incidence of prosecutions was all that was accomplished, the harmful impacts of extractive companies in fragile states would not have been prevented in the first place. The real value of legal prosecution is to clarify minimum standards of unacceptable economic activities and to reduce the incentives for entering into deals where the risk of violating those standards is present and unavoidable. In short, while legal action can have profound reformative effects on the incentive structure of market actors, these effects are likely to be incremental and uneven.

5. TOOLS: MARKET INDUCEMENTS

While voluntary and mandatory forms of regulation have differing strengths and weaknesses, they do share one shortcoming: a lack of positive inducements. Implementing emerging best practices, devoting the resources needed to sustain engagement in the plethora of voluntary initiatives, and tracking the emerging complicity liability risks, are both a costly and uncertain investment. It is particularly expensive for small-scale prospecting companies that are typically the first to enter fragile states, contributing to this category of companies’ poor track record of socially responsible business practice.

Here the challenge is to supplement regulatory prohibitions against unacceptable behaviour with economic benefits that reward good business practice. The Kimberley Process and the OECD Financial Action Task Force Against Money-Laundering demonstrate that voluntary agreements to implement a core set of regulatory standards can effect positive change when supported by effective oversight, transparent performance assessments and meaningful market inducements.

To date, however, those in a position to proffer such rewards, namely shareholders, and government and international financial lenders and regulators, have not deployed their political, regulatory and financial assets accordingly. There is a pressing need for these actors to come together to provide authoritative public policies that would help defray these costs by providing economic rewards in support of those companies that show a demonstrable commitment to improved practices.
6. RECOMMENDATIONS

Given the competitive nature of the global market place, it cannot be expected that improved conduct will naturally trickle down from progressive companies to poor performers. There is a need for new or improved global frameworks that offer real sanctions or rewards, which create level playing fields and overcome collective action problems. There is also a need to establish mechanisms which (a) discourage financial flows which may contribute to or prolong conflict; and (b) promote investment which encourages recovery from conflict:

- Work through the United Nations and other international fora to develop international agreements that establish clear and authoritative norms on the rights, responsibilities and liabilities of companies in weak and war-torn states;
- Develop robust criminal and civil mechanisms to hold companies within home jurisdictions accountable when found complicit in violations of international humanitarian law, anti-corruption conventions, and UN-mandated sanction regimes, and ensure effective enforcement and monitoring. Encourage emerging economies such as China, Brazil, India and Russia to develop and implement similar mechanisms;
- Increase the resources available for the investigation of corrupt practices under the UN Convention against Corruption and OECD’s Convention on Combating Bribery of Foreign Public Officials in International Business Transactions;
- Develop and implement complementary public policies that increase the market rewards for companies that voluntarily adopt conflict-sensitive business practices. In particular: make good practice a requirement of government lending, export credit and overseas investment provision; create ‘White lists’ that give preferential consideration to the verified best performers in government and international organization procurement; and add these standards to the listing rules of international securities and exchange commissions.
- Promote the broad adoption of the Voluntary Principles on Security and Human Rights by all governments and extended to all companies operating in conflict-prone countries. The Voluntary Principles need to establish clear criteria for participation, transparent and measurable performance and reporting obligations, and enforceable provisions for suspending or expelling non-complying members;
- Strengthen the Specific Instances Process of the OECD’s Guidelines for Multinational Enterprises by increasing the technical and fiscal resources of national contact points; by creating common, improved standards for the transparent examination of complaints and speedy resolution of disputes; and by using this process to provide explicit guidance to business about the scope of the Guidelines’ human rights provisions.

ENDNOTES

7. These include the UN Convention against Corruption, the OECD Anti-Bribery Convention, and various domestic laws, such as the U.S. Foreign Corrupt Practices Act.
This is one of six policy briefs prepared under the auspices of the Trade, Aid and Security initiative: a research project jointly coordinated by the International Institute for Sustainable Development and IUCN – The World Conservation Union, with funding from the governments of Norway and Italy.

Since 2000, the initiative has focused on the way in which trade in natural resources can contribute to violent conflict at the sub-state and international level, and on the role of foreign aid and trade liberalization—in tandem or in isolation—in accelerating or alleviating this downward spiral.

On the basis of this understanding, current research focuses on the options available to domestic and international policy-makers. This series of policy briefs recommends six key objectives that the international community should strive to achieve if trade and aid policies are to contribute to peace and security rather than increasing the likelihood and longevity of violent conflict.

Those objectives are: developing conflict-sensitive trade and aid policies; restricting the trade in conflict resources; spreading ‘good governance’; promoting conflict-sensitive business practice; and improving the management of revenues from natural resources and aid.

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