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Regulating through ethical trade

Ethical trade initiatives are a new and rapidly growing method of regulation which can offer real benefits to hard pressed regulatory agencies in developing countries. Such initiatives vary in their aims and methods but usually involve a wide range of stakeholders in trying to ensure that suppliers in developing countries treat their employees decently. Although the state is not the lead player in ethical trade its support can make a real difference. In fact without government support ethical trade would not happen.

Globalisation has meant that many Northern-based multinational companies (MNCs) now produce goods in developing countries where they can pay much lower wages than they would have to in their home countries. The benefits for the MNC are obvious. But what do the production workers themselves get out of it? Because their biggest advantage is the relative cheapness of their labour it is not difficult to see that they are at risk of exploitation. Where there are few alternative ways of making a living it is possible for employers to impose low pay levels and dangerous working conditions. And, since there is often a long chain of contractors and subcontractors stretching from the MNC's headquarters to the small factory or homeworker in the developing country, it can be relatively easy for the MNC to avoid responsibility for what is happening at the other end of the chain. Even if regulations exist to protect such workers there may be difficulties in enforcing them - in many developing countries regulatory agencies are overstretched and under-resourced.

This situation has prompted the growing interest in ethical trade initiatives. These aim to improve the social and environmental impacts of global supply chains through voluntary codes of conduct amongst large producers with suppliers or subsidiaries in developing countries. They are concerned with labour standards such as freedom of association and rights to collective bargaining; the abolition of forced labour, child labour and employment discrimination; health and safety; disciplinary procedures and pay levels. Some also focus on environmental issues such as sustainability and limiting pollution.

Carrots and sticks

For any regulation to work there must be incentives for enterprises to comply. When the state or its agencies are effective regulators then the desire to avoid legal penalties acts as a strong incentive. Where regulation is voluntary, as in ethical trade, this incentive is often missing. Instead threats of consumer boycotts or formal regulation encourage good behaviour as do, more positively, hopes of greater market share or the ability to charge above average prices. But ethical trade is not driven by economic incentives alone. Evidence suggests that hearts as well as brains are used in decision-making. Peer pressure, ideas of morality and corporate reputation are also powerful drivers.

How is ethical trade regulated?

Ethical trade initiatives seek to change the behaviour of developing country producers but pressure is not applied directly. Instead activity focuses on

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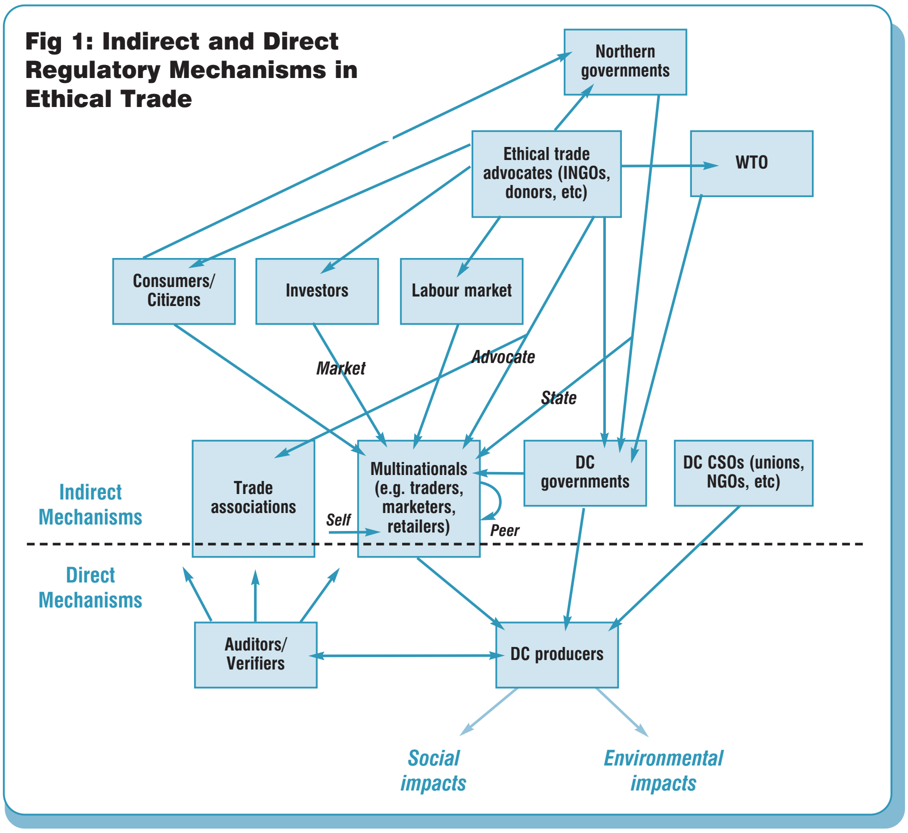
organisations in the North, most of which are also multinationals, such as retailers or those who contract with developing country producers or own them as subsidiaries.

Some ethical trade initiatives have many regulatory links. One element in a recent Christian Aid campaign aimed to get UK citizens to pressurise the UK government to pressurise the World Trade Organisation (WTO) to change the rules that affect developing country governments in order to get these governments to alter the trading environment for multinationals and local producers. Here we see global supply chains mirrored by global regulatory governance chains, as summarised in Figure 1.

Fig 1: Indirect and Direct Regulatory Mechanisms in Ethical Trade



Ethical trade involves different types of regulation. Rules and codes are perhaps the most widely known method. Hundreds of firms have adopted their own codes of conduct, as have many industrial sectors. This might well be described as *self regulation* although it is worth noting that many such codes attempt to influence the behaviour of a multinational's suppliers rather than the multinational itself. Codes of conduct have been criticised as being more about public relations than improving workers' pay and conditions. Here government can contribute by providing incentives and helping publicise codes so that they can be compared with what is actually happening. The state can also form partnerships with NGOs who are willing to check whether codes are being implemented.

There are also core codes which are intended to be applied in many different contexts. These include Social Accountability 8000 (SA8000) and the UK Ethical Trade Initiative's model code. Here we see *co-regulation*, a cooperative effort between enterprises and those ethical trade advocates who have taken the lead in developing such core codes. The state also has a valuable role to play here. In the UK, for example, the EU and the British government help facilitate and fund the Ethical Trade Initiative. Although they are not dominant partners, their presence gives the organisation extra authority.

Consumer demand is also an extremely important regulator – indeed it is often seen as the driving force of ethical trade. If enterprises can demonstrate good social and environmental performance then more customers are attracted. Similarly investors, especially major investors like pension funds, may target them. Improved pay and conditions will attract workers and lead to better industrial relations. We could call this *market regulation* because it works through demand (from consumers) and supply (from investors and the labour market).

Peer regulation comes into play, for example, when enterprises are allowed to join trade associations, or excluded from them, according to their performance. The influence of peer pressure can also be seen when competitors demonstrate that ethical behaviour can create markets. This happened when fair trade initiatives set up alternative trading organisations dealing direct with small-scale producers and their communities. They were able to prove that some consumers were willing to pay premium prices in return for feeling confident that producers were being dealt with fairly.

Advocacy is an important part of ethical trade initiatives. This includes trying to persuade producers that it is in their best interests to comply with social and environmental standards and providing them with information on best practice, lobbying governments to create better regulations and informing consumers about production conditions. This method of promoting behavioural change could be considered *advocacy regulation*.

Finally, direct *state regulation* is also involved in ethical trade when, for example, governments exempt high performing enterprises from future regulation or involve them in its design. Evidence suggests that the desire to avoid formal regulation can be a key motivator behind multinationals' 'voluntary' actions, so significant benefits can flow from state action being well coordinated with ethical trade initiatives. There is scope for local government too. In the Philippines, for example, it was possible to find many civil society groups who were willing to be trained to carry out participatory audits of local firms. Enterprising local governments should be able to find resources for such activities in their own localities. For ethical trade initiatives to flourish, innovative partnerships need to be built between national and local government, business and civil society.

The importance of information

All of these regulatory methods depend on flows of information. Trade associations need to know that producers are actually implementing codes of conduct rather than letting them gather dust on the shelf. Governments need to be sure they really are encouraging good behaviour rather than falling victim to sophisticated public relations exercises. Consumers need trustworthy information about producers' social and environmental behaviour before they can reward this through their purchasing decisions.

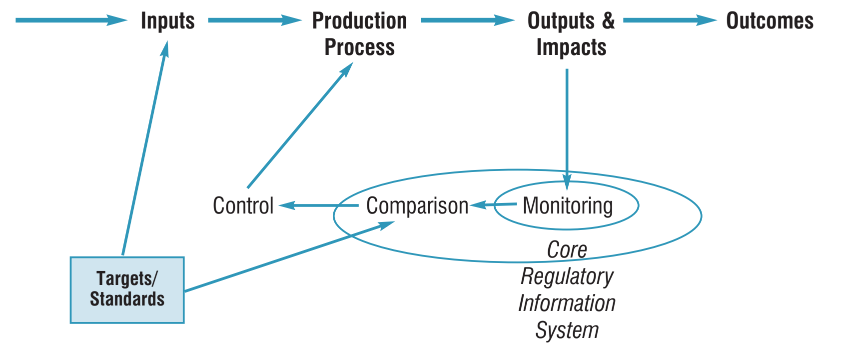
How can we judge the quality of the information? First we need to consider how *relevant* it is to the interests of the various stakeholders. These include not just primary employees of large firms but also secondary producers such as home workers, small producers and sub-contractors. We need to ask whether the information is *complete* and *clear* – can everyone understand it, especially consumers? Is it *accurate* and *reliable* –

has it been thoroughly checked? Is it *timely* – is it up to date and does it reach people quickly enough?

As Figure 2 below shows, generating such information involves firstly inspecting the production process and ensuring it meets the standards that have been set. This is usually done though formal social and environmental audits within large companies but increasingly independent monitors are used such as consultants working to the SA8000 standard. Ethical trade advocates may also undertake independent monitoring, sometimes covertly but usually with the enterprises' cooperation, and will often take responsibility for holding producers to account against ethical standards. Increasingly there are demands for more participatory approaches which emphasise wider consultation with local stakeholders.

We need to look critically at this information gathering process. What are the motivations of those involved, both researchers and respondents? Are people suspicious about how the information might be used? Are they reluctant to give truthful answers for fear of the consequences? It is important to remember that data is never neutral. It reflects its context and the attitude of those who generate and handle it. Important decisions have to be made about who is involved in collecting and analysing data and how the process is carried out. Wide consultation with local stakeholders is needed.

Figure 2: The Core Information System of Ethical Trade



The information then has to be presented in ways that are useful to those involved. Labelling schemes and ethical branding can be credible and authoritative ways of providing reassurance to consumers at point of sale. Rugmark, for example, identifies child labour-free carpets while the Forest Stewardship Council's label identifies products taken from sustainably managed forests. But studies show that information delivered prior to sale has greater impact in terms of priming potential consumers – so information in the form of more detailed analysis and campaigning material is also important.

For ethical trade to work it is also essential that information is fed back from consumers to producers and affects their behaviour. Sales volumes can be analysed to show how customers are responding but information on their attitudes and motivations can also be gained from surveys.

And finally the most important information relates to whether ethical trade has achieved its goals. Have labour standards improved in developing country producers or not? Have desired environmental improvements happened?

Consumers feel better – but do workers benefit?

Ethical trade can have positive or negative impacts. Real-world examples of the former include: fewer children making clothes and carpets for Central American and Indian suppliers; workers being reinstated and allowed to unionise in Central American garment factories; better environmental management in Thai electronics factories; and improved health and safety conditions in South East Asian footwear production. But attempts to improve conditions for Southern workers can also result in multinationals abandoning them for more compliant suppliers elsewhere, forcing workers into even worse conditions in local enterprises or unemployment. Initiatives which try to curb child labour without sufficient understanding of their need to earn money have resulted in children being forced into crime and prostitution.

It is clear that assessing the impact of ethical trade initiatives is essential to ensure they are having the desired effect. However this is still in its infancy, partly because ethical trade is a relatively new practice itself and partly because it presents challenges for regulatory impact assessment (RIA). Because ethical trade operates on a global scale with many different stakeholders, initiatives and objectives it can be hard to identify everyone involved or to find out which initiative has had what effect. Also we are often dealing with intangibles such as brand, reputation and trust and with indirect means of control such as peer pressure. Such things are hard to assess. And of course if negative impacts were to be found this could damage both multinational sales and developing country suppliers so secrecy may well be a problem.

Problems with assessing impact

Sometimes, when trying to assess the impact of ethical trade, the wrong framework is used and the wrong things are measured. Perhaps only a few activities within a factory are examined or the broader impacts on the local community are ignored. By focusing on a few particular indicators, investigators risk missing other important issues.

At other times the problem may be that things are measured wrong. The wrong questions are asked and processes are merely described instead of being judged against a benchmark. Dara O'Rourke gives a fascinating account of working alongside ethical auditors from PriceWaterhouseCoopers. They failed to spot hazardous chemicals and interviewed workers inside managers' offices where they were afraid to give truthful answers. They even advised managers on how to get round local overtime laws! Here we see a supposedly worker-orientated initiative being fatally undermined by the managerialist viewpoint of the 'experts'.

Another problem, common in impact assessment, is failing to understand which cause has led to which effect. This is partly because trade is complex but also because we do not know enough about how regulatory measures and other factors influence management decisions. More interviews with managers are needed, as are other research measures that can get to grips with the relationship between regulation and individual human behaviour.

And, last but not least, is the problem of design-reality gaps. When a regulatory initiative is designed assumptions are made which may not correspond with reality. For example efforts to curb child labour which assumed it was an evil that needed to be banned did not understand how important this labour was, both economically and socially, to poor households. Only when design-reality gaps were closed did such regulations begin to work as they were intended.

Other initiatives have failed because they have assumed trade unions to be independent and to have the same function as they generally do in the North. When in fact 'yellow unions', i.e. those sponsored by management, are involved results will be different from those expected. Attention to design-reality gaps is particularly important when, as is often the case with ethical trade, regulations are designed in the North for use in the South.

Better Impact assessment

So how should we judge the performance of ethical trade regulatory systems?

Existence First we need to ask what systems exist. They turn out to be strong in some sectors but weak or absent in others. Measures aimed at raising labour standards have concentrated on relatively cheap branded consumer goods such as clothing, footwear and toys. Efforts to protect the environment are found mainly in the primary sector (forestry, oil, mining) and resource-based manufacturing such as chemicals and wood products.

Extent Secondly we need to ask who and what is covered. Within a particular global supply chain attention seems to fall on some areas and not others. For example initiatives may fail to reach home-workers and casual workers. And some have been criticised for reflecting the interests of those who created them rather than the concerns of local workers and their communities: the design-reality gap problem. Others may be ambitious in their goals but offer rather less detail about how they are to be implemented.

Expedience Thirdly we need to ask whether regulatory goals are appropriate to social and environmental purposes. Some commentators, especially when they are comparing the goals of ethical trade with what they think state regulation would aim for, feel that ethical trade initiatives do not aim high enough. On the other hand some think that the goals are unrealistic and beyond what enterprises can be persuaded to achieve. Perhaps these criticisms are not surprising given ethical trade's short history. Providing lessons are learned from experience, improvements in coverage and appropriateness should follow.

Effectiveness Of course we need to ask whether the regulation achieves its goals. As we have seen both positive and negative impacts can occur. Some consumer campaigns have been relatively successful, such as the growth of fair trade coffee. However many have failed or had little impact. In other cases achievements may not actually be the result of the ethical trade initiative but of something else. For example successes in reducing child labour in India may be due more to stricter enforcement of pre-existing government legislation rather than to ethical labelling initiatives. When enterprises have adopted their own codes of conduct this has often been criticised as a 'window-dressing' public relations exercise rather than a genuine effort to improve the pay and conditions of Southern workforces.

Efficiency The next question is whether regulation is cost efficient. Here there is not much data to go on. Obviously any regulation costs more than no regulation. But is regulation through ethical trade likely to be cheaper than regulation by the state? This could be argued either way. Perhaps the enterprises' 'insider knowledge' of their own activities will help keep administrative costs down. On the other hand the involvement of many stakeholders might increase costs. In the absence of any direct evidence all we can say is that regulation through ethical trade will shift the burden with 'new' stakeholders – like ethical trade advocates – facing new costs. Costs for producers themselves will depend on the size of the changes they have to make to meet the new standards.

Externalities And, finally, what other effects does regulation have? There can be no doubt that ethical trade has raised the profile of social and environmental development and helped both consumers and enterprises in the North understand the consequences of their actions in the South. It has created networks of stakeholders in global supply chains and made informal dialogue possible. This has helped develop mutual trust – a very valuable commodity in regulatory systems. Trust promotes flexibility and learning and can actually enable rather than undermine state regulation if stakeholders come to share goals and decide that legislation is the best way to achieve them. Something like this happened in the European textile and clothing sector where dialogue and institution building led to an agreement with legal status that covers core labour standards.

In sum, regulation through ethical trade has developed as an attempted 'middle path' seeking to answer the criticisms of both state regulation on the one hand, and 'leaving it to the market' on the other. It is new and it has attracted its own criticisms especially when it is poorly designed. In some cases, though, it is delivering benefits in developing countries and it adds a number of new ideas to the 'regulatory toolkit'. Far from being a threat to state regulation, it can breathe fresh life into regulatory agencies and provide them with new roles as key players in emerging regulatory networks.

This CRC Policy Brief draws heavily on the CRC Working Papers below:

No 8. Heeks, R. and Duncombe, R. *Ethical Trade, Information and Communication Technologies (ICTs) and Self-Regulation*. 2001

No 41. Duncombe, R. and Heeks, R. *Information, ICTs and Ethical Trade: Implications for Self-Regulation.* 2002

No 53. Heeks, R. amnd Duncombe, R. *Ethical Trade: Issues in the Regulation of Global Supply Chains.* 2003

All available at www.competition-regulation.org.uk/publications.htm

And the CRC Conference Paper:

Carino, L. and Heeks, R. *Alternative Regulatory Mechanisms: A View from the South*. 2004 available at: www.competition-regulation.org.uk/sapapers.htm

And the CRC Conference Presentation

Heeks, R. et al *Impact Assessment of Non-Traditional Regulation: Insights for RIA from Ethical Trade*. 2003

at www.competition-regulation.org.uk/conferences/regreformnov03/riainfo.html

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