Chapter 6

Good Business Demands Good Governance

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Imagine a large conference room, coffee cups and half-eaten sandwiches atop a long rectangular table, a CEO seated at the head surrounded by regional senior managers flashing year-end revenues and projected sales on flat screens, making plans for global market expansion. This familiar scene plays out time and again at typical annual business planning sessions.

In a global market, these executives must consider where to invest, operate, and expand their product and service offerings while competing for market share with the brightest and the best the world has to offer. The information they gather, the tools they use, and the decisions they make will figure prominently not only in their business growth, but in the economic growth, job creation, and development success of the countries vying for their company's investment dollars.

Market size, trade openness, workforce skills, wage costs, tax structure, and numerous other criteria play a role in any company's investment decisions, but what ultimately determines the viability of their investments—and their staying power—can be summed up as the presence or absence of the rule of law.

BUSINESS CARES ABOUT RULE OF LAW

Yet there seems to be a misperception among some non-governmental organizations, academics, and intellectuals that business actually benefits from the absence of the rule of law, that companies prefer an environment where they can bribe their way into the market or exploit a lax regulatory environment and turn it to their advantage. And it is true that there are some unscrupulous actors who would like nothing better than to find and capitalize on such inappropriate advantages.

But it is also true that the vast majority of companies perform best in an open, transparent, and meritocratic environment—where good governance leads to good business. The companies that are most sought after by countries worldwide, with brand loyalty and an image to protect, have too much to lose to play fast and loose with the rules.

These are the companies that understand brand integrity is critical to their business success. Accordingly, they have institutionalized internal processes, procedures, and policies and have instituted training programs to ensure their corporate compliance with local laws, bilateral and multilateral trade and investment treaties, and, for U.S. companies, the U.S. Foreign Corrupt Practices Act (FCPA).

These are the companies that have a sustainable business plan, pay their taxes, bring sophisticated labor and environmental standards, create jobs, and establish roots in the communities where they do business. They are companies that rely on the existence of a strong rule-of-law regime in their decision to invest in any given market.

RULE OF LAW IS CRITICAL TO BUSINESS DECISIONS

Few factors rival the rule of law when it comes to critical factors in a company's ability to do business profitably and maintain a sustainable business model over time. Companies making decisions on where to establish business operations are investing in several senses of the word: in terms of capital, to be sure, which once committed cannot easily be shifted to another locale, but also in terms of investing in the stability of the local business climate. Rule of law is a strong proxy for political, social, and legal stability. Companies look to invest in markets where they have confidence in the integrity of public and private institutions and where there is fairness, enforcement, and proper adjudication of the law.

Doing business globally is a fact of life for any company that wishes to thrive in today's world market, including many members of the U.S. Chamber of Commerce, but even for the biggest and the best of them, global business can present serious challenges. Too often, and in too many countries, the rules of the game are subject to unpredictable change.

Most significantly, shortcomings in a country's rule-of-law regime present a wide range of challenges, including widespread and petty institutional corruption; lack of legal certainty, predictability, transparency, and due process; inconsistent laws or inadequate enforcement; and often outright political interventions in judicial, regulatory, or administrative processes. Both business and the public consumer bear the cost where rule of law is weak, complex, contradictory, or nonexistent. For example, a company will naturally shy away from a market where corruption and bribery are rampant, fearful of putting sizeable investment at risk where corrupt lawmakers and judicial officers have the unfettered ability to ignore due process and legal precedent in court proceedings or raise costly barriers to trade without notice or right of appeal.

When no one is sure where the law draws the line or which law applies, companies can be subject to seizure of their assets, as well as the arrest of their employees for alleged breach of vague laws, and can encounter privacy and confidentiality violations. A company will take into serious consideration the risk of severe sanctions for conducting business within an unpredictable or illegal environment—including hefty fines and imprisonment under the FCPA and local laws.

> Let us remind ourselves why our fight against corruption is so important. Weak rule of law and corruption create a vicious cycle. A lack of rule of law breeds corruption. That, in turn, corrodes the ability of rule of law institutions to promote human rights, maintain law and order, ensure the integrity of public institutions, support economic growth and deliver services. ...
>
> Corruption costs the average developing country more than a quarter of a billion dollars per year.
>
> —Ban Ki-moon[1]

Recently, a number of countries have become more pronounced in their corruption, lack of transparency, protectionism, and failure to provide due process. Some have engaged in abusive litigation against international companies with awards in favor of the local plaintiffs in the billions of dollars, creating a dangerous precedent. This global uptick not only presents a systemic risk to the multilateral trading system that cannot be ignored, but also puts each one of these countries in jeopardy of losing international

Case Study: Ecuador

Over a period of many years, investors in Ecuador have been embroiled in a series of investment disputes. In 2011, according to the U.N. Conference on Trade and Development's *World Investment Report 2012*, Ecuador was tied for second in terms of number of investment treaty arbitration claims lodged against it, including four new claims in 2011 alone.[2]

Ecuador's response to these disputes has been to withdraw from the ICSID2 Convention and move to terminate bilateral investment treaties (BITs) with 13 countries, including the United States. In fact, Ecuador has asked a U.S. court to deny one investor the right to arbitration under the existing BIT—a request the judge has now dismissed—and more recently began filing lawsuits against investors in third countries to circumvent the ICSID settlements.

A U.S. Department of Commerce report, *Doing Business in Ecuador: 2012*, spells out the dangers facing foreign investors:

> [T]he legal complexity resulting from the inconsistent application and interpretation of its existing investment laws complicates enforcement of contracts and increases the risks and costs of doing business in Ecuador. *Government officials and private Ecuadorian businesses have used regulatory schemes and questionable legal maneuvers to affect foreign company operations in the country.* Companies have sometimes been confronted with requirements of additional payments not negotiated in original agreements. Receiving full and timely payments due can be another recurring problem. Business disputes with U.S. companies can become politicized, especially in sensitive areas such as the energy sector [emphasis added].[3]

An earlier report by the Commerce Department, *Doing Business in Ecuador: 2010*, provides some insight into the ideology behind Ecuador's heavy-handed approach to investors:

> [T]he Government of Ecuador has modified the country's investment regime in response to key provisions included in Ecuador's October 2008 Constitution. For instance, Article 339 of the Constitution provides that "the State will promote national and foreign investment … prioritizing national investment." Also, "foreign direct investment will be complementary to national investment … and be targeted in accordance to the needs and priorities defined in the National Development Plan." Article 422 of the Constitution states that "Ecuador will not enter into international agreements or instruments under which the Ecuadorian State would have to cede sovereign jurisdiction to international arbitral tribunals in contractual or commercial matters between the State and individuals or corporations."[4]

In other words, investment is welcome in Ecuador but only on the government's terms and without the protections that investors have previously received under international agreements. Consequently, legal certainty is far and away the biggest question mark for any company considering capital investment in Ecuador.

investments and related socioeconomic growth and jobs.

Yet for a country to apply the rule of law in a balanced, cohesive, consistent, and transparent manner, it must first understand what is meant when the private sector refers to the rule of law.

DEFINING RULE OF LAW FOR BUSINESS

As we seek to arrive at a consensus definition of rule of law, let us start with what it is not: The business community certainly does not mean "rule by law" where the lack of checks and balances on the will of the political elite allows them to manipulate nominally democratic mechanisms to achieve a precooked authoritarian result. And it is not lip service to regulatory or judicial processes whose administrators are not held accountable for the integrity of those processes.

What, then, is the definition of rule of law? It is tempting to follow in the footsteps of Potter Stewart, a former United States Supreme Court Justice, who once offered this definition of obscenity: "I know it when I see it." We all know unfairness when we see it, and victims—whether citizens, employees, consumers or businesses—feel the repercussions when fairness and healthy competition in the marketplace are nonexistent.

Perhaps Britain's Dr. Eamonn Butler, co-founder of the Adam Smith Institute, a global think tank, put it most directly relative to doing business:

> Too many countries have, not the rule of law, but the rule of men. When you have to get specific permission to do something, like start a business, then you depend on the officials who wield that authority. It is a formula for delay, bureaucracy—and corruption. Under the rule of law, by contrast, the rules of property are known, established, accepted and respected. Even the poorest people are protected by the same rules. And the government too has to work within the rules—there can be no arbitrary arrest, confiscation of property, or retrospective changes in laws and contracts.[5]

Members of the U.S. Chamber of Commerce recognize that a strong rule-of-law setting does not mean a gratuitous extension of "our" law to other markets. Rather, we collaborate with like-minded businesses and organizations around the world to share experiences, compare practices, and work toward predictable and compatible principles for a legal environment that allows U.S. firms to comply with the laws of the host governments without running afoul of U.S. norms and, conversely, welcomes international companies in U.S. markets.

In fact, the Chamber opposes, as a matter of principle, extraterritorial application of some U.S. laws that ignore the reality of legitimate business operations in the global marketplace and that trap companies in the impossible situation of compliance with both the laws of home and those of the host jurisdictions. Such artificial conflicts do nothing to enhance the respect for the rule of law in either market.

Another way to define rule of law is by the advantages that accrue when it is present. For a business whose continued operations are dependent on a return on investment over time, there are several factors related to the rule of law that will determine its ability to make rational investment and operating decisions and thereby have a reasonable expectation of returning a profit.

The U.S. Chamber has identified five business rule-of-law factors whose presence helps to attract sustainable, long-term investment to any given country:

- **Transparency.** Laws and regulations applied to business must be readily accessible and easily understood.
- **Predictability.** Laws and regulations must be applied in a logical and consistent manner regardless of time, place, or parties concerned.
- **Stability.** The state's rationale for the regulation of business—for example, promotion of negotiation and implementation of trade agreements and other vehicles that strengthen rule of law, sanctity of contracts, and compliance with international law—must be consistent and coherent over time, establishing an institutional consistency across administra-

tions, and free from arbitrary or retrospective amendment.
- **Accountability.** Investors must be confident that the laws will be upheld and applied equally to government as well as the private sector and civil society: for example, anti-bribery and corruption issues.
- **Due Process.** When disputes inevitably arise, they must be resolved not by ad hoc arrangements or special interventions, but in a fair, transparent, and predetermined process.

Where these factors are present, investment thrives, economies grow, jobs are created, and prosperity follows. Where they are absent, corruption thrives, ambiguity reigns, investment dollars flee, and tax revenues plummet.

BUSINESS LEADING BY EXAMPLE

For responsible businesses, the goal is more rule of law, not less. The absence of a strong rule-of-law environment has a chilling effect on corporate investment. Responsible companies believe in setting a good example on this issue. In addition to promulgating internal legal compliance procedures and policies, these companies use creative and innovative methods to assist the markets in which they do business, such as setting clear standards for local contractors and guidelines for employees, engaging as a responsible stakeholder in public policy debates, and conducting progress assessments that highlight the positive impact of strong rule of law.

Given the importance of rule-of-law considerations to companies' global investment and operation decisions, it should be no surprise that a solid rule-of-law regime is quickly becoming a central plank in businesses' international policy agenda. That agenda includes measures intended to:

- **Foster a global business environment** in which countries respect the rule of law and provide due process under law to investors, producers, and service providers of every nationality;
- **Highlight violations** of the rule of law and advocate for their prompt and just resolution;
- **Vigorously defend** the rule of law, sanctity of contracts, respect for property rights—including intellectual property—and advocate for the promulgation of fair, transparent, and consistent laws and a quick resolution of conflicts;
- **Foster an understanding** that there is a spectrum of regional realities related to rule of law, ranging from those that impede business and investment, to those undermining national competitiveness, to those posing an outright threat to democratic institutions;
- **Promote the negotiation and implementation** of vehicles such as trade agreements for the strengthening of government institutions related to rule of law and highlight, where applicable, provisions in existing and pending trade agreements that improve governmental transparency, combat corruption, and protect due process; and
- **Help to ensure** that the benefits of rule of law and constitutional processes are more broadly shared and understood throughout our societies.

THE NEED FOR BUSINESS-SPECIFIC INDICATORS

So let us go back to that global business planning session in the conference room. As the senior managers review the company's business development plans, they discuss the various factors that will determine their strategy moving forward. A key factor in this process is rule of law.

Companies rely on publications such as the *Index of Economic Freedom*, as well as indices published by the World Bank, Transparency International, the World Justice Project, the American Bar Association, and others, which include rule-of-law rankings of countries around the world. These provide independent assessment tools regarding access to justice, transparency, and strengthening the rule of law.

Greater work is needed, however, in developing metrics and indicators specific to the global business environment. Such indicators would provide an empirical basis for private-sector engagement of multilateral institutions and non-governmental organizations (NGOs). The private sector is a key stakeholder in a strong rule-of-law environment. For companies to be able to make the most educated decisions, it is necessary that their informational needs are considered in identifying rule-of-law indicators that are critical to their business analysis.

After assessment comes implementation. Once operating, companies too often must cope with rule-of-law challenges completely on their own. The circumstances are usually sensitive and company-specific, with significant political and economic risk involved. Especially where substantial fixed investments are involved, companies may be prevented from blowing the whistle for fear of host government retaliation. New metrics would give these companies an evidence-based tool to defend their business position with informed arguments to address denial of the rule of law.

Rule-of-law indicators that are critical to corporate management's business development decision-making process include:

1. Corruption and bribery, specifically as they apply to government procurement and other business activities;
2. Regulatory and policy trade barriers, such as the adoption of protectionist measures;
3. Existence and enforcement of real property and intellectual property protection laws;
4. Adherence to trade, investment, and tax treaties or agreements;
5. Resolution of business disputes and outcomes;
6. Transparent government policymaking; and
7. Adherence to litigation and international arbitration rulings regarding sanctity of contracts and agreements and the expropriation of land, facilities, or businesses.

CONCLUSION

Societies that have stable, predictable, and transparent institutions enjoy investor confidence and economic growth. Conversely, those with weak institutions and processes tend to experience delayed socioeconomic development and political instability; pay a high risk premium for investments; and suffer through volatility in prices, supply, and employment.

One of the basic tenets of the U.S. Chamber of Commerce is that business should enjoy a statutory and regulatory environment that provides transparency, predictability, stability, accountability, and due process in global markets. Our goal is to identify spaces where the rule of law as it relates to the business community is weak, contradictory, or nonexistent and provide a forum to address and advocate on these lapses.

Undertakings such as identifying business-specific rule-of-law indicators would provide critical information to companies that are seeking to better understand the risks involved in investing and operating in any given foreign market, as well as an empirical basis for private-sector engagement with multilateral institutions and NGOs whose performance measurements and rankings shape perception of a country's adherence to the rule of law.

Ultimately, it is incumbent upon the private sector to create a voice for itself that focuses on rule of law as it is applied to the business environment. The U.S. Chamber's Coalition for the Rule of Law in Global Markets aims at being such a voice—in partnership, consultation, and collaboration with willing stakeholders around the world—to provide specific business-related rule-of-law indictors and analysis as critical assessment tools for business planning.

Endnotes

1 U.N. Secretary General Ban Ki-moon, remarks at U.N. High Level Rule of Law Meeting Panel Discussion on "Strengthening the Rule of Law: The Fight Against Corruption and Its Impact on Sustainable Economic Growth," September 24, 2012.

2 United Nations Conference on Trade and Development, *World Investment Report 2012*, May 2012, p. 120, http://www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf (accessed October 31, 2012).

3 U.S. Department of Commerce, U.S. Commercial Service, *Doing Business in Ecuador: 2012*, July 2012, pp. 35–36, http://www.buyusainfo.net/docs/x_8284643.pdf (accessed October 31, 2012).

4 U.S. Department of Commerce, U.S. Commercial Service, *Doing Business in Ecuador: 2010*, July 2010, p. 40, http://www.buyusainfo.net/docs/x_4848464.pdf (accessed October 31, 2012).

5 Eamonn Butler, "Wealth Depends on the Rule of Law," Adam Smith Institute, November 9, 2004, http://www.adamsmith.org/research/articles/wealth-depends-on-the-rule-of-law (accessed November 3, 2012).