

International Transparency

Transparency policies have the potential to reduce risks and improve public services in the United States, although they must overcome many obstacles to do so, as we have seen. But can targeted transparency reduce risks and improve services that cross national boundaries? That is a more difficult question.

Assessing three important cross-border transparency policies, we find preliminary evidence that such policies can help further nations' shared agendas, even when no overarching treaty guides international action. At best, targeted transparency provides a form of governance without government.

In some ways, international transparency policies work like domestic policies. The analytical framework we have developed to assess the effectiveness of domestic policies can also assess the effectiveness of international policies. The effectiveness of international policies, like that of domestic policies, depends heavily on whether policies are user-centered and improve over time. But international policies also confront two unique challenges. First, they must earn legitimacy. Second, they must become embedded not only in the decision routines of information users and disclosers but also in national laws, regulations, and enforcement practices of participating nations.

Whether targeted transparency can become a useful tool of international governance is a question with new urgency. Markets are integrating rapidly, while governance remains fragmented, defined by traditional national geographical boundaries. National governments have increasing difficulty framing rules for markets and for collective action unilaterally.

At the same time, the failure of national transparency systems can have dire international consequences, as two recent examples illustrate.

In 2001–2002, the sudden collapse of Enron, WorldCom, and other respected U.S. companies destroyed the savings of investors not only in the

United States but around the world. The failure of U.S. financial accounting rules to keep up with market changes increased risks to investors – without regard to national boundaries. Reforms became an international effort.

In 2003, the outbreak of a virulent infectious disease known as Severe Acute Respiratory Syndrome (SARS) spread from a few villages in China to thirty countries in six months. National transparency failed as Chinese officials delayed reporting of provincial outbreaks. Late and incomplete information created international panic. In the end, SARS killed more than 700 people and caused an estimated \$40 billion in economic losses.

Of course, the growing interdependence of nations has increased calls for strengthened international institutions. Yet formal treaties and multinational agreements remain relatively rare, and efforts to reform the United Nations, the World Bank, and other international institutions proceed slowly. As the need for cross-border governance increases, transparency policies provide one pragmatic means of pursuing shared priorities.

This chapter represents a first step toward assessing targeted transparency as a tool of international governance. It asks three questions:

- How do international targeted transparency policies work?
- Why are such policies emerging now?
- What factors contribute to their effectiveness?

Our analysis is based on examination of three international cases chosen for the diversity of their origins and goals, their relative maturity, and their potentially broad impact. We first examine in detail the evolution of international corporate financial reporting. We do so because our analysis of domestic cases suggests that transparency policies are likely to be most mature in the financial sector. International corporate financial reporting grew out of thirty years of private-sector efforts by an informal committee of accountants to harmonize disclosure rules across major securities markets. The committee's aims were to reduce investor risks and improve corporate governance. By 2005, those private efforts had evolved into public mandates as the committee gradually adopted rules for participation and procedural fairness, and as national governments in major securities markets endorsed its standards.

We then analyze two international transparency cases of current importance – one concerning public health and the other concerning food safety – for comparison. International infectious disease surveillance, the first case, has long aimed to reduce deaths and illnesses by limiting the spread of diseases from one nation to another. A moribund system was re-created and

broadened when the SARS epidemic of 2003 revealed the urgent need for rapid and accurate international reporting.

By contrast, the labeling of genetically modified foods, the second case, represents, so far, a costly and unsuccessful international transparency effort. Nations participating in international food markets have failed to agree about whether genetic modification of grains presents safety risks that warrant public disclosure and what form that disclosure should take when consumer preferences vary widely and science remains uncertain.

HOW DO INTERNATIONAL TRANSPARENCY POLICIES WORK?

Transparency is a widely acclaimed value in international governance. Targeted transparency, however, has a specific meaning. As we have seen, targeted transparency means the government-mandated disclosure by corporations or other private or public organizations of standardized, comparable, and disaggregated information regarding specific products or practices to a broad audience in order to further a defined public purpose.

These policies differ from more familiar forms of international transparency. Their specific regulatory purpose distinguishes such policies from broad efforts by the United Nations, World Bank, national governments, and other institutions toward more transparency in decision making. Their reliance on the accountability and permanence of public mandates distinguishes them from the many efforts by private organizations to create international transparency systems that will, for example, reduce public corruption or improve environmental protection or labor standards.¹

Targeted transparency policies' reliance on information itself as a regulatory tool distinguishes these policies from the more familiar form of regulatory disclosure – standard setting and compliance transparency. Standard setting and compliance transparency rely on information as an input to the framing and enforcement of government rules.²

At the outset, we find that international targeted transparency policies share the architectural elements of domestic policies, discussed at length in Chapter 3. Different as they are, international accounting, infectious disease surveillance, and labeling of genetically modified foods all feature the same architectural elements: a defined policy purpose; specified discloser targets; a defined scope of information; a designated information structure and vehicle; and an enforcement mechanism.

International transparency systems also work in essentially the same way as domestic systems, following the action cycle described in Chapter 4. Disclosure of factual information creates incentives for consumers and citizens

to change their choices. Those changed choices in turn create incentives for corporations or other disclosers to align their practices more closely with public objectives.

Scores of international targeted transparency systems have emerged in recent years. Besides the three we study in this chapter, prominent examples include food-ingredient, country-of-origin, and nutritional labeling coordinated by the United Nations' Codex Alimentarius; stringent auto safety and fuel-economy disclosure adopted by Europe, China, Japan, and other nations; labeling of tobacco products under the Framework Convention on Tobacco Control; the labeling of hazardous chemicals under UN guidance; and the European Union's cross-border reporting requirements for toxic pollution.³

Scholars and commentators have begun to acknowledge the importance of international targeted transparency in their recent work. In *Global Public Policy: Governing Without Government?* Wolfgang H. Reinicke suggests that "applying strict principles of disclosure-based regulation is one important way to allow public sector and other non-state actors to review industry activity on a regular and timely basis."⁴ In *Why Globalization Works*, Martin Wolf suggests that "[t]he flow of reliable *information* and the ability to *trust* are the life-blood of markets. . . . Regulators can help by certifying the quality of a company's processes or products, their financial soundness or whatever else may be relevant."⁵ And in *A New World Order*, Anne-Marie Slaughter suggests optimistically that

regulation by information . . . allows regulators to move away from traditional command-and-control methods and instead provide individuals and corporations with the information and ideas they need to figure out how to improve their own performance against benchmarked standards. This approach is gaining popularity in the United States, is increasingly prevalent in the European Union, and is being tried at the United Nations.⁶

WHY NOW?

Even as markets have integrated rapidly over the last two decades, governance remains problematic.⁷ No nation advocates ceding broad sovereignty to a world government. And even limited international rules, taxes, subsidies, and other conventional forms of public intervention often have proven politically difficult to create and enforce. In such circumstances, a question arises: can international transparency policies offer a relatively light-handed pragmatic means of protecting investors, improving the safety of products, minimizing the spread of diseases, and improving cross-boundary services such as transportation?

The emergence of international transparency policies has been driven by three long-term trends that suggest their lasting importance. First, in a political change, national governments in the world's largest markets have eliminated quotas and reduced tariffs, foreign exchange controls, interest rate ceilings, securities regulation, and other barriers to international trade and investment.⁸ Second, in an economic change, shipping and travel costs have plummeted, helping to expand international trade and tourism.⁹ Third, in a technological change, rapid advances in computing power and the Internet have dramatically lowered the costs of international business transactions and increased the potential power of transparency.¹⁰

These changes have transformed the character as well as increased the volume of international business. As the debate in the United States over outsourcing suggests, it has become increasingly cost-effective for firms to locate workers and facilities in many countries. At the same time, investors are seeking higher returns outside their home countries. In 1980, global cross-border purchases of stocks, bonds, and derivatives amounted to about \$49 billion. By 1990, that figure had almost quintupled to \$237 billion. By 2000, it had nearly quintupled again, to \$1.06 trillion.¹¹ By the mid-1990s, more than 45,000 transnational corporations with 280,000 foreign affiliates accounted for about a third of the world's output.¹²

Such market integration has not been truly global, of course. Business transactions remain more geographically limited than frequent references to "globalization" might suggest.¹³ As of 2003, about 90 percent of all capital moving across borders still flowed among the industrialized countries of Europe, North America, Japan, and Australia. Virtually all of the remaining 10 percent involved a group of high-growth developing countries known as emerging markets: China, India, and the rest of industrializing Asia, along with the larger Latin American economies such as Brazil, Mexico, and Venezuela. This 90/10 split in capital flows between industrialized and emerging market countries has been constant since at least the 1970s.¹⁴

Securities markets have remained even more concentrated. Almost half of the globe's corporate market value is held in the New York Stock Exchange and Nasdaq. Adding a handful of others – the Tokyo, London, Euronext, and German exchanges – accounts for about three-quarters of the world's publicly traded corporate value.¹⁵ Investors also continue to display a significant "home bias" in their purchase of stocks. In 2000, portfolios around the world were still made up almost entirely of domestic stocks. United States investors held 89 percent U.S. stocks, Japanese investors held 92 percent Japanese stocks, and United Kingdom investors held 78 percent U.K. stocks.¹⁶

As a final cautionary note on inflated predictions of globalization, history teaches that unanticipated future events may slow or reverse the process of

market integration. Periods of rapid economic growth have generally coincided with periods of rapid market integration. But those times have been interspersed with periods of slower growth and less integration. Contemporary observers often point to the years from 1870 to 1914 as a time of rapid integration of capital markets, technological innovation that reduced transportation and communication costs, growing international trade, and population migration. But this integration slowed with the outbreak of World War I.¹⁷ Recent backlashes against globalization in both industrialized and developing nations and new barriers erected to the movement of goods and people as part of antiterrorism measures indicate that countervailing forces remain important.

Nonetheless, the demand for international systems of problem solving is likely to continue to grow. As more products, services, manufacturing operations, financial transactions, and people cross borders, conflicts over how to protect investors, assure the safety of cars, food, and medicines, reduce environmental risks, and protect public health will also increase.

In response to such market integration, as well as new scientific findings and periodic crises, governments have begun to adopt cross-border transparency policies. When domestic securities markets cratered during the Asian financial crisis of the mid-1990s, banking and securities regulators concluded that more transparency would help avoid future surprises. When scientists concluded that a range of events from melting glaciers in the Arctic to droughts in Africa could be traced to global warming, pressure increased for nations and corporations to disclose the climate-altering emission of greenhouse gases. When improved monitoring suggested that mercury and other toxic pollutants could travel long distances, policymakers began to design transparency measures for cross-border toxic pollution. When terrorism fears called attention to nations' porous borders, officials worked toward new international tracking and disclosure systems for shipping containers, air travel, microbes, and immigrants.

By our definition, an international transparency policy is effective if it creates lasting changes in the products or practices of target organizations that advance the shared priorities of the sponsoring nations. Empirical studies are needed to definitively measure the effectiveness of specific international policies, but so far few such studies have been published. The three policies we have studied offer suggestive insights about the potential for international transparency.

International corporate financial reporting provides an example of a transparency policy that has gained strength by becoming increasingly user- and discloser-centered and that appears likely to prove effective.

Infectious disease reporting provides a different model. Ad hoc responses to the SARS epidemic revived a moribund public health transparency measure and set a new course for international reporting.

By contrast, efforts to address public concerns about food safety by labeling genetically modified foods remind us about the limits of transparency in international public policy. To date, such labeling has failed to serve the needs of consumers or to keep pace with changing science and markets.

FROM PRIVATE COMMITTEE TO PUBLIC MANDATE: INTERNATIONAL CORPORATE FINANCIAL REPORTING

The newly emerging system of international corporate financial reporting illustrates how a private group of experts can create a transparency policy that grows into a public mandate. But it also illustrates how difficult it can be for such policies to gain legitimacy.

The idea that companies that seek public investors in more than one country should report their finances in a uniform way emerged in the 1970s in response to growing confusion about conflicting national accounting requirements. Exponential increases in cross-border investment left companies, regulators, and investors struggling with an outdated patchwork of variable national rules. The accounting profession, with its international perspective, long professional tradition, technical expertise, and quasi-public role, had the strongest and most enduring interest in harmonizing national standards.

As early as 1973, Henry Benson, the head of the Coopers Brothers accounting firm in Britain (later Pricewaterhouse Coopers), brought together leading accountants from nine countries to form the International Accounting Standards Committee (IASC) to issue proposed international rules for financial disclosure. Although the group operated independently, it was technically a committee of the International Federation of Accountants, a membership organization of accounting associations that promoted improvements in standards, auditing practices, ethics, and education in many countries.¹⁸

By 2005, this small private effort had grown into a robust public mandate. Approximately a hundred nations, including the twenty-five countries of the European Union, had authorized companies to use international standards in addition to or instead of national disclosure rules. Most leading stock exchanges, including those in the U.K., Japan, France, Germany, and Austria, accepted financial reports based on international standards. Although the United States still required foreign companies to reconcile their accounting

with U.S. rules when they sold stock on U.S. exchanges, American regulators had issued qualified statements that they too planned to accept international standards by 2007. Most significant of all, the European Union *required* the use of such standards by all companies listing in member countries as of January 1, 2005.¹⁹

As we have discussed, transparency policies must be user- and discloser-centered to be effective, embedding new information in decision routines. By 2006, there were signs that international accounting standards were becoming embedded in the choices of international investors and that firms were paying attention. International accounting standards appeared quite likely to be effective in furthering their stated purposes, at least to some degree. Those purposes included improving market efficiencies by lowering the cost of capital, minimizing hidden risks to investors, reducing market volatility, and improving corporate governance.

What accounts for the apparent success of international financial reporting? Transparency effectiveness is always improbable. Especially in the international arena, one would expect that the political deck would be stacked against rigorous reporting. Multinational companies have both the motivation and the resources to fight demands for transparency, while national governments are committed to established traditions that could be expected to outweigh shared interests. By contrast, those who benefit from transparency – whether investors, consumers, or employees – remain separated by language, location, and cultural traditions. They would not be expected to either sustain interest or provide resources to maintain and improve transparency systems. Those dynamics could produce a “race to the bottom” in which a least common denominator of disclosure prevailed.²⁰ Why did rigorous international standards prevail instead?

Our analysis suggests that five factors have contributed to the success of the new international accounting standards. With the exception of competition among national regulators, these factors track those that contribute to the success of domestic transparency standards:

- a costly information problem
- competition among national regulators to influence international standards
- support from multinational corporations
- the influence of established groups representing investors’ interests
- crises that highlighted the need for international standards.

We consider each of these factors in turn.

A Growing Information Problem Creates Costly Confusion

Rigorous international reporting standards gained support because they addressed a growing information problem. The problem was that companies headquartered in different countries added up their profits and losses in different ways.

Beginning in the 1930s, the United States had produced voluminous, specific accounting rules that reflected a considerable tolerance of risk, focused on the needs of public shareholders, were independent of tax calculations, and allowed companies relatively little discretion. Seventy years later, those rules exceeded a hundred thousand pages in length. By contrast, France, Germany, Japan, and other civil-law countries had produced less voluminous, less specific accounting rules that reflected a relatively risk-averse approach to business, focused on the needs of banks and other creditors, combined investor and taxation data, and allowed companies considerable discretion in their application.

Regulators Compete to Control International Transparency

At the same time, international organizations and regulators in dominant markets competed to control the terms of international accounting. The United Nations, the European Commission, the United States, and a group of international accountants oriented toward U.S. and U.K. traditions each maneuvered for three decades to gain international recognition of international accounting standards that reflected their unique political and economic interests.

However, by the mid-1990s, both U.S. and European regulators had concluded that other nations would not accept their systems of financial reporting as the international standard, and the UN had dropped out of the competition. Instead, U.S. and European authorities focused their efforts on competing to influence the financial reporting standards being drafted by the private-sector IASC. Making a qualified commitment to allow reporting on U.S. exchanges using such standards by 2007, U.S. regulators lobbied successfully to gain the United States a position as a nonvoting member of the IASC board and to participate in board discussions, comment on drafts, and provide research and technical assistance to the committee.²¹

Meanwhile, European Commission officials attempted to gain leverage by warning that each standard would be subject to European Union (EU) endorsement to assure that it furthered European public interest, was understandable, and presented no conflict with European accounting principles.

In 2002, the commission formally required most publicly traded companies headquartered in the EU to adopt the private-sector-created international accounting standards by 2005.²² Adoption of a single set of accounting rules represented an important step toward creating a single European market, and the commission preferred IASC rules to increasing dominance by the United States as international standard setter.

The IASC responded by strengthening its own status as an expert body while providing procedures to structure nations' participation in standard setting. In 2002, the committee reorganized as the International Accounting Standards Board (IASB). The board's guidelines provided for published agendas, open meetings, notice and comment concerning rule making, and other due process requirements. By 2005, the new board had issued a virtually complete set of accounting standards.²³

Multinational Companies Embrace Transparency

Some multinational corporations also found reasons to favor rigorous international disclosure. As securities markets integrated, such companies increasingly listed on more than one country's stock exchange. Such cross-listing created new reporting costs. At least as important, it created new credibility costs when national rules produced different balance sheets. In an often-cited example, Daimler-Benz, the first German company to adopt U.S. disclosure rules, reported 1993 profits of \$102 million using German accounting standards but net losses of nearly \$579 million under U.S. rules.²⁴ "[I]n the end nobody knew whether the company was making a profit or suffering a loss," noted Karel van Hulle, accounting administrator for the European Commission.²⁵ To avoid such confusion, many multinational firms advocated one set of international standards.

Influential Groups Represent Users' Interests

Meanwhile, a number of well-established groups representing the interests of dispersed investors began to call for more rigorous disclosure policies. Each group had its own reasons for doing so. Institutional investors supported rigorous accounting rules in order to strengthen their market positions. In the United States and Europe, pension funds, mutual funds, and other institutional investors favored international standards so they could diversify abroad without having to expend resources on interpreting financial standards created in accordance with multiple policies. By 2002, a McKinsey survey reported that 90 percent of large institutional investors favored an international financial accounting system.²⁶

Major stock exchanges in mature markets also favored international accounting standards as a way of reducing barriers to foreign listings, which represented an important growth opportunity for them. From 1990 to 2003, for example, the proportion of New York Stock Exchange companies based outside the United States grew from one in fifteen to one in six.²⁷ The New York Stock Exchange's 1994 adoption of "The world puts its stock in us" as its motto reflected both a new reality and the exchange's strategy for future growth.

Accounting firms themselves led the effort to create international standards. Although they worked for disclosing corporations, accounting firms prospered only if they also served the interests of information users. Multiple conflicting corporate balance sheets not only confused investors but also raised doubts about the credibility of accounts and accountants. Therefore, as we have noted, the big accounting firms began working through the International Federation of Accountants (IFAC) to promote auditing, ethics, and education reforms to strengthen the administration of international standards, and international accounting firms provided the bulk of the funding for the International Accounting Standards Committee from the 1970s on.²⁸

Crises Add Momentum for Rigorous Reporting

Finally, crises such as the Asian financial collapse of the mid-1990s mobilized pro-disclosure interests by highlighting the need for greater international transparency. Crises demonstrated the growing volatility and interdependence of national economies, the ineffectiveness of conventional stabilizing measures, and the high cost to be paid in economic decline and human suffering for inaccurate and incomplete financial information.²⁹ In fact, corporate accounting flaws did not play a central role in the Asian crisis. Nonetheless, the economic destabilization that accompanied the crisis spurred moves toward improvements in both government and corporate disclosure systems that were endorsed by the International Monetary Fund (IMF), the G-7, and U.S. and European regulators.³⁰

The U.S. accounting scandals in 2001–2002 demonstrated that U.S. accounting rules failed to provide full disclosure of potential risks to investors. Humbled U.S. officials suggested they might even drop the requirement that non-U.S. companies follow U.S. reporting rules. "If we think the international approach is better or equal, we will propose moving" in that direction, conceded Robert Herz, chairman of the Financial Accounting Standards Board.³¹

Countervailing Pressures Reduce Harmonization

While the confluence of all these factors created a situation in which a rigorous international transparency system rapidly gained momentum, countervailing pressures slowed harmonization. As proposals for new accounting standards became more specific, national interests began to diverge. In 2004–2005, for example, a dispute about how to account for derivative financial instruments erupted into accusations by French bankers and European regulators that international standards lacked accountability and were too oriented toward U.S. disclosure traditions. National regulators, including those representing the EU and the United States, announced that they would review international standards one at a time, reject those that conflicted with national laws, and continue to treat the others as supplementary to national rules.³² In addition, it remained uncertain how much the fact that disclosure rules were based on the immediate needs of current dominant markets would limit the rules' future adaptability to reporting needs in China, Vietnam, and other emerging markets that did not share Anglo-American traditions.

Variable national capacities created additional roadblocks to international standards. Many countries and companies simply lacked the talent and resources to adopt sophisticated new accounting rules. National enforcement authority and practices varied widely even among major industrialized countries. In February 2003, the *Economist* reported that "Europe's systems for ensuring the accuracy of company accounts look full of holes." Auditors faced few restrictions on their non-audit work (creating potential conflicts of interest), and most securities regulators lacked authority to investigate flawed reporting. In six EU countries, the European Federation of Accountants concluded that there was no enforcement of accounting rules at all.³³

U.S. and European regulators as well as international accounting organizations initiated efforts to educate, train, and monitor regulators and accountants in less-advanced countries.³⁴ Still, the variability of national practices continued to pose a challenge to the effectiveness of international standards.

In addition, some disclosing corporations opposed more rigorous financial transparency. Companies with concentrated ownership and limited need for outside capital had little to gain and sometimes much to lose from stricter disclosure. They benefited from keeping information secret from competitors, avoiding litigation, and maintaining tightly controlled systems of corporate governance.³⁵ Smaller stock exchanges, too, might suffer from great uniformity if companies sought greater liquidity by listing on larger exchanges abroad.³⁶

In addition, domestic crises provoked some government actions that raised, rather than lowered, barriers to international capital flows. New rules adopted in the wake of the corporate scandals of 2001–2002, for example, increased requirements associated with listing on U.S. exchanges.

Legitimacy Issues Undermine Transparency Efforts

More important, the effectiveness of international standards was also threatened by continuing doubts about their legitimacy. To be effective, international targeted transparency policies had to be accepted as legitimate by information disclosers, users, and officials of national governments. Could a policy that emerged from a private-sector group gain acceptance as a public mandate? Anne-Marie Slaughter notes that it is problematic for private actors to uphold the public trust, since “corporate and civic actors may be driven by profits and passions, respectively.”³⁷

Initially, international standards followed what Robert Keohane and Joseph Nye have called the “club model” of legitimacy, in which self-appointed experts bargain over public issues. In Keohane’s analysis, this model has become less and less tenable in international governance. He suggests that there are three core elements of legitimacy: *accountability*, *participation*, and *deliberation*. Accountability depends on the adequacy of chains of delegation between international institutions, national governments, and national mechanisms that allow national publics to monitor international institutions. Participation is facilitated by processes such as public agendas and open meetings. Deliberation benefits from the free flow of information and from inclusion of diverse groups and interpretation by objective third parties.³⁸ In Keohane’s view, network-based disclosure systems such as international financial accounting are particularly prone to “democratic deficits,” since their links to accountable democratic processes may be weak or indirect and their procedures for due process and other aspects of administrative fairness may not be well developed.³⁹

When examined through the lens of Keohane’s analysis, the emerging system of international financial accounting illustrates some of the conflicts that must be resolved if an international transparency system is to achieve legitimacy. The reformed IASB remained a private-sector deliberative body that relied on existing national regulators and enforcement mechanisms to carry out disclosure requirements. Decision making was designed to provide insulation from national politics, with a governing board of accounting experts who explicitly did *not* represent national constituencies. The board consisted of twelve members in 2006: three from the United States, two

from the U.K., and one each from Germany, France, Sweden, South Africa, Canada, Australia, and Japan.⁴⁰

The board members, in turn, were selected by an International Accounting Standards Committee Foundation (IASCF), which exercised general oversight. Its nineteen-member self-perpetuating board of trustees was designed to be “representative of the world’s capital markets and a diversity of geographical and professional backgrounds” as well as “financially knowledgeable.” Foundation trustees served three-year terms, with a limit of two terms and with a chair elected by the trustees.⁴¹

In other ways, however, the international accounting system was structured to promote legitimacy. Under 2002 rules, IASB meetings were required to be public. Ten of twelve board members served full-time, and board members were limited to two five-year terms. The board and affiliated organizations employed a professional staff, and their deliberations were supplemented by the International Financial Reporting Interpretations Committee and the geographically diverse Standards Advisory Council. (In 2006, the Standards Advisory Council consisted of four members from North America, fourteen Europeans, two Africans, nine from the Asia-Pacific region, three Latin Americans, and an Israeli, as well as seven representatives of international organizations.)⁴²

Linkages to public and private networks also promoted legitimacy. A network of national securities regulators, the International Organization of Securities Commissions (IOSCO), brought together regulatory agencies from over a hundred countries to cooperate on financial regulation, including accounting oversight, and to support the board as international standard setter.⁴³ The International Federation of Accountants (IFAC), a membership organization of international accountants, led the effort to create international standards and worked to improve domestic and international accounting practices.⁴⁴

Nonetheless, acceptance of international accounting standards by governments, investors, and companies was not assured in 2006. Debates continued concerning “fair-value” versus “historical-cost” accounting, the use of complex rules versus simpler principles, and the dynamics of enforcement. European representatives expressed growing impatience with what they considered to be the Anglo-American tilt of proposed rules, which they argued could increase the volatility of earnings reports and substantially change profit and loss statements. A spokesman for the EU noted, “We are in favour of convergence, but convergence somewhere in the middle of the Atlantic as opposed to somewhere on Staten Island.”⁴⁵

Are International Accounting Standards Effective?

Researchers have begun to examine the impact of international accounting standards. They have found initial evidence that standards are sustainable along the dimensions discussed in detail in Chapter 5. They have confirmed that international accounting standards are more rigorous than many national accounting systems. They require higher-quality disclosure (better measurement, more information, timelier reporting) than national accounting systems outside of the United States and U.K.⁴⁶

Researchers have suggested that comparability of financial information across markets is an important factor in encouraging international investment. A 2003 study by investigators at Harvard and the University of Pennsylvania found that U.S. institutional investors invested more heavily in foreign firms whose financial statements and accounting methods conformed fairly closely to rigorous disclosure rules.⁴⁷ Other inquiries have found that international standards help to reduce information imbalances between companies and investors at least as well as U.S. standards.⁴⁸ Firms that engage in more rigorous disclosure than required in their home country seem to experience lower bid-ask spreads, higher trading volume, and lower share price volatility. (The bid-ask spread is the difference between the price at which market makers will purchase shares – the bid price – and the price at which they will sell – the ask price.)⁴⁹

Lessons to date from the evolving system of international financial accounting suggest that targeted transparency policies may be effective in reducing risks, even if they originate in private networks and outside the recognized bounds of international governance. A small voluntary disclosure system grew into a user-oriented and improving public mandate because it addressed serious information gaps, benefited from the advocacy of groups that represented the needs of dispersed information users, and tapped into the core interests of national regulators and some disclosing companies. But differing national interests, traditions, and capacities may limit harmonization in practice, creating an illusion of international uniformity that masks variable reporting.

IMPROVING A MORIBUND SYSTEM: INTERNATIONAL DISEASE REPORTING

International transparency policies need to improve over time for the same reasons as national policies – because political compromises almost always

produce initial systems that are weak and incomplete, because organizations that stand to lose from greater openness game the system, and because policies must keep pace with changing markets, changing science, and changing public priorities. Continuing improvement is particularly difficult to achieve in international transparency systems since consensus among nations often requires overcoming dominant national interests, as illustrated by the next case – international reporting of infectious diseases.

Disease reporting represented one of the earliest international efforts to employ transparency as a policy tool. Starting in the mid-nineteenth century, nations joined forces to control the spread of infectious disease and reduce resulting interruptions in trade and travel. Transparency in the form of rapid reporting of disease outbreaks was recognized as critical to preventing the spread of deaths and illnesses. Beginning in 1951, the World Health Organization (WHO), an arm of the United Nations governed by a World Health Assembly (now representing 192 member governments),⁵⁰ required governments to disclose cases of specified infectious diseases within set time periods. The organization also mandated specific public health activities at ports and airports, as well as trade and travel restrictions.⁵¹

But by the mid-1990s, this policy was languishing. The reporting system covered only three diseases – plague, cholera, and yellow fever – and had never been updated to deal with devastating new threats, including the spread of AIDS. Also, the WHO's surveillance system relied on reporting by national governments that often ignored even the narrow reporting requirements. As David Fidler of Indiana University notes, "WHO member states routinely violated their . . . obligations to report outbreaks of diseases subject to the Regulations" out of fear of economic repercussions.⁵² Such failures reflected the fact that countries had different incentives to report or withhold information. Reporting failures were tolerated in part because U.S. and European officials turned their attention elsewhere as vaccines and antibiotics minimized common infectious diseases.

In the 1970s and 1980s, however, a resurgence of infectious diseases and the AIDS epidemic reawakened U.S. and European governments' concern about disease spread and highlighted the failings of the WHO system. Finally, in 1995, the World Health Assembly directed the WHO to revise the failed government-centered reporting system, a slow and difficult process.⁵³

Meanwhile, networks of public and private groups began to use the capabilities of information technology and the Internet to put new reporting mechanisms into practice. In 2000, WHO officials joined with other public and private groups to legitimize one of those efforts – the creation of the Global Outbreak Alert and Response Network to pool public and private

sources for rapid identification and confirmation of and response to international outbreaks of disease.⁵⁴

However, it was a public health crisis – the sudden spread of SARS in 2002–2003 – that truly brought disease reporting into the information age. Tragically, the disease spread quickly while information flowed slowly. Starting with a small outbreak in China's Guangdong Province in November 2002, SARS reached thirty countries in six months, killing an estimated 774 people. Thanks to the speed of international travel, it spread to five countries within twenty-four hours from one infected individual in a Hong Kong hotel.⁵⁵

Transparency failures helped promote the spread of the disease. It took four months for the Chinese government to acknowledge the SARS outbreak and for the WHO to respond with a global alert (March 12, 2003),⁵⁶ despite much earlier reporting by ordinary citizens in millions of cell phone and Internet messages and by the private ProMED-mail system.⁵⁷ The lack of timely, accurate information not only contributed to deaths and serious illnesses but also fueled public fears that resulted in huge economic costs, estimated at \$40 billion.⁵⁸

Once the outbreak was confirmed, however, the WHO and public health authorities around the world responded quickly and creatively with new transparency measures. They cobbled together informal networks that enabled them to communicate directly with the public through daily Web updates, satellite broadcasts, and news conferences. Through the nascent Global Response Network, sixty teams of medical personnel moved to control the disease in affected areas while a network of eleven infectious disease laboratories in nine countries worked on causes and diagnosis, linked by a secure Web site and daily conference calls. Within a month, collaborating researchers were able to identify the disease's cause. Even without formal authorization from its members to do so, the WHO recommended against nonessential travel to Hong Kong, Guangdong Province, Beijing, and Toronto, Canada. U.S. and Canadian authorities issued broader warnings against unnecessary travel to China, Singapore, Hanoi, and Hong Kong.⁵⁹

Meanwhile, the Chinese government, much criticized for its initial transparency failures, worked to catch up. China declared a nationwide war on SARS in April 2003, apologized for not informing the public more quickly about the outbreak, pledged accurate and timely reporting in the future, created a public hotline, and replaced the national health minister and Beijing's mayor for their roles in the cover-up. Chinese officials shut down government offices, schools, and universities in affected areas and instituted quarantines to prevent public gatherings and stop travel.⁶⁰

By July 2003, the epidemic was under control. After the fact, WHO members renewed their commitment to revise International Health Regulations, acknowledged the legitimacy of the WHO's impromptu travel advisories, and endorsed the legitimacy of using nongovernmental sources of information for surveillance.⁶¹

A WHO report concluded that the SARS crisis showed how failure to disclose outbreaks could lead to "loss of credibility in the eyes of the international community, escalating negative domestic economic impact, damage to health and economics of neighboring countries, and a very real risk that outbreaks within the country's own territory can spiral out of control."⁶²

On the positive side, the crisis played a central role in improving international transparency to reduce public health risks. The SARS outbreak spurred action by national governments that stood to benefit from timely reporting and demonstrated that attempts to hide information about outbreaks could carry a high price in reputational damage and in the promotion of public fears that cycled out of control in the absence of reliable information. Crisis also mobilized powerful intermediaries such as public health authorities, hospitals, and private information networks, as well as ordinary citizens themselves, to improve both public disclosure and specialized information-sharing networks.

Finally, SARS provided an early demonstration of the power of information technology to transform international transparency systems. Electronic networks of ordinary citizens in China were the first to express concern that a new disease was spreading and suggest that the government was covering up the full extent of public health risks. David Fidler notes that "[i]nformation provided by non-state actors provided the catalyst for WHO and other countries to intensify pressure on the Chinese government."⁶³ In effect, the users of information also became its sources, pooling their fragments of knowledge to map the spread of a deadly disease.

Legitimacy remains a difficult issue for international disease monitoring. Such monitoring traditionally was anchored in a formal agreement among nations, which created more legitimacy than characterized the private efforts to establish international financial accounting standards, for example. But informal practice, driven by immediate crisis, departed from formal agreement terms. As we have seen, WHO officials had to rely on nongovernmental information during the SARS crisis and issue advisories without authorization from its governing World Health Assembly. In response to that crisis, the WHO issued new international health regulations in May 2005, which are scheduled to enter into force in 2007.⁶⁴

Whether and how quickly the WHO and national authorities will integrate new transparency mechanisms into international disease surveillance also remains to be seen. Where resources and talent are scarce and other priorities pressing, as in many developing countries, progress depends not only on political will but also on how much assistance nations with advanced medical capacity are willing to offer.

In addition the evolution of international infectious disease surveillance shows how crisis and the Internet can help to improve the sustainability of targeted transparency. Crisis can tip the political balance in favor of more rigorous disclosure by coalescing the interests of diverse information users around the world. The Internet, in turn, can lower the costs of sharing information, make it easier to customize data, provide instantaneous communication, and empower information users. Whether these opportunities lead to lasting improvements in targeted transparency systems depends on the will and energy of policymakers in each case.

THE LIMITS OF INTERNATIONAL TRANSPARENCY: LABELING GENETICALLY MODIFIED FOODS

International efforts to resolve how and whether to label foods made from genetically modified crops have so far made little progress. With nations' core interests deeply divided, a European labeling regime that remained costly and did not meet consumers' needs, an ingredient-segregation process prone to errors, and no constituency powerful enough to improve the system, this targeted transparency effort remained ineffective in 2006.

Safety and environmental issues concerning genetically modified (GM) foods spread from the United States to Europe and developing countries beginning in the mid-1990s. Initially, GM corn, soy, and other crops provided resistance to pests, pesticides, or herbicides, or provided extra vitamins, proteins, or other nutrients. In the future, GM plants promised drought resistance and immunity to or treatments for specific diseases. However, the creation of new allergens and environmental effects remained a concern.⁶⁵

Primed by earlier food scares that were unrelated to genetic modification, the European public responded to the sudden introduction of GM foods in 1996 and 1997 with fear. The EU regulated genetically modified crops as a novel health and environmental issue. Employing a precautionary principle of approving foods only when scientific evidence proved them safe, the EU required thorough review and risk assessment for each field trial and product introduction. In the United States, by contrast, government officials

decided to approve GM crops on a case-by-case basis, using conventional safety criteria.

In the late 1990s, European Union member states placed a de facto moratorium on importing bulk shipments of products that might contain unapproved GM organisms, and they required labels on packaged foods containing GM corn or soy. The United States rapidly increased production of GM crops.

The European ban proved extremely costly for developing countries, many of whose farmers relied on European markets for their crops. Zambia, Zimbabwe, Mozambique, and Malawi rejected U.S. food aid in 2002 because shipments contained genetically modified corn, despite near-famine conditions. The corn was meant for famine-relief consumption, not planting. But African officials feared that some of it might find its way into farmers' fields and threaten their access to European markets.

In 2004, the EU adopted an exacting system for labeling and tracking GM foods and animal feed. In principle, labeling was not an unreasonable approach to resolving this international puzzle. Europe, the United States, and developing countries shared an interest in promoting efficient food markets, yet the attitudes of their publics and governments toward GM food differed widely. Why not use labeling to promote informed choice without imposing any explicit restrictions on these foods?

In practice, however, differences in nations' fundamental views of whether risks warranted public action and in the economic interests of importing and exporting nations led to a costly stalemate over labeling. Responding to its voters' acceptance of GM crops and its farmers' economic interests in planting them, the United States did not require labeling. In voluntary guidelines, the Food and Drug Administration (FDA) recommended that any labels that companies did employ feature statements that products were (or were not) genetically engineered or were (or were not) made using biotechnology, rather than statements that products were "GM free," since some degree of contamination was unavoidable.⁶⁶ In an unrelated regulatory change, the United States introduced rules to standardize labeling of organic foods, a growing portion of the U.S. food market. Those rules included a requirement that foods labeled organic could not contain genetically modified ingredients.⁶⁷

The high costs of tracking and labeling created an economic disincentive to plant GM crops for farmers who sold to European importers. In effect, labeling prevented many farmers in developing countries from planting such crops, since few had the capacity to segregate crops and maintain an audit trail. Nor did managers of grain elevators, railroad cars, processing facilities, and food manufacturing plants in developing countries have the capacity to



Figure 6.1. European No-GMO Label. Photo by David Weil, June 2005

build separate facilities for conventional and GM grains. Even U.S. officials estimated that crop segregation and tracking requirements to export GM crops to Europe might increase food production costs by 10 to 30 percent.⁶⁸

Labeling was also of questionable value in communicating with a fearful public. There were many different genetic modification processes. Each had different potential environmental and health consequences. Simply labeling foods as genetically modified did not provide consumers with any factual information about variable health or environmental risks of specific GM ingredients. See Figure 6.1 for an example of labels.

In addition, EU officials admitted that creating products with absolutely no GM ingredients was simply infeasible. That meant that consumers who wanted to avoid consumption of genetically modified corn or soy could not do so. In Europe, regulators wrote the rules so that “GM-free” products could contain 0.9 per cent of genetically modified corn or soy.⁶⁹

The European public wanted the facts but did not get them. A careful study of public perceptions about GM crops in five European countries, sponsored by the European Commission and conducted in 1998–2000, found that European consumers were neither categorically supportive of nor opposed to genetic modification. Instead, they wanted to know about

specific risks, benefits, and uncertainties – precisely the kind of detail that labeling did *not* provide. Furthermore, with memories of reassurances about mad cow disease still fresh, Europeans were generally distrustful of any messages from authorities – corporate promises of benefits or government reassurances about safety.⁷⁰ Labeling simply for the presence or absence of genetic modification, therefore, could feed public fears without fostering informed choices.

Legitimacy remained an issue as well. Many of the European Union member countries continued a *de facto* ban on the import of GM grains as of 2006, despite the European Commission's efforts to replace the ban with the new labeling system. Meanwhile, the United States and exporting companies challenged the EU's ban in the World Trade Organization (WTO) as an unauthorized restraint of trade. In February, 2006, the WTO ruled that the ban was not based on scientific evidence, raising questions about whether member states would capitulate, accept fines, or appeal. The WTO issued a final decision on September 29, 2006.⁷¹

Persistent scientific uncertainties meant that polarized debate about the safety and environmental effects of GM crops was likely to continue. In the United States, the National Research Council remained supportive of the benefits of GM crops but also emphasized the importance of assessing each product individually because of potential risks from allergens, contamination of other plants, or damage to insects or animals. Meanwhile, the Research Directorate General of the EU, as well as French and British authorities, acknowledged that no human health or environmental problems have yet been associated with GM crops, but they also cautioned about potential long-term risks. The truth was that a great deal still was not known about the effects of genetic modification of foods.

As of 2006, a transparency system that labeled genetically modified foods seemed unlikely to prove sustainable or effective. The central problems remained disagreements among nations about whether there was a safety problem that called for mandated disclosure and the conflicting economic interests of importing and exporting nations. Tracking and labeling were not yet embedded even in the practices of the member nations of the European Union. There appeared to be little inclination by nations outside Europe to adopt similar rules. At least in its early years, GM labeling failed to improve public safety or market efficiency, its two intended purposes.

These three cases suggest how important it is for designers of international transparency policies to start by asking how people make choices and how new information might inform and improve those choices. International

financial reporting gained strength because it responded to the information needs of investors, analysts, competitors, and disclosing companies. Infectious disease surveillance gained strength because it employed computer power and the Internet to respond to an urgent need for information about the spread of SARS.

However, these cases also suggest that the conditions for effective international transparency are even more demanding than those for effective domestic policies. The most difficult challenge remains that of gaining legitimacy. Only those policies that are authorized by treaties or other formal agreements among governments gain legitimacy easily. International policies with weak or indirect links to democratic processes create a “democratic deficit,” meaning that they lack strong links to democratically accountable decision processes.⁷² Both the small private-sector effort that produced international financial reporting and the ad hoc responses by public health authorities to the SARS crisis raised legitimacy issues that have not yet been fully resolved.

One remedy would be for national governments to reach an informal consensus concerning appropriate participation and accountability measures for international transparency systems. Such a consensus could provide a baseline from which designers of new policies could improvise. Over time, such a consensus might produce increasing convergence concerning due process, equal protection, and other administrative principles.⁷³

Designers of international transparency policies also face special hurdles in embedding requirements in national decision making. Virtually all international transparency policies rely on actions by national governments for implementation, enforcement, maintenance, and repair. Ultimately, their effectiveness depends on mobilizing national rule-making and enforcement authority. Policymakers therefore struggle to establish standardized disclosure rules while tailoring reporting requirements to fit the priorities and traditions of participating nations, with their diverse cultural backgrounds, educational patterns, and social and economic priorities. An understanding of variable national will and capacities, and a commitment to provide capacity-strengthening assistance is therefore central to the success of international transparency systems.

Where national variations persist, effectiveness will depend on making those variations themselves transparent. Pragmatic partial harmonization may be a workable compromise if policymakers create transparency concerning national differences. In the case of international financial reporting, each nation will determine over time what degree of harmonization with international accounting standards makes sense politically and

economically. Those with strong interests in convergence of accounting rules might join in a limited network of countries that commit to high-quality, strictly comparable, rigorously enforced disclosure standards. Others might accept some but not all standards or adopt standards on paper that are not fully put into practice. Individual companies might also find reasons to follow international standards with varying degrees of rigor. Such mixed reporting will not provide full comparability. The more variations are transparent, however, the more investors can still discern relative risks.

Competition among transparency regimes might even provide benefits. It could create incentives for countries to continue to experiment in order to improve their measures, perhaps creating a further “race to the top” among nations and companies vying for the highest standards of transparency.

Our analysis of three international cases suggests that, for the most part, the structure, workings, and effectiveness of international policies parallel those of national policies. That is significant because it means that national and international transparency systems represent variations on a single governance theme. It also means that designers of national and international transparency systems can learn a great deal from one another to the benefit of both.