

## **Introduction**

The global developments discussed at this conference have led to a situation where companies that are rooted in the social values and ethics of western society, often do not require the same social standards to be followed at the remote end of their operations, namely in the developing world. While pursuing the main goal of business - high profit - they do not respect the values they are based upon domestically.

This situation has become unsustainable. Consumers as well as governments and non-governmental organizations have started to criticize this behavior as they have learnt about it from media. The public has clearly expressed its concerns about breaching the accepted social rules, although in a distant country, where social ethics may be however substantially different. This has created a new pressure on the business community. Suddenly, companies were expected to ensure respect for their social values also within the international supply chain in order to satisfy consumers' and the society's expectations. In other words they were asked, even though they had no formal legal responsibility to do so[1], to act as international regulators and in this function replace states that have no available legal means to internationally enforce social and environmental concerns.

First, this paper examines the voluntary (ethical) v. mandatory (legal) basis of corporate social responsibility (CSR). Second, it examines the relationship between CSR, law and business ethics. Third, it tries to answer the question if there is a need for a hard[2] legal regulation of CSR within international supply relationships or if ethical norms, e.g. expressed in the form of self-regulation, may better serve the purpose. And finally, it suggests possible ways for the future development of suitable regulatory methods for enhancing social standards within international supply chains. The questions are approached solely from the perspectives of legal theory and socio-legal analysis.

### **Voluntary v. mandatory character of CSR**

The corporate social responsibility is usually characterized as a set of voluntary measures of companies under which they accept the effects that their behavior has on the environment and society. This approach, however, has been stated to be inaccurate and even deceptive[3]. The discussion whether CSR is of voluntary or mandatory character has

divided both the public and the academia[4]. Advocates of voluntary based CSR claim that a descriptive regulation would hinder the wide stakeholder dialogue as a base for this concept and would erase innovation forced by the competition within this area. On the other hand, mandatory based CSR is supported by those claiming that competition and business driven CSR is not sufficient and does not ensure an adequate protection to the relevant social values[5]. They are concerned that the voluntary approach would allow the business community to dictate CSR standards instead of responding to stakeholders' needs. In order to take a position in the discussion over the binding power of CSR, it is necessary to delimitate what the term covers.

It is often suggested, that CSR includes only behavior beyond the law. If this is the truth then the voluntary v. mandatory discussion is pointless, since every activity would be either a mandatory legal obligation (law) or a voluntary action (CSR). Hence the question would not be whether CSR is voluntary or mandatory, but rather what issues are so crucial that they should be excluded from the CSR concept and regulated by law[6]. This position would make it even more difficult to speak about CSR on the international level, since the scope of CSR would differ in each jurisdiction.

The approach that CSR covers only non-legal activities is certainly not a general standpoint. The summary of the EU Green paper on corporate social responsibility, for example, states: *"Being socially responsible means **not only fulfilling the applicable legal obligations, but also going beyond compliance ...**"*[7]. Another example may be found in companies' codes of conduct where legal compliance is usually in the first place among the CSR requirements. Based on these and other similar examples, it may be argued that the CSR concept includes not only behavior beyond the law but also the relevant legal obligations, primarily within the area of labor and environmental law. In such case, the CSR activities are of a mixed character, partly voluntary and partly mandatory. This drives me to the conclusion that law and CSR are interconnected[8] and cannot be separated; in other words, the law influences voluntary CSR initiatives and vice versa[9]. CSR is founded in both legal (mandatory) and ethical (voluntary) rules.

But this is not the only argument to claim that the discussion over the voluntary v. mandatory character of CSR is unnecessary and incorrect. The discussion further overlooks the fact that except for direct legal liability, the obligation to socially responsible

behavior is often derived from indirect legal obligations and economic and social drivers which lead companies to act against their primary short-term objective, i.e. striving for the highest possible profit[10]. An example of an indirect legal regulation is an obligation of selected type of companies to report on their CSR activities in certain jurisdictions[11] and the threat of listing their name in a list of poor performers[12]. The economic drivers include for example conditioned export credit guarantees[13] by compliance with social and/or environmental standards[14], the development of the socially responsible investment strategy, or the increasing number of institutional investors claiming CSR in target companies. The social drivers are primarily represented by the pressure of consumers, NGOs, media and national governments, who themselves, unable and/or unwilling to interfere, use their power to at least influence corporate behavior.

Given the partly legally based and partly economically and socially driven nature of CSR, companies are in fact forced to adopt environmentally and socially oriented procedures into their operation. Thus, it seems rather illusory to speak about CSR as a merely voluntary concept.

### **Relation between CSR, law[15] and ethics**

As it was argued above, law is an inherent part of CSR. CSR and its regulation emerge from ethical norms of society[16] and a common understanding of morality[17]. As the theory of integrative social contract[18] asserts, consent without coercion is the determining factor to claim that a norm or a value is universal. But is it possible to delimitate the content of a common morality in the contemporary international society? Globalization, on the one hand, enables frequent and intensive international business interaction. On the other hand, the new pluralistic society faces uncertainty regarding the consensus over the fundamental business related ethical norms[19]. The cultural and geographical variety of the globalized society makes it difficult, if not impossible, to agree on the common underlying moral values. The conflicting and constantly changing social values in pluralistic society thus hinder development of an operational definition of the CSR concept[20]. The ethical ambiguity may be overruled by means of positive law[21]. But here a question arises, i.e. if using law to delimit ethics is the right way to go. And is it possible to develop a universally

applicable and observed legal regulation of CSR without agreement on the underlying values?

To summarize this part, CSR, law and ethics are tightly interrelated. Even though ethical and legal norms are not the same, these two normative systems are inseparable in the CSR area. Ethics serve as a source of law, especially in “soft” fields as CSR, and as a ground for its legality and normative force[22]. There is no clear distinction between law and ethics within the CSR concept and its regulation. The ethical foundation is called upon constantly and referred to by all kinds of legal regulations. The legal regulation has mostly form of a soft law instrument; there is almost no hard regulation of sustainability concerns within supply chains[23]. The state is not relied upon in case of breach, sanctions are based in the ethical values of society and take usually form of a public damnation. From these facts it can be concluded that CSR regulation behaves as an informal law[24]. But does this situation, which is mixing ethical and legal norms, ensure efficient safeguarding of social concerns?

### **Effectiveness of legal and ethical normative systems in regulating CSR among supply chains**

Although CSR is to a certain extent governed by law and, as argued before, is further enforced by non-legal measures of governments, society and investors, some claim that it is not sufficient. Several NGOs have called for stricter legal regulation and enforcement of CSR activities within international supply chains. But more regulation can be justified only if it actually brings wider observance and protection of social standards.

There are several arguments for leaving the area of CSR to be governed solely by business ethics. The already mentioned promotion of innovation and competition is one of them. However, as practice shows, ethics have failed to ensure that businesses will live up to their moral undertakings, especially in host states[25]. The reason may be sought in the vagueness of ethical rules[26] without possibility to gain an authoritative interpretation and without institutionalized ways of their enforcement. Even though legal rules may be formulated imprecisely, there is always higher certainty regarding their content and possibility to eventually ask a court or another competent body to give an authoritative

interpretation. Given the failure of ethical rules, the morality argument underlying the CSR concept that the benefits of globalization are not fairly distributed among society, in other words that the western society benefits to the prejudice of the developing countries[27], now becomes a ground for legal regulation of the responsibility of businesses for the cross-border effects of their environmental and social performance. Further, the vagueness of ethical rules may cause companies to be reluctant in going beyond legal requirements[28], because they may fear the litigious risks of their CSR statements[29].

Another argument for enacting CSR obligations is the claim that positive law has transformed into the ethical standard of the contemporary society[30]. It is difficult to support this view in general, but easier to agree that this claim may be valid in relation to the business community. It is the nature of business existence to strive for profit in the framework given by the legal order. Any action going beyond legal requirements is usually costly and as such must be justified to the shareholders of a company. In case that such an action does not bring profit, e.g. as a good name or competitive advantage, it is not natural for a business to perform it. The positive law thus serves as the ethical ceiling of business operations. In such a situation, institutionalization of the obligation by law supplements the motivational force of the underlying moral norm[31] and serves as an explanation to the shareholders.

The third argument states that the legal form of obligation supports acceptance of its underlying value. Although this may be true, it does not ensure wider observance of the rule. On the opposite, as it was noted by some academics[32], highly regulated areas often experience high levels of infringement[33]. In this relation the threat of creative compliance in connection with CSR regulation should be mentioned[34]. Companies search ways of circumventing the objective of a certain law, without technically breaching it. It is thus important to foster compliance in line with the spirit of the laws instead of the mere letter of law.

The failure of ethical norms in effective regulation of CSR, the positive law being the ceiling of business ethics rather than the floor, and the wider acceptance of moral value when enacted may, even though with the mentioned reservations, speak for legal regulation of the corporate responsibility.

To the contrary, the danger of over-regulation supports the thought of minimal governmental regulatory intervention expressed in libertarian legal theory[35]. The tendency to regulate all aspects of companies' behavior goes hand in hand with the transformation of positive law into the "ethical ceiling" of business[36]. The endeavor to govern all business activities by specific rules raises the possibility of creative compliance. Possibility of circumvention may be decreased by enacting principle-based regulation[37]. But rules based on principles do not constitute an optimal solution either, especially when being criticized for legal uncertainty and for offering too broad a space for interpretation.

A shift in the attention from the underlying moral objective to the process of how to achieve it may be another argument against broad legislation within CSR[38]. An example can be found in reporting obligations. Companies seem to concentrate more on the procedure of reporting than on the subject of it.

On the one hand, the practice has shown that a merely ethical normative system is not able to secure business compliance with social and ethical standards, especially in foreign countries. On the other hand, broad legal regulation does not seem to solve the situation either. Therefore, there is a need to develop new regulatory forms and their combinations that will establish a balance between the ethical and the legal foundation of CSR.

### **Outline for future use and development of suitable regulation**

Experiencing the failure of ethical rules proved that a legal regulation is to a certain level necessary. But threats connected with overregulation and preclusion of innovation by strict limits given to the business behavior lead to a development of new regulatory techniques in the area of CSR. Regulation is understood in a broader sense than as a prescriptive hard law. The following definition used by Zerk seems appropriate: "*regulation...encompasses any form of social control or influence, regardless of its source...*"[39]. Regulatory techniques vary from hard legal regulation of "command and control" nature on one side of the spectrum, through soft-law and economic and legislative incentives, such as guidelines of international organizations, model regulations or tax reliefs, in the middle, to diverse means of self-regulation, in the form of codes of conduct and contract regulation, on the

other side of the spectrum. Further, under the broad understanding of regulation the notion of law has undergone a substantial shift. It is difficult to classify regulatory types that are mutually overlapping without having distinctive borders. A soft-law may have effects of a hard-law if enforced by a court or if compliance is demanded by a state-made legal regulation[40]. Also, state-made legal regulation can become looser and principle-based, so its hard legal effects are limited. Thus the borders of law are unclear and subject to continuous change. Although all regulatory forms are having partly useful effects in international matters, the problem resides in uncertainty about their mutual relation, lack of international obligatory force, and thus difficulties with their cross-border enforcement.

Academic literature has touched upon this issue and offered some solutions. The often suggested model is a wider use of so-called meta-regulation. The objective of meta-regulation in the CSR area is forming corporate conscience; to motivate companies to do what they ought to do under ethical rules[41]. Meta-regulation is therefore not a direct regulatory means; it rather motivates than prescribes responsible corporate behavior. The motivation usually takes the form of a financial or market-based incentive. The US Foreign Corrupt Practice Act may serve as an example; assuring lower fines when a corruption practice is found in a company that has a code of conduct and anti-corruption procedures in place. But also this approach is criticized for possible misunderstanding between regulators and regulated persons about the objective of such a norm, and for its concentration on procedures rather than the substance of social concerns.

However, we may find positives and negatives in each regulatory form. What seems more important now is the ability of a norm to actually influence corporate behavior. The observance ratio is usually higher, if the regulated subjects' values identify with the underlying moral imperative of the norm. The identification is then higher if the regulated subjects take part in the norm's creation. This leads us to the possible application of the theory of discourse ethics as developed by Jürgen Habermas to the rule-making process[42]. The drawbacks of the application of discourse ethics in the area of CSR lie in the power imbalance between the stakeholders and the lack of procedural rules for conducting a discourse among them[43].

Given that there is currently no global understanding of substantive content of the CSR concept, there is a plurality in regulatory techniques on global, local as well as corporate



levels, and given that externally imposed obligations do not support wider adoption of the social responsible behavior among businesses, a solution may be sought in developing hard law procedural norms on conducting discourse among stakeholders which would allow adopting specified legal or extra-legal norms on global (e.g. global private initiatives), local (e.g. national laws) and corporate level (e.g. codes of conduct or business contracts). This idea needs to be examined and tested by future research.

## **Conclusion**

From the previous discussion it is obvious that the question is not whether the regulation of CSR so far is binding or not, but rather what type of regulation can best influence the actual behavior of companies within their supply chains.

Neither ethical rules nor hard legal rules seem to be satisfactory when being the only regulatory force. Thus, new types of regulation and their combination must be discovered and tested.

A solution to the problem of low compliance and problems with enforcement of CSR rules in cross-border relationships may be found by developing regulation while using the process described in the theory of discourse ethics. However, given frequent power imbalances, strict procedural rules would be needed to ensure contemplated effects. Further, the differences in perception of social ethics based on a geographic location make it necessary to conduct discourse separately on the global, local and corporate levels, in order to ensure that the differences will be reflected in the final substantive rules.

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[1] Buhmann, *Corporate Governance: The International Journal of Effective Board Performance* 2006, p. 190.

[2] For the purpose of this paper, the definition of hard law introduced by Abbott and Snidal is adopted. Under this definition “hard” law “refers to legally binding obligations that are precise (or can be made precise through adjudication or the issuance of detailed



*regulations) and that delegate authority for interpreting and implementing the law.*"Abbott og Snidal, *International Organization* 2000, p. 421.. For further discussion on definition of hard and soft law and their relation see Shaffer og Pollack, *Minnesota Law Review* 2010, p. 706-799..

[3]McBarnet, Doreen, "Corporate Social Responsibility Beyond Law, Through Law, for Law" in McBarnet; Voiculescu ogCampbell, *The new corporate accountability: Corporate social responsibility and the law*, p. 585., Ward, *Legal Issues in Corporate Citizenship*, , Sobczak, *Business Ethics Quarterly* 2006, p. 168.

[4] Zerk, *Multinationals and corporate social responsibility: limitations and opportunities in international law*, p. 32 et seq.

[5] The advocates of mandatory approach to CSR are led by NGOs and other human rights and environmental groups and trade unions. For example in UK these subjects have joined in the Corporate Responsibility (CORE) Coalition, fighting for changes in law and judicial practice to enhance higher responsibility of UK business for their activities abroad. For further information about CORE see <http://corporate-responsibility.org/>. Some of their proposals on changes in law may be found in Watson, 18 June 2007,. The governmental interference into regulation of CSR within supply chains was supported also by UN Special Representative for Business and Human Rights, John Ruggie, see Ruggie,.

[6] Monaghan, *Accountability Quarterly* 2003, p. 1.

[7] Green Paper - Promoting a European framework for Corporate Social Responsibility, COM(2001) 366 - Summary, available at [http://europa.eu/legislation\\_summaries/employment\\_and\\_social\\_policy/employment\\_rights\\_and\\_work\\_organisation/n26039\\_en.htm](http://europa.eu/legislation_summaries/employment_and_social_policy/employment_rights_and_work_organisation/n26039_en.htm); highlighting added

[8] Zerk, *Multinationals and corporate social responsibility: limitations and opportunities in international law*, p. 35.

[9] Ward, *Legal Issues in Corporate Citizenship*, p. 5.

[10] McBarnet, Doreen, "Corporate Social Responsibility Beyond Law, Through Law, for Law", p. 4, in McBarnet; Voiculescu ogCampbell, *The new corporate accountability: Corporate social responsibility and the law*, p. 585.; It must be stated that acting in socially responsible way leads arguably to long-term and more sustainable profits.

[11] E.g. France and Denmark.

[12] E.G. UK Environmental Agency.

[13] Financial guarantee provided by a government or a financial institution enabling companies to export goods and services in situations where payment for them may be delayed or subject to risk.

[14] Applicable e.g. in the Netherlands and Sweden.

[15] Wherever the term "law" or "legal" is used in this section, it refers to hard law or hard legal regulation. When other types of legal regulation are used, the terms are specified: "soft law", "self-regulation" etc.

[16] Ruud og Ruud, *Proceedings of the Business, Society & Government Consortium of the Midwest Business Administration Association* 2010, p. 52.

[17] Frederiksen, J, *Bus, Ethics* 2010, p. 369.

[18] Integrative Social Contracts Theory is a theory of business ethics developed by Thomas Donaldson and Thomas Dunfee. It is based on the theory of social contract of political philosophers including Thomas Hobbes, John Locke, Jean-Jacques Rousseau and John Rawls. The Integrative Social Contracts Theory provides a framework under which business decisions are made with respect to their effects on the relevant communities and taking into account the ethical norms and universal moral standards.

[19] Gilbert og Rasche, *Business Ethics Quarterly* 2007, p. 190. Human Rights Council, *Clarifying the Concepts of "Sphere of influence" and "Complicity"*.

[20] Ruud og Ruud, *Proceedings of the Business, Society & Government Consortium of the Midwest Business Administration Association* 2010, p. 52.

[21] Fisher, *J, Bus, Ethics* 2000, p. 115.

[22] McCarty, *J, Bus, Ethics* 1988, p. 886.

[23] California Transparency in Supply Chains Act coming into effect on January 1, 2012 is one of the few.

[http://info.sen.ca.gov/pub/09-10/bill/sen/sb\\_0651-0700/sb\\_657\\_bill\\_20100930\\_chaptered.html](http://info.sen.ca.gov/pub/09-10/bill/sen/sb_0651-0700/sb_657_bill_20100930_chaptered.html)

[24] Buhmann, *Corporate Governance: The International Journal of Effective Board Performance* 2006, p. 190.. "Informal law is a set of normative ideas and patterns of behavior and action that are not based on sharp distinction between law and morals, or between law and fact. It is not formulated by a central, state or national authority. ...Its sanctions are of a moral or practical character."

[25] Constantly growing number of companies named in relation to insufficient protection of their employees and environment is a proof of that. For some examples see e.g.

<http://www.laborrights.org/creating-a-sweatfree-world/sweatshops/resources/12211>.

[26] Michael, *Corporate Social Responsibility Initiative Working Paper No. 19. Cambridge MA: John F. Kennedy School of Government, Harvard University.* 2006, p. 24.

[27] Zerk, *Multinationals and corporate social responsibility: limitations and opportunities in international law*, p. 46, 47.

[28] Monaghan, *Accountability Quarterly* 2003, p. 8.

[29] Example of litigation based on CSR statements is US case Nike v. Kasky.

[30] Fisher, *J, Bus, Ethics* 2000, p. 115-127.. Di Lorenzo, *J, Bus, Ethics* 2007, p. 275-299..

[31] Apel, *American Journal of Economics & Sociology* 2007, p. 54.

[32] Stuntz, *Harvard Law Review* 2003, p. 1701-1747.. "One might suppose that where law is largely absent, behavior is pretty bad. Yet it turns out to be nearly the other way around. The two areas where law is arguably the *largest* presence in ordinary life - driving cars and paying taxes - are probably the two areas where there is the largest amount of self-conscious cheating."

[33] This concern shall be related and considered in the area of CSR reporting.

[34] McBarnet, *After Enron, Corporate Governance, Creative compliance and the uses of Corporate Social Responsibility*, 2005.

[35] Represented e.g. by Friedrich Hayek.

[36] Fisher, *Bus, Horiz*, 1990, p. 30.

[37] McBarnet, Doreen, "Corporate Social Responsibility Beyond Law, Through Law, for Law" in McBarnet; Voiculescu ogCampbell, *The new corporate accountability: Corporate social responsibility and the law*, p. 585.

[38] Michael, *Corporate Social Responsibility Initiative Working Parer No. 19. Cambridge MA: John F. Kennedy School of Government, Harvard University*. 2006, p. 12.

[39] Zerk, *Multinationals and corporate social responsibility: limitations and opportunities in international law*, p. 42.

[40] An example may be found in the section 1 of the Danish Marketing Practices Act. "Section 1. Traders subject to this Act shall exercise good marketing practice with reference to consumers, other traders and public interests." If non-complying, companies risk the possibility to be fined.

[41] Parker, Christine, "Meta-Regulation: Legal Accountability for Corporate Social Responsibility?", in McBarnet; Voiculescu ogCampbell, *The new corporate accountability:*

Corporate social responsibility and the law, p. 585..

[42] Gilbert og Rasche, *Business Ethics Quarterly* 2007, p. 187-216.; Apel, *American Journal of Economics & Sociology* 2007, p. 49-70.; Unerman og Bennett, *Accounting, Organizations & Society* 2004, p. 685-707.

[43] Gilbert og Rasche, *Business Ethics Quarterly* 2007, p. 202.