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# BATTLING CORRUPTION WITHIN A CORPORATE SOCIAL RESPONSIBILITY STRATEGY

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*"If anyone travels on a road in search of knowledge, Allah will cause him to travel on one of the roads of Paradise." — The Prophet Mohammad Ibn 'Abdullah (570–632)<sup>2</sup>*

*"Knowledge is a treasure, but practice is the key to it." — Ibn Khaldoun, Al-Moqaddima, Scholar and Statesman (1332–1406)<sup>3</sup>*

## I. INTRODUCTION

Bribes<sup>4</sup> and kickbacks<sup>5</sup> are common in international commerce and trade.<sup>6</sup> Corruption remains taboo even though it is widely known that

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2. SAHIH BUKHARI, KNOWLEDGE, no. 356, 311, Vol. 1, bk. 3, *translated in* Univ. So. Calif., Center for Muslim-Jewish Engagement, <http://www.usc.edu/schools/college/crcc/engagement/resources/texts/muslim/hadith/abudawud/025.sat.html>.

3. AL-MUQADDIMAH IBN KHALDOUN, [THE INTRODUCTION OR PROLEGOMENON] 21 (Dar AlShaab: 1959, Arabic Source). Ibn Khaldoun was a lawyer, sociologist, economist, and Muslim jurist. He wrote his masterpiece, “Muqaddimah or Prolegomenon,” in 1377 A.D. It is the first of seven volumes of “Kitab AL-‘Ibar.” See IBN KHALDOUN, THE MUQADDIMAH: AN INTRODUCTION TO HISTORY (N. J. Dawood ed., Franz Rosenthal trans., Princeton Univ. Press 1958) for an English translation.

4. “To promise, give or offer something, often illegally, . . . to procure services or to gain influence.” Definition of “bribe,” COLLINS LANGUAGE, <http://www.collinslanguage.com> (search “bribe” under the “English” tab).

5. “[P]art of an income paid to a person in return for an opportunity to make a profit, often by some illegal arrangement.” Definition of “kickback,” COLLINS LANGUAGE, <http://www.collinslanguage.com> (search “kickback” under the “English” tab).

6. SEC. AND EXCHANGE COMM’N COMM. ON BANKING AND URBAN AFFAIRS, REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES (1976), [hereinafter SEC. AND EXCHANGE COMM’N], *cited in*

corporations often resort to such practices when dealing with those in the public sector, be they national or foreign public officials.<sup>7</sup> In the mid-1970s, the United States Securities and Exchange Commission (SEC) found that illegal payments to foreign public officials and politicians were widespread in the United States corporate sector.<sup>8</sup> This discovery led to national legal reform and the enactment of the United States Foreign Corrupt Practices Act of 1977 (FCPA).<sup>9</sup>

However, it was not until the mid-1990s that the international community responded to the persistent calls from various organizations to implement regional and international conventions.<sup>10</sup> Undoubtedly, the United States played a fundamental role in lobbying for a global response to what it saw as a universal problem that seriously affected legitimate competitiveness in international business.<sup>11</sup>

Various institutions, including the World Bank, generated further impetus for international measures and drew attention to the economic and social impact of corruption.<sup>12</sup> They especially highlighted the close link between corruption, development, and poverty.<sup>13</sup> These developments stimulated the adoption and ratification of a series of regional and international anti-corruption agreements from the mid-1990s to the early part of this century.<sup>14</sup> Today, companies with substantial economic strength, guided by profit maximization and investor obligations, have the potential to drive a state's agenda and policies, including investigation and enforcement of corrupt practices. In this regard, "corporations must see themselves as having social responsibilities to enable meaningful progress

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INDIRA CARR & OPI OUTHWAITE, *Investigating the Impact of Anti-Corruption Strategies on International Business: An Interim Report*, Univ. of Surrey, May 27, 2009, n.5, available at <http://www.surrey.ac.uk/law/pdf/Corruption/Interim%20Report%20FINAL.pdf>.

7. SEC. AND EXCHANGE COMM'N, *supra* note 6.

8. *Id.* at 12.

9. CARR & OUTHWAITE, *supra* note 6, at 4. One of the most vital reasons for the enactment of the bribery prohibitions, according to the Foreign Corrupt Practices Act (FCPA) House Report signed on December 19, 1977, by President Carter, was that more than 400 corporations had admitted making illegal or questionable payments as of October of 1977. These companies, including some of the largest and most widely held public corporations in the United States, disclosed corporate payments in excess of \$300 million to foreign government officials, politicians, and political parties. In this regard, the legislative history reflects that a primary concern of Congress was the damage that such payments have caused to American relations with foreign nations in critical areas of the world. See WALLACE L. TIMMENY & ROBERT B. VONMEHREN, PRACTICING LAW INSTITUTE, FOREIGN CORRUPT PRACTICES ACT: THREE YEARS AFTER PASSAGE 13-27 (1981).

10. CARR & OUTHWAITE, *supra* note 6, at 4.

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

towards fighting corruption.”<sup>15</sup>

Recently, companies have distanced themselves from images of profit-centeredness and exploitation by embracing socially responsible behavior.<sup>16</sup> This behavior embodies what is often referred to as corporate social responsibility (CSR).<sup>17</sup> By adopting specific codes of conduct, many companies have begun to promote integrity, transparency, and benevolent corporate citizenship both internally and externally.<sup>18</sup> “Much of this change in corporate attitude seems to have been triggered by civil society.”<sup>19</sup> For instance, environmental activists, non-governmental organizations (NGOs), and the media have widely publicized the illegal logging and deforestation activities of multi-national corporations.<sup>20</sup> “Increasingly, civil society sees itself as a major player in raising local and global awareness of social issues and as having the capacity to influence the behaviour of state and non-state actors.”<sup>21</sup> CSR status is reinforced by the greater presence of public stakeholders at corporate meetings and negotiations within international institutions.<sup>22</sup>

Since the second half of the twentieth century, CSR discussions have grown. The corporate and academic worlds use various terms and expressions to describe CSR, including “society and business,” “public policy and business,” “social matters management,” “stakeholder management,” and “corporate accountability.”<sup>23</sup> Essentially, CSR represents both a legal and social instrument that can remedy the ills of

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15. *Id.* at 5. In other words, it is vital to ensure that companies recognize the responsibilities they owe to local communities and society at large and that they behave in a liable manner that takes into consideration the role played by the private sector in social issues, environmental protection, and the eradication of poverty.

16. *Id.*

17. *Id.* See also ROGER CROWE, ET. AL, *DEVELOPING VALUE: THE BUSINESS CASE FOR SUSTAINABILITY IN EMERGING MARKETS*, (2002) available at <http://www.sustainability.com/library/developing-value>. CSR is a relatively recent term used to refer to the general obligation and duties of businesses to participate in creating wealth, to obey formal and informal laws of society, and to enhance the welfare and the improvement of society. Within a global and free trade environment, governments and business understand that their respective competitive positions and access to capital – especially within a capitalist-based and free market economy – increasingly depend on public perception that they respect the highest global and international standards.

18. CARR & OUTHWAITE, *supra* note 6, at 5.

19. *Id.*

20. *Id.*

21. *Id.*

22. See generally *Principle Ten*, UNITED NATIONS GLOBAL COMPACT, <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle10.html> (last visited Feb. 1, 2011).

23. H.R. BOWEN, *SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN* 51–71 (1953). One of humankind’s greatest challenges this century will be to ensure sustainable and balanced development. This can be realized only if there is respect for the natural systems and the international standards and norms protecting core societal values.

globalization that handicap sustainable development.<sup>24</sup> CSR can also be viewed as an interlocutory term that concentrates on various fields of private and commercial business to create a positive impact on the society in which a business operates. This framework may include human rights law, labor law, environmental law, and other fields. However, from a moral or ethical perspective, anti-corruption and anti-bribery issues have received considerably less attention than those of environmental protection, human rights, or labor rights. This is perplexing since corruption has harmful effects on the living conditions of all individuals.<sup>25</sup>

Many see corruption as a problem pertaining exclusively to white-collar workers and administrative and government officials.<sup>26</sup> This is an inaccurate perception. Like labor, human, and environmental rights, corruption mitigation represents a critical aspect in advancing the CSR field. To stimulate comprehensive change in CSR, not only must officials set goals and make improvements in the areas of labor, environmental, and human rights, but they must also work toward removing corruption, bribery, and unethical behavior from corporate culture.

Corruption is a crosscutting and devastating phenomenon, be it political, social, economic, or cultural.<sup>27</sup> Several corporations have argued that accountability and transparency reduce corruption, with administrative

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24. Kristina K. Herrmann, *Corporate Social Responsibility and Sustainable Development: The European Union Initiative as a Case Study*, 11 IND. J. GLOB. LEGAL STUD. 205, 205 (2004).

25. However, this is rapidly changing, especially recently, due to a realization of the devastating and dangerous effects of corruption on societies in general. In the past, mostly legal scholars and political scientists addressed corruption concentrating only on political, administrative, and government corruption through extortion and bribery. Only in the last fifteen years, economists have realized and started to provide evidence of the detrimental effects of corruption in monetary, economic, and business terms when dealing with business and commercial transactions on national and global levels.

26. In contrast, because of the direct impact human rights, labor rights, and environmental rights have on our everyday lives, CSR advocates have prioritized the advancement of such rights in general. Anti-corruption standards should be considered "enabling standards," without which CSR is unattainable.

27. Corruption stunts growth, distorts economies, and corrodes the social structure. It undermines society and development. Poor and developing countries are hardest hit. It is possible to combat corruption and reduce its negative impact only if political will is credible enough to attract a genuine support of civil society, all government stakeholders, and the private sector in order to attack both passive and active corruption. See Michael Johnston & Sahr Kpundeh, *Building a Clean Machine: Anti-Corruption Coalitions and Sustainable Reform* (World Bank, Policy Research Working Paper No. 3466, 2004), available at [http://www.wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2005/02/01/00009486\\_20050201162214/Rendered/PDF/wps3466.pdf](http://www.wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2005/02/01/00009486_20050201162214/Rendered/PDF/wps3466.pdf). See also Sahr Kpundeh, *Political Will in Fighting Corruption*, in CORRUPTION AND INTEGRITY IMPROVEMENT INITIATIVES IN DEVELOPING COUNTRIES (United Nations Development Program, 1998) [hereinafter Kpundeh, *Political Will*], available at <http://mirror.undp.org/magnet/Docs/efa/corruption/Chapter06.pdf>.

integrity being crucial to achieving better governance. Yet while the world realizes the importance of eliminating corruption, the problem of how to curb this phenomenon persists.

Corporate bodies and NGOs must organize and design procedures to reduce the opportunity for corruption and create incentives for public integrity.<sup>28</sup> Corporate collaboration with states, NGOs, and civil society provides an effective means of creating a visible, legitimate reform movement that allows all interested people to learn from each other.<sup>29</sup> Thus, it is vital for corporate organizations to build coalitions to counteract corruption.<sup>30</sup> Accordingly, with the globalization and international expansion of trade, corporations should pay increasing attention to their ethical values and social responsibilities. To achieve these targets, corporations have utilized various tools.<sup>31</sup>

The following analysis falls into three sections. Having established the conceptual and ethical groundwork in Part One, Part Two contains an analysis of CSR principles. Part Three examines the role of CSR in battling unethical behavior, especially corruption, through anti-corruption policies and other measures for combating this phenomenon with particular emphasis on the 2003 United Nations (U.N.) Convention against Corruption. To clarify the analysis, this Note focuses on the following two sets of inquiries: First, are corporations cognizant of the relevant anti-corruption conventions and soft-law instruments? How do they perceive these measures? What impact, if any, have these conventions had on companies? Have corporations adjusted or changed their behavior as a result? Second, have corporations voluntarily adopted codes of conduct or other internal measures that promote CSR? Do these measures include a commitment to confronting bribery or corrupt behavior internally and on the part of their agents and those in their supply chain? Is CSR a useful and effective tool in tackling corruption generally? If so, to what extent? This Note concludes in Part Four by arguing that CSR should be a priority among practitioners in fighting unethical corporate behavior.

## II. CSR PRINCIPLES AND FOUNDATIONS IN THE ECONOMIC

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28. See Johnston & Kpundeh, *supra* note 27. Cooperation among civil society, the private sector, and the government to institutionalize the attack on corruption will yield good governance; Vito Tanzi, *Corruption Around the World: Causes, Consequences, Scope, and Cures* 5 (Int'l Monetary Fund, Working Paper No. 98/63, 1998).

29. Edward G. Hoseah, *Plenary 3: Measures to Combat Corruption at the Local, National and International Level* (2001), available at <http://www.isrc.org/Papers/Hoseah.pdf>.

30. *Id.*

31. See generally Charlotte Durrant, What Are the Advantages and Disadvantages of Codes of Conduct in Regulating Moral Behavior in Business? (2008) (unpublished student paper, 2008 Institute of Business Ethics essay competition postgraduate category winner) (on file with author).

## GLOBALIZATION ERA

The growth and development of international trade and commercial business transactions reflects greater economic integration under the umbrella of globalization. Consequently, CSR has come to the forefront of corporate concerns.<sup>32</sup>

The International Organization for Standardization (ISO) defines social responsibility as the “responsibility of an organization for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that contributes to sustainable development, including health and the welfare of society; takes into account the expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the organization.”<sup>33</sup> The European Union (EU) conceptualizes CSR broadly. The EU model is described as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.”<sup>34</sup>

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32. Herrmann, *supra* note 24, at 206. See also Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 731 (2002).

33. *Guidance on Social Responsibility, Resolution 3*, (Int'l Org. for Standardization, Working Group on Social Responsibility, ISO/WD 26000, 2007). In 2003, the OECD defined CSR as the liability of businesses to develop societies in which they operate, promise investment opportunities, provide jobs and produce goods and services that consumers want to buy, and the obligation of businesses to respect the laws and regulations in the society where they exist. See also ANDREW KAKABADSE & NADA KAKABADSE, EDS., *CSR IN PRACTICE: DELVING DEEP 7* (2007). Also, CSR is known by a variety of other names including, “corporate accountability,” “corporate citizenship,” “corporate ethics,” “responsible entrepreneurship,” and “triple bottom line.” Likewise, there is a view toward referring to it as “corporate sustainability” or “responsible competitiveness,” especially as CSR becomes increasingly integrated into modern business practices. See also Jacqueline Cramer, *From Financial to Sustainable Profit*, 9 CORP. SOC. RESP. & ENVTL. MGMT. 99, 102, 106 (2002).

34. 35 *Commission Green Paper on Promoting a European Framework for Corporate Social Responsibility*, at 6, COM (2001) 366 final (July 18, 2001). See also Adam Lindgreen et al., *Corporate Social Responsibility Within the Organization*, 12 CORP. REPUTATION R. 83 (2009). In 2003, Novethic defined CSR as follows: “Linked to the application by corporations of the sustainable development principle, the concept of CSR integrates three dimensions: an economic dimension (efficiency, profitability); a social dimension (social responsibility) and an environmental dimension (environmental responsibility). To respect these principles, corporations must pay more attention to all the stakeholders [...] which inform on the expectations of civil society and the business environment.” Kakabadse, *supra* note 33, at 18. In 1974, Danone stated that CSR includes five recommendations: (1) scale workforces to meet actual needs but limit job insecurity and the negative effects on the layoffs; (2) develop and apply compensation policies that provide incentives consistent with the business conditions and environment of each company; (3) develop personal potential and encourage contributions from managers and all staff

Generally, from the definitions and concepts posed above, it is clear that a corporation is not only a self-centered, profit-making entity, but it is also an organization whose behavior is integral to society, the economy, and the environment in which it exists, whether local or global. Corporate executives and staff subscribing to this view are becoming more aware that CSR provides labor, human rights, and environmental protections to the communities in which they sit and to the people they employ.<sup>35</sup> The business case for such social responsibility among corporations is becoming clearer as globalization progresses. It includes the following: managing risks, protecting and enhancing reputation and brand equity, building trust and “license to operate,” improving resource efficiency and access to capital, responding to preempting regulations, establishing good stakeholder relationships with current and future employees, customers, business partners, socially responsible investors, regulators and host communities, encouraging innovation and new ways of thinking, and building future market opportunities.<sup>36</sup>

Questions may arise concerning the international attempts to promote CSR in its legal and social functions. One of the main roles of the U.N. is to strengthen and encourage cooperation between developing host countries and transnational corporations.<sup>37</sup> However, international norms or codes of conduct specifying corporate liabilities that protect global human rights have yet to be adopted.<sup>38</sup> Governments and private commercial corporations have made few steps toward developing legal frameworks for addressing human rights abuses in host countries.<sup>39</sup>

Those international attempts may be examined with respect to the various aspects of CSR mentioned above. As international labor law is concerned, there are several conventions and treaties between state governments and specialized organizations. For example, the International

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members, helping them to achieve both their own aspirations and the goals of the business; (4) work in partnership with employees for better working conditions and greater businesses efficiency; and (5) open and improve lines of communication with employees and their representatives. *Id.*

35. Herrmann, *supra* note 24, at 206. See also Mark Chong, *Employee Participation in CSR and Corporate Identity: Insights from a Disaster-Response Program in Asia-Pacific*, 12 CORP. REPUTATION REV. 106 (2009).

36. Herrmann, *supra* note 24, at 206–7 (citing Jane Nelson, *Corporate Social Responsibility: Passing Fad or Fundamental to a More Sustainable Future?*, 7 SUSTAINABLE DEVELOPMENT 37, 37 (2002), available at <http://www.p2pays.org/ref/40/39787.pdf>).

37. Barbara A. Frey, *The Legal and Ethical Responsibilities of Transnational Corporations in the Protection of International Human Rights*, 6 MINN. J. GLOBAL TRADE 153, 159 (1997).

38. *Id.*

39. *Id.* NGOs are also taking steps to encourage transnational corporations to use their influence to promote human rights in countries in which they are doing business.

Labor Organization (ILO)<sup>40</sup> creates specific protections for workers.<sup>41</sup> Free trade agreements (FTAs) are taken into consideration. In 1994, FTAs began to address labor rights. The North American Free Trade Agreement (NAFTA) was the first multi-lateral convention to emphasize the link between law and CSR. The North American Agreement on Labor Cooperation (NAALC), the Jordan-U.S. FTA, and the Central American Free Trade Agreement (CAFTA) followed a similar approach. In addition to labor conventions, international environmental law treaties usually contain corporate liability clauses to eliminate unfair compensation and environmental damages.<sup>42</sup> Several examples exist including the Brussels Convention on Liability for Nuclear Damage, the 1969 International Convention on Civil Liability for Oil Pollution Damage, and the 1984 Protocol to that Convention.

CSR experts acknowledge “corruption distorts market competition, breeds cynicism among citizens, undermines the rule of law, damages government legitimacy, and corrodes the integrity of the private sector.”<sup>43</sup> These adverse impacts inevitably link corruption to poverty and other social ills such as pollution and crime. Indeed, combating corruption should weigh heavily on every country’s economic and political agenda.<sup>44</sup> A rapid development of international anti-corruption standards has been realized, and a variety of incidents have compelled change in the domestic and

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40. See INTERNATIONAL LABOUR ORGANIZATION, <http://www.ilo.org> (last visited Feb. 1, 2011) (The ILO represents one of the most important key international CSR initiatives of governmental or inter-governmental bodies.).

41. The International Labor Conference (ILC) has adopted 185 conventions and 194 recommendations, including the 1949 Convention concerning the Application of the Principles of the Right to Organize and to Bargain Collectively, the 1981 Occupational Safety and Health Convention, the 1998 ILO Declaration on Fundamental Principles and Rights at Work, the Convention Concerning Discrimination in Respect of Employment and Occupation in 1958, and the Convention Number (26) of Minimum Wage-fixing Machinery in 1928. Moreover, the International Convention on Population and Development (ICPD) deals with workplace reproductive health. This convention encompasses a neutral view of reproductive health. See Phillip R. Seckman, *Invigorating Enforcement Mechanisms of the International Labor Organization in Pursuit of U.S. Labor Objectives*, 32 DENV. J. INT'L L. & POL'Y 675, 686 (2004). It is also the only document that actually adopts the right of reproductive health. It defines reproductive health as “a state of complete physical, mental and social well-being and not merely the absence of disease or infirmity.” See Rebecca Kathleen Atkins, *Multinational Enterprises and Workplace Reproductive Health: Extending Corporate Social Responsibility*, 40 VAND. J. TRANSNAT'L L. 233, 235–36 (2007).

42. See Steven R. Ratner, *Corporations and Human Rights: A Theory of Legal Responsibility*, 111 YALE L. J. 443 (2001).

43. Ben W. Heineman, Jr. & Fritz Heimann, *The Long War Against Corruption*, FOREIGN AFFAIRS, May/ June 2006, at 85.

44. See Bhanoji Rao, *A Multilateral Initiative to Combat Corruption*, HINDU BUSINESS LINE, Oct. 3, 2006, at 8, available at 2006 WLNR 23779779.

international political realm.<sup>45</sup> Notably, the Organisation for Economic Co-operation and Development (OECD) played a vital role in CSR when it adopted the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (Convention) in 1997. The Convention serves as a model for states to criminalize bribery of foreign public officials when the offenses are committed in their jurisdiction or territory.<sup>46</sup>

The legislative, executive, and judicial involvement of state governments along with private sector organizations could help further the campaign against corruption. Because unethical corporate behavior is an offense of universal dimensions, it becomes necessary—even vital—to create a new set of norms in international commercial and business transactions. For CSR to succeed, the global community must pay greater attention to sustainable development, globalization, governance, corporate sector responsibility, financial ethics, effective leadership, and business tool consistency. Therefore, the key issue is combating corruption while increasing social awareness. Moreover, to develop and enrich CSR, the private sector must share the responsibility. The business community must become willing to fight against corruption. This willingness is a vital and fundamental component of CSR in battling corruption in business transactions.

### III. THE BUSINESS ROLE OF CSR IN BATTLING CORRUPTION, EXTORTION, AND BRIBERY

The detrimental social effects of corruption and other unethical business practices in both developed and developing countries are well

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45. *See, e.g.*, Organization of American States, Inter-American Convention Against Corruption, March 29, 1996, O.A.S.T.S. No. B-58 (first multi-lateral legal framework to combat public corruption in international business transactions), *available at* <http://www.oas.org/juridico/english/treaties/b-58.html>.

46. STUART H. DEMING, *THE FOREIGN CORRUPT PRACTICES ACT AND THE NEW INTERNATIONAL NORMS* 309 (1st ed. 2005). Many steps have been taken in this area, including the treatment of the supply dynamic and the demand dynamic of corruption under the Council of Europe (COE) Criminal Law Convention; the COE Civil Law Convention concerning remedies for those whose rights and interests are affected by corruption; the EU Convention on the Protection of the Communities' Financial Interests 1997 and the EU Corruption Protocols 1996 and 1997; the Organization of African Unity Corruption Convention (OAU) 2003; and the U.N. Convention, which represents the most comprehensive and global model in battling corruption. Also, the efforts in fighting corruption and bribery have been expanding to multi-lateral lending institutions like the World Bank, the Regional Development Banks, and the International Monetary Fund (IMF). In addition, efforts extend to the international activity of NGOs like the role of the International Chamber of Commerce Business Code of Conduct (ICC) and Transparency International's (TI) efforts to highlight the perception of corruption. *See Id.*

recognized.<sup>47</sup> These practices include everything from the bribing of public officials and others in positions of power to obtain illegal licenses, creating illegitimate contracts and tax concessions, to price fixing and bid rigging.<sup>48</sup> International awareness has led to the introduction of several measures and procedures designed to curb these activities in the private sector.<sup>49</sup> These measures involve a range of stakeholder and regulatory approaches, both legal and non-legal in character.<sup>50</sup> The critical question now becomes the extent to which these measures are achieving their objectives.

#### *A. Anti-Corruption Policies as a Preliminary Tool for CSR*

The 2000 United Nations Global Compact (UNGC) signaled the opening of a global outlet for addressing corruption in the CSR movement. Although the UNGC's initial platform of nine principles neglected to address corruption, its participants soon realized that unless the issue was confronted, the UNGC could not be effective.<sup>51</sup> As a result, the tenth Anti-Corruption Principle was adopted on June 24, 2004.<sup>52</sup>

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47. CARR & OUTHWAITE, *supra* note 6.

48. *Id.*

49. *Id.*

50. *Id.*

51. The UNGC nine principles in the areas of human rights, labor, and the environment enjoy universal consensus and are derived from the Universal Declaration of Human Rights, the ILO's Declaration on Fundamental Principles and Rights at Work, and the Rio Declaration on Environment and Development. The Global Compact asks companies to embrace, support, and enact, within their sphere of influence, a set of core values in the areas of human rights, labor standards, and the environment as follows: a) Human Rights: Principle (1): Businesses should support and respect the protection of internationally proclaimed human rights and Principle (2): make sure that they are not complicit in human rights abuses. b) Labor Standards: Principle (3): Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; Principle (4): the elimination of all forms of forced and compulsory labor; Principle (5): the effective abolition of child labor; and Principle (6): the elimination of discrimination in respect of employment and occupation. c) Environment: Principle (7): Businesses should support a precautionary approach to environmental challenges; Principle (8): undertake initiatives to promote greater environmental responsibility; and Principle (9): encourage the development and diffusion of environmentally friendly technologies. *The Ten Principles*, UNITED NATIONS GLOBAL COMPACT, <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html> (last visited Feb. 1, 2011).

52. *Principle Ten*, *supra* note 22. This Principle stipulates that "[b]usinesses should work against corruption in all its forms, including extortion and bribery." *Id.* See *Anti-Corruption*, U.N. GLOBAL COMPACT, [http://www.unglobalcompact.org/Issues/transparency\\_ant Corruption/index.html](http://www.unglobalcompact.org/Issues/transparency_ant Corruption/index.html) (discussing the processes and the reasons that lead to the addition of the anti-corruption principle) (last visited Feb. 1, 2011). Notably, the UNGC is a U.N. initiative to encourage businesses worldwide to adopt sustainable and socially responsible policies and to report on their implementation. The Global Compact is a principle-based framework for businesses, stating ten principles in the fields of human rights, labor, the environment, and anti-corruption. Under the UNGC, companies are brought together with

Other CSR instruments, such as the OECD Guidelines for Multi-national Enterprises (OECD Guidelines)<sup>53</sup> and self-regulation initiatives, such as codes of conduct found in several multi-national corporations, refer to anti-corruption practices as a shared liability and duty of the business sector. The OECD Guidelines deal specifically with bribery and recommend several mechanisms to mitigate the problem in business practices. Multi-national corporations play an important role in global economic development. While guidelines are useful in principle, their success in practice depends upon the degree to which these organizations observe and abide by the regulations of their home and host countries.<sup>54</sup>

Positive developments notwithstanding, the focus of the CSR movement on anti-corruption standards largely continues to be incidental. Anti-corruption standards and policies enable social responsibility values to be realized in two ways. First, because CSR values are mutually reinforcing, anti-corruption standards can have a positive effect on other CSR goals, such as transparency. Transparent business transactions guarantee a greater degree of fairness and encourage the participation of numerous interested parties. In turn, parties, such as the media, labor unions, and environmental organizations, will each strive for their own interests, resulting in comprehensive and positive CSR conditions for society at large.<sup>55</sup>

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U.N. agencies, labor groups, and civil society. Also, the UNGC is the world's largest corporate citizenship initiative and as a voluntary initiative has two objectives: "Mainstream the ten principles in business activities around the world," and "Catalyze actions in support of broader U.N. goals, such as the Millennium Development Goals (MDGs)." *Overview of the U.N. Global Compact*, U.N. GLOBAL COMPACT, <http://www.unglobalcompact.org/AboutTheGC/index.html> (last visited Feb. 1, 2011). Historically, the UNGC was first announced by the U.N.'s Secretary-General Kofi Anan in an address to the World Economic Forum on January 31, 1999, and was officially launched at U.N. headquarters in New York on July 26, 2000. Moreover, the UNGC office is supported by six U.N. agencies: U.N. High Commissioner for Human Rights; U.N. Environment Program; International Labor Organization; U.N. Development Program; U.N. Industrial Development Organization; and U.N. Office on Drugs and Crime. See UNITED NATIONS GLOBAL COMPACT, <http://www.unglobalcompact.org> (last visited Feb. 1, 2011).

53. See generally ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2008) [hereinafter OECD GUIDELINES], available at [http://www.oecd.org/document/28/0,2340,en\\_2649\\_34889\\_2397532\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/28/0,2340,en_2649_34889_2397532_1_1_1_1,00.html) (outlining the OECD Guidelines and eleven particular policies behind them). See *Guidelines*, OECD WATCH, <http://oecdwatch.org/about-oecd/guidelines> (last visited February 1, 2011) (discussing the Guidelines and debate surrounding them). See also ETHICS WORLD, <http://www.ethicsworld.org> (last visited Feb. 1, 2011) (providing a comprehensive list and analysis of private sector codes of conducts and CSR reporting).

54. Lucinda A. Low & Timothy P. Trenkle, *U.S. Anti-Bribery Law Goes Global*, BUS. L. TODAY, July/Aug. 1999, at 14. It is important to know how Corporate Governance (CG) works among diverse jurisdictions.

55. See Marella Buckley, *Anti-Corruption Initiatives and Human Rights: The Potentials*, in HUMAN RIGHTS AND GOOD GOVERNANCE 173, 173-01 (H.O. Sanno & G. Alfredsson eds.,

Second, business practices free from corruption can secure a long-term platform of CSR goals. If ending corruption is not treated as a prerequisite to all corporate efforts, CSR practitioners will continue to work upon a foundation of quicksand, especially with respect to the environment.<sup>56</sup> The U.N. Oil-for-Food program is one such example. Designed to alleviate the suffering of the Iraqi people, the program was taken hostage by several corrupt Iraqi officials and greedy multi-national corporations. As a result, over 2,000 companies paid more than \$1.7 billion in bribes during the program.<sup>57</sup>

Examples such as these clarify that anti-corruption measures are necessary and essential conditions for sustaining CSR. Hence, combatting corruption should be a priority for the CSR movement. Otherwise, resources and efforts will continue to be wasted, as corruption always finds a way to jeopardize and displace CSR goals.

### *B. The Way Ahead*

In order to mitigate corruption, the CSR movement must take a combined confrontational and cooperative approach. Through a confrontational approach with the business sector, CSR practitioners can destabilize corrupt corporations by impacting their profit margins. Such methods can include a naming-and-shaming initiative or seeking recourse to the "Specific Instances Procedure"<sup>58</sup> of the OECD Guidelines. With the latter approach, NGOs and trade unions typically bring cases before national offices, called "National Contact Points," when multi-national corporations fail to comply with OECD Guidelines.<sup>59</sup> This procedure, although not legally binding and often subject to criticism, has triggered some positive effects.<sup>60</sup>

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2002) (discussing the mutually reinforcing impact between anti-corruption initiatives and human rights).

56. The presence of valuable natural resources may lead to bribes that affect the awarding of concessions for natural resources extraction. See JESSICA DILLON ET AL., CORRUPTION & THE ENVIRONMENT: A PROJECT FOR TRANSPARENCY INTERNATIONAL 23 (2006), available at <http://www.columbia.edu/cu/mpaenvironment/pages/projects/spring2006/Transparency%20International%20final%20report.pdf>.

57. PAUL A. VOLCKER ET AL., REP. ON THE MANIPULATION OF THE OIL-FOR-FOOD PROGRAMME BY THE IRAQI REGIME (Oct. 27, 2005), available at <http://www.iic-offp.org/documents/IIC%20Final%20Report%2027Oct2005.pdf>.

58. See OECD GUIDELINES, *supra* note 53.

59. Apart from "specific instance procedures," NCPs and governments, as well as other stakeholders, can use the OECD Guidelines to raise the awareness of companies to the risks of corruption and to encourage them to adopt mechanisms that reduce their involvement in corruption.

60. Regarding corruption, OECD Watch reports that until March 2006, nine cases have been brought in reference to alleged violations by corporations of Chapter VI of the OECD Guidelines pertaining to "Combating Bribery." See QUARTERLY CASE UPDATE (OECD Watch, Amsterdam, The Netherlands), Spring 2006, available at

In light of these approaches, CSR cooperation with the private sector should focus on anti-corruption measures and standards. CSR practitioners should conduct empirical studies in order to determine the extent of immediate and long-term damages that corrupt practices have had on the business sector. This has been described as the “business case against corruption.”<sup>61</sup>

### C. *Why Should Businesses Care and What Can the Private Sector Do?*

What about the influence and power of the private sector in leading anti-corruption initiatives?<sup>62</sup> To what extent is the private sector responsible for rooting out public sector corruption? Should businesses even assume this social responsibility? Though not a traditional responsibility, several trends highlight the private sector’s initiative to tackle systemic corruption. Today, we see increased attention among businesses to the following initiatives: stakeholder engagement, which plays a critical role in ensuring business sustainability, especially by encouraging transparency; the CSR function as seen in the practice of integrating CSR throughout all departments within companies; innovative corporate governance mechanisms and internal controls; and collaboration between businesses and civil society as seen through collective action and knowledge sharing.<sup>63</sup> Examples include Transparency International’s

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[http://oecdwatch.org/publications-en/Publication\\_1874/at\\_download/fullfile](http://oecdwatch.org/publications-en/Publication_1874/at_download/fullfile). The Trade Union Advisory Committee to the OECD has also brought several claims against corporations, although in general they refer to alleged violations of the Labor and Employment Chapter of the OECD Guidelines and only incidentally to corruption. See TRADE UNION ADVISORY COMM., THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES: TUAC INTERNAL ANALYSIS OF TREATMENT OF CASES RAISED WITH NATIONAL CONTACT POINTS: FEBRUARY 2001 MAY 2005, (n.d.), available at <http://old.tuac.org/statemen/communiq/ListofcasesMai5e.pdf>. Although a confrontational view is sometimes needed, it is usually the case that a cooperative initiative between business sectors and CSR practitioners will attain more effective and long-term respect for CSR. See PRICEWATERHOUSECOOPERS, CONFRONTING CORRUPTION: THE BUSINESS CASE FOR AN EFFECTIVE ANTI-CORRUPTION PROGRAMME 27 (2008) (citing Huguette Labelle, *Civil Society and the Private Sector: Fighting Corruption is Good Business*, DEVELOPMENT OUTREACH, Sept. 2006) [hereinafter BUSINESS CASE], available at <http://www.pwc.com/gx/en/forensic-accounting-dispute-consulting-services/pdf/pwc-confronting-corruption.pdf>.

61. See BUSINESS CASE, *supra* note 60.

62. See Press Release, Global FS Consulting Exchange, Building a Culture of Compliance is the Key Driver in Widespread Use of Anti-Corruption Programs (Dec. 7, 2006), available at [http://web.archive.org/web/20080204031654/http://www.conference-board.org/utilities/pressDetail.cfm?press\\_ID=3019](http://web.archive.org/web/20080204031654/http://www.conference-board.org/utilities/pressDetail.cfm?press_ID=3019).

63. Peter Brew & Jonas Moberg, *The Power of Joining Forces – The Case for Collective Action in Fighting Corruption*, in BUSINESSSES AGAINST CORRUPTION: CASE STORIES AND EXAMPLES: IMPLEMENTATION OF THE 10TH UNITED NATIONS GLOBAL COMPACT PRINCIPLE AGAINST CORRUPTION 128 (Birgit Errath ed., 2006), available at [http://www.unglobalcompact.org/docs/issues\\_doc/7.7/BACbookFINAL.pdf](http://www.unglobalcompact.org/docs/issues_doc/7.7/BACbookFINAL.pdf). See also AMINA EL-SHARKAWY ET. AL., A REPORT ON THE GLOBAL HIGH-LEVEL E-DISCUSSION:

Integrity Pacts, UNGC Networks,<sup>64</sup> and the involvement of international and local Chambers of Commerce.

*1. Ethical Legality and Morality in Corporations and CSR*

Notions of legal ethics and morals in businesses began emerging in the 1990s and have expanded in the United States—particularly in large firms—and Europe. Codes of conduct, or codes of ethics, necessarily reflect the regulated culture of the companies that utilize them. The nature and effectiveness of these codes depend on the extent to which industries utilize them. Most codes contain a statement of the corporation's major philosophical principles and values and articulate the ethical parameters in guiding employees' actions and behaviors.<sup>65</sup> Nonetheless, these codes of ethics are voluntary in the U.S. government, even after financial scandals in some large firms. Codes of ethics represent an important part of corporate culture and constitute an essential CSR tool. They should provide a supportive, moral framework for employees rather than constitute a repressive, dictatorial method of control over them.<sup>66</sup>

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TOWARDS A MORE SYSTEMATIC FIGHT AGAINST CORRUPTION: THE ROLE OF THE PRIVATE SECTOR (2006), available at [http://www.improvinggovernance.be/upload/documents/summary\\_PartnCombatCorpt.pdf](http://www.improvinggovernance.be/upload/documents/summary_PartnCombatCorpt.pdf). Collective action with other companies offers an effective way to create a level playing field on which to compete and increases the impact on local business practices beyond the capacity of any one company.

64. U.N. Global Compact Networks are clusters of UNGC participants who come together to advance the UNGC's 10 Principles for CSR. Currently, over sixty networks throughout the world exist. Their role facilitates the progress, both local and foreign subsidiaries of a corporation, in their implementation of the Ten Principles, while also creating opportunities for multi-stakeholder engagement and collective action. *Local Networks, UNITED NATIONS GLOBAL COMPACT*, <http://unglobalcompact.org/NetworksAroundTheWorld/index.html> (last visited Feb. 4, 2011).

65. Durrant, *supra* note 31, at 2–3.

66. *Id.* at 2–5. “As a part of ‘moral management,’ codes can be seen to help employees make ethical decisions by clarifying their conception of what is expected from them and giving them ‘ethical justifications’ for their decisions. Codes can help organizational members look beyond the ‘ethical legality’ of a situation, prescribed by law, to its ‘ethical morality,’ aiding consideration of their ‘fiduciary obligations’ including but also beyond the corporate structure.” *Id.* at 2. Also concerning the “theory of ‘organisational bureaucracy’ in which members of an organisation are regulated under a ‘firmly ordered system of super- and sub-ordination,’ codes could therefore be seen as suppressing individuality and restricting, or indeed freeing, an organizational member, from moral deliberation.” *Id.* at 3. “Ethics of care and feminist ethics also find codes of conduct problematic, and, similar to postmodern ethics emphasise the importance of ‘feeling rather than thinking’ when dealing with ethical dilemmas.” *Id.* at 4. Some scholars “found that codes were ‘not powerful enough tools to affect ethical decision making behaviour’ and that if they were to be influential, it would be through the methods used to communicate them rather than the content of the codes themselves.” *Id.* at 5. Also, other scholars have “found that codes were ineffective because they were disregarded by organizational members, and because they were viewed by management ‘as documents to be produced, publicised, and then ignored.’” *Id.* It is difficult, especially practically, for these codes to achieve their job in controlling the

## 2. *Ethical Leadership and CSR*

Ethical leadership is essential if codes of conduct are to be adhered to and are to be used to successfully regulate the moral behavior of employees. If employees consider corporate leadership unethical, codes of conduct will fall into contempt. Therefore, codes are only as good as the leaders who advocate for them.<sup>67</sup> One scholar found that most employers were unlikely to have a code of ethics, and employees often considered such administrative measures to be ineffective as an ethical tool in small businesses.<sup>68</sup> Yet the small business sector constitutes a considerable portion of the economy on both a national and global scale.

In 1996, the International Chamber of Commerce (ICC) adopted a more stringent code of conduct outlining rules to combat extortion and bribery in international business transactions. Provisions include the prohibition of accepting bribes or kickbacks, requirements for companies to control payments by their agents, and rules concerning record keeping and auditing illicit payments or secret funds. Although the ICC urged its members to adopt these rules, they were intended as a voluntary code of corporate conduct rather than a formal measure. Whether codes of conduct are the correct means to be used for CSR purposes remains to be seen. But should such measures be used with a range of other ethical instruments?<sup>69</sup>

In sum, the approaches used to confront corruption are usually divided according to ethical or business reasoning; however, the former model does not seem to be as persuasive as the latter.<sup>70</sup> For this reason,

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ethical conduct and behavior among the organizational members. *Id.*

67. *Id.* at 5–6.

68. *Id.* at 5.

69. See, J.A. Byrne, *Businesses Are Signing up for Ethics*, BUSINESS WEEK, Feb. 15, 1988, at 101. See also Archie Carroll & Michael Meeks, *Models of Management Morality: European Applications and Implications*, BUSINESS ETHICS: A EUROPEAN REVIEW, April 1999, at 108–16; Cathy Cassell et al., *Opening the Black Box: Corporate Codes of Ethics in their Organizational Context*, 16 J. BUS. ETHICS 1077, 1077–93 (Jun. 1997); Gerald F. Cavanagh et al., *The Ethics of Organizational Politics*, 6 ACAD. MGMT. REV. 363, 363–374 (1981); Margaret Ann Cleek & Sherry Lynn Leonard, *Can Corporate Codes of Ethics Influence Behavior?*, 17 J. BUS. ETHICS 619, 619–630 (Apr. 1998); Lawrence B. Chonko et al., *Ethics Code Familiarity and Usefulness: Views on Idealist and Relativist Managers under Varying Conditions of Turbulence*, 42 J. BUS. ETHICS 237, 237–252 (Feb. 2003).

70. This is in part due to the general underestimation of the negative effects of corrupt business practices on the everyday lives of individuals. On the other hand, the business case is probably more powerful in relation to the fight against corruption than with respect to issues of human rights, labor, and the environment. Corruption can corrode the soul of financially efficient businesses. For instance, a common corrupt practice within the private sector is the potential supplier's bribery of an employee in charge of purchases in order to be selected as a regular supplier. In such an event, the most efficient supplier and the one providing the best cost will not be selected, which means that the company is wasting resources. Corrupt practices are also common with regard to hiring personnel and through embezzlement of property belonging to the company. These other corrupt acts and unethical

CSR practitioners should concentrate on working closely with the private sector in order to increase the level of transparency, encourage internal loyalty, and affect better commercial relations with the public sector. The UNGC provides the following key reasons to avoid corruption: legal risks; reputational risks; higher financial costs; repeat demands via tolerance; exposure to blackmail; erosion of internal trust; and a general vested interest of companies in sustainable social, economic, and environmental development.<sup>71</sup>

*D. Eliminating Competitive Disadvantage in the International Market Economy and Enhancing Transparency Standards*<sup>72</sup>

An issue that requires urgent attention from both the business and CSR communities is competitive disadvantage. If a company is bribing a foreign public official in order to secure a contract, other corporations are likely to take the same approach to remain competitive. This so-called prisoner's dilemma perpetuates the self-justifying, yet unethical, rhetoric: "If others are doing it, I have to do it in order to maintain business opportunities."<sup>73</sup> Consequently, in 1997 the U.S. Government addressed the issue in order to promote a more level playing field in international business transactions.<sup>74</sup> The United States' efforts culminated in the OECD Convention on Combating Bribery in International Business Transactions.<sup>75</sup> As a result, all OECD members and six non-members agreed to criminalize bribery of foreign public officials.<sup>76</sup> However, today with the rise in

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private sector practices can harm in many ways, most notably financially, as in the Enron scandal.

71. See BUSINESSES AGAINST CORRUPTION: CASE STORIES AND EXAMPLES: IMPLEMENTATION OF THE 10TH UNITED NATIONS GLOBAL COMPACT PRINCIPLE AGAINST CORRUPTION (Birgit Errath ed., 2006), available at [http://www.unglobalcompact.org/docs/issues\\_doc/7.7/BACbook\\_FINAL.pdf](http://www.unglobalcompact.org/docs/issues_doc/7.7/BACbook_FINAL.pdf).

72. In other words, "Fair Competitive Markets" as an economic and legal notion, simultaneously introduced to the global free market economy represents a central issue that has highly harmful and damaging consequences for the business community.

73. This argument is not new and was repeatedly used by the American business sector regarding their European competitors after the enactment of the FCPA in 1977. See TIMMENY, *supra* note 9; ANATOL RAPOPORT & ALBERT M. CHAMMAH, PRISONER'S DILEMMA (Univ. of Mich. Press 1965) (discussing the prisoner's dilemma).

74. FRITZ HEIMANN & GILLIAN DELL, TRANSPARENCY INTERNATIONAL, 2006 TI PROGRESS REPORT: ENFORCEMENT OF THE OECD CONVENTION ON COMBATING BRIBERY OF FOREIGN PUBLIC OFFICIALS (Jun. 26, 2006), available at [http://www.transparency.org/content/download/7489/46695/file/TI\\_SecondOECDProgressReport.pdf](http://www.transparency.org/content/download/7489/46695/file/TI_SecondOECDProgressReport.pdf). Undoubtedly the United States represents the leading force against corrupt business practices carried out abroad. In 2005, there were thirty-five prosecutions in U.S. courts against multi-nationals. As of June 2006, there were fifty-five investigations underway. *Id.*

75. See DEMING, *supra* note 46, at 309.

76. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, CONVENTION ON COMBATING BRIBERY OF FOREIGN PUBLIC OFFICIALS IN INTERNATIONAL BUSINESS TRANSACTIONS AND RELATED DOCUMENTS (2010), available at <http://www.oecd.org/>

foreign direct investment (FDI) in emerging markets, international competition has once again incentivized corrupt corporate practices in securing business deals. In light of the fact that multi-national companies from OECD countries are reluctant to face corruption, countries from emerging markets must lead their multi-national corporations toward stronger CSR standards in their international business transactions.<sup>77</sup>

If multi-national corporations from OECD countries want to remain competitive, they need to level the playing field with their global counterparts. This initiative requires joint efforts between CSR practitioners and the business sector. Most of the applied CSR mechanisms exist in corporations from the West. Hence, attention must be paid to developing CSR mechanisms and policies in these often-neglected emerging economies.

Unethical and illicit corporate behavior also distorts competition between multi-nationals and small and medium sized enterprises (SMEs). Since competition between multi-national corporations and SMEs is limited, it must be addressed in order to mitigate corrupt practices from businesses at all economic levels.<sup>78</sup> Because of their limited resources, it is difficult to expect SMEs to hire regulatory personnel to manage new internal anti-corruption programs or adopt ethical codes and internal reporting procedures.<sup>79</sup> Thus, it is vital to target corruption in SMEs in

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dataoecd/4/18/38028044.pdf. Non-OECD members that were parties to the convention include Argentina, Brazil, Bulgaria, Chile, Estonia, and Slovenia. The adoption of many international treaties and the participation in several global approaches towards the development of CSR reflects that Egypt has a strong basis for the principles of CSR. Although Egypt did not ratify the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of 1997, it played an active role. Egypt only recently signed the OECD Declaration on International Investment and Multi-national Enterprises. Egypt is the first Arab and African country to sign this declaration, which is considered a new phase and step in Egyptian investment policy. This signing will require the adoption of new strategies and standards with regard to CSR in general and CSR of foreign investors in particular. Egypt has a problem with the proper applicability of various laws and regulations. It is a problem of corruption. Social awareness must be raised and collective measures are highly recommended to curb corruption.

77. Despite most of the emerging market countries making several efforts to fight and cut corruption domestically, many still have a lenient attitude toward corrupt practices and unethical, immoral behavior in businesses overseas. *See, e.g.*, DONALD R. CRUVER, *COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT: A GUIDE FOR U.S. FIRMS DOING BUSINESS IN THE INTERNATIONAL MARKETPLACE* (2d. ed. 1999); JEFFREY P. BIALOS & GREGORY HUSISIAN, *THE FOREIGN CORRUPT PRACTICES ACT: COPING WITH CORRUPTION IN TRANSNATIONAL ECONOMIES* (1997).

78. As most efforts to battle corruption involving the private sector are aimed at large multi-nationals, SMEs escape from transparent, legal, and licit business practices and therefore possess a comparative advantage. This needs to be changed. For instance, the application of the Tenth Principle of the anti-corruption program of the UNGC is designed in a style that would be impossible for SMEs to apply. *See Principle Ten, supra* note 22.

79. All of these are costly, and SMEs cannot be realistically expected to participate in anti-corruption programs if participation demands higher costs and less profit maximization.

order to have a coherent strategy and comprehensive policy against corruption worldwide.<sup>80</sup>

*E. U.N. Convention Against Corruption 2003: A New Tool for Corporate Social Responsibility*<sup>81</sup>

In 2003, the U.N. adopted the Convention against Corruption (U.N. Convention),<sup>82</sup> which reflected the fundamental spirit of CSR. The U.N. Convention has proven valuable in addressing the fight against corruption, particularly in the field of international business transactions. The primary objectives of the U.N. Convention are the criminalization of corrupt practices, the implementation of measures to deter and prevent corruption, the establishment of legal mechanisms for recovering stolen assets, and the means of providing technical and mutual legal assistance and information exchange. These objectives focus on both the public and private sectors.<sup>83</sup> In addition, the Convention is comprised of articles that criminalize acts closely related to corruption or connected to it, such as laundering the returns of corruption, concealing or holding the revenues of corruption, and assisting or encouraging corruption. Furthermore, these agreements allow for remedies such as the freezing, seizing, and confiscation of assets

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These anti-corruption programs for SMEs should be external and carried out by stakeholders in a consulting role in the form of making informative decisions. For SMEs, combating corruption will not only enhance competitive markets but will also have an impact on the battle against corruption in general. While efforts to curb corruption by large corporations have the effect of fighting "grand corruption," "petty corruption" will be more effectively curbed by anti-corruption standards and measures in the SMEs sector.

80. In reality, CSR should pay more attention to the SME sector. *See generally* U.N. INDUST. DEV. ORG., *CORPORATE SOCIAL RESPONSIBILITY: IMPLICATIONS FOR SMALL AND MEDIUM ENTERPRISES IN DEVELOPING COUNTRIES* (2002). *See also* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *OECD SME AND ENTREPRENEURSHIP OUTLOOK 2005* (3rd ed. 2005), *available at* <http://books.google.com> (search ISBN number "9789264009240").

81. *See* United Nations Convention Against Corruption, G.A. Res. 55/61, U.N. DOC. A/RES/55/61 (Oct. 31, 2003), *available at* [http://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026\\_E.pdf](http://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf). Under the U.N., the different regional anti-corruption efforts culminated in the adoption in October of 2003 of the U.N. Convention Against Corruption. It is the first globally negotiated anti-corruption convention to address and introduce the bribery of public officials in the context of international business. Many of the concepts and measures reflected in the OECD Convention, the Inter-American Convention, the COE Criminal Law Convention, and the COE Civil Law Convention have been incorporated into the U.N. Convention. However, this treaty is more comprehensive in its scope of applicability than the other anti-corruption initiatives. Additionally, both United States and Egypt have signed and ratified the U.N. Convention. *See also* Consent & Undertaking of Metcalf & Eddy, Inc., *United States v. Metcalf & Eddy, Inc.*, No. 99-CV-12566-NG (D. Mass. Dec. 14, 1999), *available at* <http://corporatecompliance.org/Content/NavigationMenu/Resources/ComplianceBasics/MetcalfEddy.pdf>.

82. *See* DEMING, *supra* note 46, at 337.

83. *Id.* at 338.

acquired through criminal acts as defined in the provisional articles. The United Nations Convention also permits compensation for the harms caused by any of those criminal acts. Following this critical step, the CSR movement has developed and achieved a series of measures and tools for exercising pressure on the private business sector to consider the social, cultural, and environmental consequences of their corporate practices.<sup>84</sup>

At both the national and global level, the counterattack on corruption has evolved through an increasingly integrated legal framework of multi-lateral treaties, national laws, and legal regulations.<sup>85</sup> Until recent years, CSR advocates have largely left corruption to the jurisdiction of state and national law enforcement authorities.<sup>86</sup> However, CSR practitioners have begun to improve the legal framework and enforcement mechanisms through cooperation with the business sector.<sup>87</sup> With these efforts culminating in 2003, the U.N. Convention has become the most comprehensive, effective, and vital tool in eliminating corruption within the private sector to date.<sup>88</sup>

According to the U.N. Convention, there are several stipulations, duties, obligations, and recommendations for state parties in the fight against corruption that have considerable potential impact on business practices. Consequently, states must develop comprehensive anti-corruption policies and practices.<sup>89</sup> Additionally, they must criminalize bribery of foreign public officials.<sup>90</sup> Within the private sector, states must criminalize the embezzlement of property in business dealings and ensure that persons are held both civilly and criminally liable and subject to effective and proportionate fiscal and administrative sanctions.<sup>91</sup> In

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84. This can be realized and achieved by voluntarily utilizing CSR initiatives; although these CSR tools are not binding, they have been fairly efficient. The OECD Guidelines, the U.N. Global Compact, the Extractive Industry Transparency Initiative, and the International Chamber of Commerce Anti-Corruption Commission are all examples.

85. DEMING, *supra* note 46, at 309, 319, 337, 361. The most notable multi-lateral conventions concerning the private sector are the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1997; the Inter-American Convention Against Corruption 1996; the United Nations Convention Against Corruption 2003; and the African Union Convention on Preventing and Combating Corruption 2003. For an in-depth analysis of national laws and regulations against corruption, see *Text of the OECD Declaration on International Investment and Multinational Enterprises*, OECD, [http://www.oecd.org/document/53/0,3343,en\\_2649\\_34887\\_1933109\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/53/0,3343,en_2649_34887_1933109_1_1_1_1,00.html) (last visited Feb. 6, 2011).

86. DEMING, *supra* note 46, at 305–08.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* Most of these illicit criminal acts and behaviors should be treated as felonies rather than misdemeanors, according to the main classification of the criminal offenses, due

addition to confronting problems with private-sector bribery, corruption, and concealment of these actions,<sup>92</sup> the U.N. Convention promotes ethical standards in corporate accounting and record keeping, monitoring, and auditing, and also emphasizes transparency among private entities and the prevention of conflicts of interest.<sup>93</sup>

CSR practitioners should bear in mind that while the potential of the U.N. Convention is great,<sup>94</sup> its effectiveness depends on the level of state action. While one of the initial goals for the CSR movement is to apply pressure on national governments to implement and enforce the Convention, CSR practitioners should hold the business sector to higher standards of accountability through governmental action and policy initiatives.

#### IV. CONCLUSION AND POLICY RECOMMENDATIONS

“The advent of globalization has brought about unprecedented changes in the pace and nature of business practices in both the community market place and the work place. In the context of an evermore connected and inter-reliant world, intense demand for economic growth pressures societies to address myriad environmental, economic, social, and health issues facing populations, businesses, and governments.”<sup>95</sup>

Nothing erodes sustainable economic development more than corruption. Given its systemic pervasiveness, the private sector plays a critical role and has a vested interest in assuming social as well as economic responsibility. Though implementation rests firmly in the hands of national governments, corporations cannot ignore their critical role in creating a sustainable anti-corruption initiative.<sup>96</sup> Looking ahead, companies face several challenges.<sup>97</sup> However, the private sector can generate viable

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to the serious implications and devastating impacts on society. *See also* SUE TITUS REID, *CRIME AND CRIMINOLOGY* (McGraw-Hill, 9th ed. 1999).

92. United Nations Convention Against Corruption, *supra* note 81, at arts. 21, 24.

93. *Id.* art. 12, ¶¶ 1–2.

94. *See* Durrant, *supra* note 31, at 6.

95. ZYNIA L. RIONDA ET AL., *CORPORATE SOCIAL RESPONSIBILITY IN PRACTICE CASEBOOK* (July 2002), available at [http://www.rhcatalyst.org/site/DocServer/CSR\\_casebook.pdf?docID=101](http://www.rhcatalyst.org/site/DocServer/CSR_casebook.pdf?docID=101).

96. Sustainable anti-corruption initiatives can be implemented through codes of conduct or ethics. As stated before, codes of conduct can harness the market power of informed consumers to halt abuses against workers in developing countries. Governments cannot inspect every workplace and catch every lawbreaker. Codes of conduct offer new options through private sector self-regulation using civil society vigilance. *See* Lance Compa, *Trade Unions, NGOs, and Corporate Codes of Conduct*, NGO CAFÉ, <http://www.gdrc.org/ngo/codesofconduct/compa.html> (last visited Feb. 6, 2011).

97. *Id.* Codes of conduct should address the corporation’s functional responsibilities toward other constituency groups, not just the narrow focus of internal employees. Any code of conduct must reflect the local needs of workers and guarantee the core standards of the ILO, provide the resources, training, monitoring, and reporting mechanisms to make it work,

solutions to fight corruption by serving as a role model to the larger business community. Through collaboration with government and civil society in knowledge-sharing forums, through creation of an ethical corporate culture via increased responsibilities, and through innovative solutions to reduce the risk of corruption in corporate governance, the private sector can make a significant impact.

CSR practitioners must prioritize the battle against corruption. It is important to focus on specific goals and policies and build upon the current mechanisms developed by the international community, especially the U.N. Convention.<sup>98</sup> The CSR movement possesses the potential to strengthen commitments made by state parties by developing model theories into everyday business practice. Therefore, it should be concerned with protecting and promoting integrity, stability, and good governance while encouraging the disruption and control of serious crime. Through such commitments, states will increase the wellbeing of their national economies, institutions and enterprises and promote a better understanding of the real and practical risks facing business today.<sup>99</sup>

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and be clear and in accordance with recent labor law and corporate law standards. Codes of conduct also need to reflect the right of workers to freely associate, to form and join trade unions, and to bargain collectively. They should also define the minimum standard of wages. Moreover, they must provide for the hours of work that comply with applicable laws and industry standards. In addition, codes of conduct must reflect the principles of non-discrimination at all levels and the obligation of the corporation to make an effort to improve working conditions. Jill Murray, *Corporate Codes of Conduct and Labour Standards*, INT'L LABOUR ORG., <http://actrav.ilo.org/actrav-english/telearn/global/ilo/guide/jill.htm> (last visited Feb. 6, 2011).

98. An effective enforcement and execution of this treaty will benefit the business sector because it will comprehensively level the playing field among business competitors. In contrast, effectiveness could be enhanced by collaboration between CSR teams and the private sector. The focus on anti-corruption and its integration in the corporate citizenship agenda are two of the most important developments. They contribute to greater market integrity and hold the promise of infusing improved governance in the public and private spheres alike.

99. It is important to focus on the threats confronting the financial system—in particular financial institutions—from those who engage in self-dealing, corrupt practices, and fraud, or who assist and facilitate the crimes of others. Such threats, however, are complex and manifest themselves at many diverse levels. For instance, as in previous years, considerable emphasis is placed on the problems that confront those who operate in the financial world, primarily as a result of regulatory and enforcement actions designed to address specific criminal issues, such as disruption of highly profitable crime or terrorism. Thus, programs should be designed by those working in enforcement, compliance and the financial sector with the deliberate intention of focusing on real and practical issues and providing, at a truly international scale, better approaches and greater co-operation. Consequently, the new regulatory systems that will be brought into operation, both domestically and universally, will inevitably place much greater emphasis on ensuring integrity and sanctioning those who abuse their positions of trust. It also attests to the deep concern of governments and financial institutions as to the extent of the risks to stability and security thrown up by economic and financial crimes such as corruption, abuse and in particular the impact of money laundering

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and organized crime. Therefore, it is important to get a better understanding of the real issues involved in preventing and controlling economically motivated fiscal crime.

# CORPORATE SOCIAL RESPONSIBILITY FROM THE CHINESE PERSPECTIVE

Ying Chen, LL.M.\*

## I. CORPORATE SOCIAL RESPONSIBILITY (CSR) AND SOCIAL PROBLEMS IN CHINA

In recent years, several serious incidents causing numerous deaths have garnered special attention from the Chinese Central Government. Coal mines are dangerous in China, and accidents frequently occur throughout the provinces. These accidents, which have resulted in thousands of deaths, have been due to the neglect of safety standards by coal mine owners in favor of economic profit.<sup>1</sup> Moreover, in September 2008, several large milk and formula companies in China were involved in a notorious product quality scandal known as the “Milk Powder Scandal” or “Infant Formula Scandal.” Over 1,200 infants were sickened, hospitalized, and some even died, after being fed formula contaminated with melamine, an industrial chemical that can cause kidney stones and other complications in infants.<sup>2</sup> Major newspapers in China have also frequently reported social problems such as physical abuse of workers, dangerous working conditions, unfair wages, product quality scandals, and industrial pollution. All of these problems involve a fairly new issue in China: Corporate Social Responsibility (CSR).

It would be inaccurate to say that CSR is a completely new issue in China because the Chinese government has been committed to the improvement of CSR for decades.<sup>3</sup> The Chinese government seeks to substantially increase social wealth to satisfy social needs; it takes measures to foster job growth; it strives to promote social welfare; and it tries to control pollution to guarantee a better environment.<sup>4</sup> All such efforts are carried out for the sake of corporate development.<sup>5</sup> Nevertheless, the term CSR is fairly new in China. The numerous CSR-related laws in China indicate that the government highly values CSR in most aspects of its

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1. *China Coal Mine Blast Death Toll Reaches 92*, BBC NEWS (Nov. 22, 2009), available at <http://news.bbc.co.uk/2/hi/8372760.stm>.

2. Jane Macartney & Sophie Yu, *Chinese Milk Powder Contaminated with Melamine Sickens 1,253 Babies*, THE TIMES, Sept. 16, 2008, available at <http://www.timesonline.co.uk/tol/news/world/asia/article4758549.ece>.

3. Xiaodong Han, *Corporate Social Responsibility, An Interview with Liu, Peng, Director of Department of Employers, China Enterprise Confederation* (translated by Meifang Xia), BEIJING FORUM (Oct. 10, 2007), <http://www.beijingforum.org/en/ShowArticle.asp?ArticleID=657>.

4. *Id.*

5. *Id.*

policies related to sustainable economic and social development. However, the lack of enforcement of CSR standards in China has been problematic.

## II. RECOGNITION AND LEGISLATION OF CSR IN CHINA

### A. *Chinese Companies' Attitude on CSR*

The concept of CSR in China was vague before 1978. It was not until China adopted certain economic reform policies in 1978<sup>6</sup> that western CSR ideas were introduced. Since then, transnational corporations have been entering the Chinese market. When these corporations cooperate or trade with Chinese companies, some require their Chinese partners to meet their own, established CSR standards. To ensure the implementation of CSR standards, these transnational corporations normally carry out CSR inspections of their Chinese partners. Potential Chinese partners who fail to meet these standards lose the opportunity to do business with these transnational corporations.<sup>7</sup>

Because they are required by their foreign partners to take responsibility for the social and environmental impacts of their business activities, Chinese companies are incentivized to develop CSR awareness. As a result, many Chinese companies have begun to take proactive steps to meet their foreign partners' requirements.<sup>8</sup> In addition, because of economic reforms, a market economy has gradually replaced the planned economy in China, and many state-owned enterprises have transitioned to private ownership. Under this new socialist market economy, many Chinese companies have become independent legal persons that "feature self-management and profit risks."<sup>9</sup> They have the legal obligations of CSR and are responsible for the economic, social, and environmental impacts of their activities. Accordingly, CSR awareness is increasingly being developed in many Chinese companies, especially among export-related companies.<sup>10</sup>

### B. *CSR Legislation in China*

Complementing the increasing awareness of CSR in many Chinese companies, the Chinese government has recognized the importance of

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6. See generally *Why Is China Growing So Fast?*, INTERNATIONAL MONETARY FUND, <http://www.imf.org/external/pubs/ft/issues8/> (last visited Jan. 20, 2011).

7. Li-Wen Lin, Note, *Corporate Social Accountability Standards in the Global Supply Chain: Resistance, Reconsideration, and Resolution in China*, 15 CARDOZO J. INT'L & COMP. L. 321, 325–26 (2007).

8. Han, *supra* note 3.

9. *Id.*

10. *Id.*

implementing CSR standards for sustainable economic growth, as evidenced by the incorporation of CSR standards into domestic legislation.<sup>11</sup> The statutory basis for implementing some CSR standards has already been laid in the Chinese legal system.

### *1. The Company Law of the People's Republic of China*

In 1993, when the Company Law of the People's Republic of China (the 1994 Company Law) was first promulgated, the term corporate social responsibility was not explicitly mentioned, but the concept of CSR was indirectly embedded in this law.<sup>12</sup> Article 14 of the 1994 Company Law required companies to abide by the law, observe professional ethics, strengthen the development of socialist culture and ideology, and subject themselves to supervision by the government and the public.<sup>13</sup> Furthermore, Articles 15 and 16 emphasized the importance of protecting and promoting workers' rights such as employee skill training, safe production, and the organization of trade unions.<sup>14</sup> Article 15 articulated each company's responsibility to "protect the legitimate rights and interests of its staff and workers, strengthen labor protection, and ensure safe production"<sup>15</sup> and also required each company to "provide its workers with vocational education and in job training in various forms to improve their working quality."<sup>16</sup> Article 16 granted workers the right to "organize a trade union in accordance with the law to carry out trade union activities and protect their legitimate rights and interests"<sup>17</sup> and provided that "[a] company shall provide the necessary conditions for activities of its trade union."<sup>18</sup>

In 2005, the 1994 Company Law was amended. This amended law, effective January 1, 2006, is known as the 2006 Company Law.<sup>19</sup> In the

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11. Eric W. Orts, *The Rule of Law in China*, 34 VAND. J. TRANSNAT'L L. 43, 111 (2001); see also Lin, *supra* note 7, at 354–55.

12. See generally *Zhonghua Renmin Gongheguo Gongsifa* (中华人民共和国公司法) [Company Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Dec. 29, 1993, effective July 1, 1994), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=641&keyword=company law>.

13. *Id.* art. 14.

14. *Id.* art. 15, 16.

15. *Id.* art. 15.

16. *Id.*

17. *Id.* art. 16.

18. *Id.*

19. *Zhonghua Renmin Gongheguo Gongsifa* (中华人民共和国公司法) [Company Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006), available at LAWINFOCHINA <http://www.lawinfochina.com/law/display.asp?db=1&id=4685&keyword=companylaw> [hereinafter 2006 Company Law].

2006 Company Law, the term social responsibilities is explicitly articulated, and companies are required to maintain CSR while pursuing economic profit.<sup>20</sup> Article 5 of the 2006 Company Law states that “[w]hen undertaking business operations, a company shall comply with the laws and administrative regulations, social morality and business morality. It shall act in good faith, accept the supervision of the government and the general public, and bear social responsibilities.”<sup>21</sup> Article 17 strengthens labor rights’ protection by obligating companies to enter into formal employment contracts with their employees.<sup>22</sup> Article 18 specifies trade union and related workers’ rights and requires companies to “carry out union activities and safeguard the lawful rights and interests of the employees.”<sup>23</sup> Each company must also “provide necessary conditions for its labor union to carry out activities.”<sup>24</sup> The labor union, on behalf of the employees, must “conclude the collective contract with the company with respect to the remuneration, working hours, welfare, insurance, work safety and sanitation and other matters.”<sup>25</sup> The 2006 Company Law lists broad guidelines for doing business in a socially and environmentally responsible manner. More importantly, for the first time, the 2006 Company Law explicitly recognized corporate social responsibility and provided the statutory basis for all companies in China to undertake CSR standards.<sup>26</sup>

## 2. *The Code of Corporate Governance for Listed Companies in China (2001)*<sup>27</sup>

Following the 1994 Company Law, the China Securities Regulatory Commission and the State Economic and Trade Commission promulgated the Code of Corporate Governance for Listed Companies in China (the Code) in 2001. The Code explicitly emphasizes the importance of companies’ social responsibilities and encourages listed companies to incorporate these responsibilities into their everyday business operations. Article 86 of the Code states that “[w]hile maintaining the listed company’s development and maximizing the benefits of shareholders, the company shall be concerned with the welfare, environmental protection and public interests of the community in which it resides, and shall pay attention to the

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20. Lin, *supra* note 7, at 359.

21. 2006 Company Law, *supra* note 19 art. 5.

22. *Id.* art. 17.

23. *Id.* art.18.

24. *Id.*

25. *Id.*

26. Lin, *supra* note 7, at 359–61.

27. Shangshi Gongsi Zhili Zhunze (上市公司治理准则) [Code of Corporate Governance for Listed Companies in China] (promulgated by the China Securities Regulatory Comm., State Economic and Trade Comm., Jan. 7, 2001), available at [http://www.ecgi.org/codes/documents/code\\_en.pdf](http://www.ecgi.org/codes/documents/code_en.pdf).

company's social responsibilities."<sup>28</sup> However, the Code applies only to listed companies instead of all companies in general. Also, the Chinese administrative departments instead of the legislature adopted it; therefore, the Code is not generally binding.

### 3. *The Labor Law of the People's Republic of China (1995)*<sup>29</sup>

The Labor Law of the People's Republic of China (1995) (the Chinese Labor Law) aims to equalize bargaining power between employers and workers.<sup>30</sup> It provides general rules regarding labor conditions and employment practices, articulates the rights and interests of laborers,<sup>31</sup> and specifies dispute mechanisms and their working procedures.<sup>32</sup> The Chinese Labor Law mandates minimum standards for a working age,<sup>33</sup> labor contracts,<sup>34</sup> working hours,<sup>35</sup> fair wages,<sup>36</sup> labor safety and sanitation,<sup>37</sup> social insurance,<sup>38</sup> and other standards for employers to follow. In addition, it grants workers the right to "participate in and organize trade unions in accordance with law[.]"<sup>39</sup> and it provides special protection for female and juvenile workers.<sup>40</sup> This Law is a state law of general binding effect, enabling all workers to claim their rights under the law.

### 4. *The Trade Union Law of the People's Republic of China (2001)*<sup>41</sup>

The Trade Union Law of the People's Republic of China (the Chinese Trade Union Law) was promulgated on April 3, 1992, and amended on

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28. *Id.* art. 86.

29. Zhonghua Renmin Gongheguo Laodong Fa (中华人民共和国劳动法) [Labor Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Congress, July 5, 1994, effective Jan. 1, 1995), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=705&keyword=The Labor Law of the People's Republic of China>.

30. See generally *id.* art. 17.

31. *Id.* art. 1.

32. *Id.* art. 77-84.

33. *Id.* art. 15.

34. *Id.* art. 16-35.

35. *Id.* art. 36-45.

36. *Id.* art. 46-51.

37. *Id.* art. 52-57.

38. *Id.* art. 5, 70-76.

39. *Id.* art. 7.

40. *Id.* art. 58-65.

41. Zhonghua Renmin Gongheguo Gonghui Fa (中华人民共和国工会法) [Trade Union Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 3, 1992, amended by the Standing Comm. Nat'l People's Cong., Oct. 27, 2001), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=2088&keyword=tradeunionlaw> [hereinafter Trade Union Law].

October 27, 2001. This law builds upon the Chinese Labor Law and defines the goal of trade unions as “[r]epresenting the interests of the employees and protecting the legal rights and interests of the employees.”<sup>42</sup> It also grants workers the right to participate in and organize trade unions in accordance with the law “regardless of their nationalities, races, sexes, occupations, religious beliefs or educations.”<sup>43</sup> Trade unions, through their leadership, are formed with the goal of protecting employees’ rights.

Although the Chinese Trade Union Law explicitly states that it protects workers’ rights in the trade unions, it may fail to do so in practice. There is only one organization, the All China Federation of Trade Unions (ACFTU), that can legally represent workers in China.<sup>44</sup> Thus, all references to a trade union in China are really references to the government-controlled trade union: the ACFTU and its branches. In order to allow unions to better serve workers, the Chinese government must ease its control of trade unions.

*5. The Law of the People’s Republic of China on Protection of Consumer Rights and Interests (1994)*<sup>45</sup>

In addition to regulating working conditions and protecting and promoting labor rights, the Chinese government also regulates the external social responsibilities of companies. The rights of consumers are increasingly given importance in China. The Law of the People’s Republic of China on Protection of Consumer Rights and Interest (the Chinese Consumer Law), promulgated in 1993, is proof of this.<sup>46</sup> The Chinese Consumer Law regulates the relationships between consumers and businesses that sell goods or services. It was “formulated for the protection of the legitimate rights and interests of consumers”<sup>47</sup> and to ensure fair competition in the marketplace. Product safety and product liability are emphasized in the Chinese Consumer Law. Under this law, business operators are legally responsible for their products and services.

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42. *Id.* art. 2.

43. *Id.* art. 3.

44. HUMAN RIGHTS WATCH, HUMAN RIGHTS AND THE 2008 OLYMPICS IN BEIJING-BUSINESS AND LABOR RIGHTS, (Oct. 24, 2008), available at <http://www.hrw.org/campaigns/china/beijing08/labor.htm>; see also Nicholas, *supra* note 6, at 167.

45. Zhonghua Renmin Gongheguo Xiaofeizhe Quanyi Baohu Fa (中华人民共和国消费者权益保护法) [Law of the People's Republic of China on Protection of Consumer Rights and Interests] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 1993, effective Jan. 1, 1994), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=6137&keyword=consumerrightsandinterests>.

46. *See id.*

47. *Id.* art. 1.

In accordance with the Chinese Consumer Law, if there is a dispute regarding consumer rights and interests, Chinese consumers have several options. They can choose “(1) to consult and conciliate with business operators; (2) to request to consumer associations for mediation; (3) to appeal to relevant administrative departments; (4) to apply to arbitral organs for arbitration according to the arbitral agreements with business operators; [or] (5) to institute legal proceedings in the people’s court.”<sup>48</sup> The Chinese Consumer Law is a state law of general binding effect. It articulates companies’ social responsibilities, provides guidelines for consumers to claim their rights, and promotes a fair environment for all companies.

*6. The Environmental Protection Law of the People’s Republic of China (1989)*<sup>49</sup>

Environmental responsibility is one of the most important components of CSR. In addition to taking care of their employees and consumers, business operators are responsible for the impacts their activities have on society and sustainable development, particularly on the environment. The purpose of the Environmental Protection Law of the People’s Republic of China (the Chinese Environmental Protection Law) is to protect and improve the environment and to prevent and control pollution, as well as other public health hazards.<sup>50</sup> The law emphasizes the relationships among environmental protection, human health, and sustainable economic growth.<sup>51</sup> In general, the Chinese Environmental Protection Law covers environmental concerns of natural resources,<sup>52</sup> natural ecological systems,<sup>53</sup> agricultural environment,<sup>54</sup> marine environment,<sup>55</sup> and pollution control.<sup>56</sup>

In addition, the Chinese Environmental Protection Law strengthens environmental monitoring.<sup>57</sup> It also establishes special departments to investigate local environments and make environmental impact assessments, enabling these departments to draw up specific plans for local

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48. *Id.* art. 34.

49. *Zhonghua Renmin Gongheguo Huanjing Baohu Fa* (中华人民共和国环境保护法) [Environmental Protection Law of the People’s Republic of China] (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 26, 1989, effective Dec. 26, 1989), available at LAWINFOCHINA, [http://www.lawinfochina.com/law/display.asp?db=1&id=1208&keyword=environmental protection law](http://www.lawinfochina.com/law/display.asp?db=1&id=1208&keyword=environmental%20protection%20law).

50. *Id.* art. 1.

51. *Id.*

52. *Id.* art. 7.

53. *Id.* art. 17, 19.

54. *Id.* art. 20.

55. *Id.* art. 21.

56. *Id.* art. 10–15.

57. *Id.* art. 11.

governments on how to reduce pollution, improve local environments, and promote sustainable development.<sup>58</sup> More importantly, Chapter IV of the Chinese Environmental Protection Law mandates corporate environmental responsibility regarding pollution control.<sup>59</sup> Companies are legally obligated to reduce or eliminate pollution and bear liability in accordance with relevant provisions. If a company breaks the law, it is subject to warnings, fines, administrative sanctions, and even criminal responsibility.<sup>60</sup>

### 7. Other Laws and Regulations that Promote CSR in China

There is growing demand in China to develop CSR, and Chinese policymakers appear to recognize this trend. In recent years, the Chinese legislature has passed numerous laws and regulations regarding the improvement of CSR in China. In addition to the laws discussed above, the Product Quality Law of the People's Republic of China (1993),<sup>61</sup> Food Hygiene Law of the People's Republic of China (1995),<sup>62</sup> Law of the People's Republic of China on Coal Industry (1996),<sup>63</sup> Law of the People's Republic of China on Donations for Public Welfare (1999),<sup>64</sup> Provisions on the Prohibition of Using Child Labor (2002),<sup>65</sup> Production Safety Law of

58. *Id.* art. 12.

59. *Id.* art. 24–34.

60. *Id.* art. 35–45.

61. Zhonghua Renmin Gongheguo Chanpin Zhiliang Fa (中华人民共和国产品质量法) [Product Quality Law of the People's Republic of China] (promulgated by Standing Comm. Nat'l People's Cong., Feb. 22, 1993, effective Sept. 1, 1993), *available at* LAWINFOCHINA, [http://www.lawinfochina.com/law/display.asp?db=1&id=1834&keyword=product quality](http://www.lawinfochina.com/law/display.asp?db=1&id=1834&keyword=product%20quality).

62. Zhonghua Renmin Gongheguo Shipin Weisheng Fa (中华人民共和国食品卫生法) [Food Hygiene Law of the People's Republic of China] (promulgated by Order No. 59 of the President of the People's Republic of China, Oct. 30, 1995, effective Oct. 30, 1995), *available at* LAWINFOCHINA, [http://www.lawinfochina.com/law/display.asp?db=1&id=116&keyword= FoodHygieneLaw](http://www.lawinfochina.com/law/display.asp?db=1&id=116&keyword=FoodHygieneLaw).

63. Zhonghua Renmin Gongheguo Meitan Fa (中华人民共和国煤炭法) [Law of the People's Republic of China on the Coal Industry] (promulgated by the Standing Comm. of Nat'l People's Cong., Aug. 29, 1996, effective Dec. 1, 1996), *available at* LAWINFOCHINA, [http://www.lawinfochina.com/law/display.asp?db=1&id=1034&keyword=coal industry](http://www.lawinfochina.com/law/display.asp?db=1&id=1034&keyword=coal%20industry).

64. Zhonghua Renmin Gongheguo Gongyi Shiye Juanzeng Fa (中华人民共和国公益事业捐赠法) [Law of the People's Republic of China on Donations for Public Welfare] (promulgated by Order No. 19 of the President of the People's Republic of China, June 28, 1999, effective Sept. 1, 1999), *available at* LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=6238&keyword=welfare>.

65. Jinzhi Shiyong Tonggong Guiding (禁止使用童工规定) [Provisions on the Prohibition of Using Child Labor] (promulgated by Decree No. 364 of the State Council of the People's Republic of China, Oct. 1, 2002, effective Dec. 1, 2002), *available at* LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=2510&keyword=CHILD>.

the People's Republic of China (2002),<sup>66</sup> Law of the People's Republic of China on the Prevention and Control of Water Pollution (2008),<sup>67</sup> Energy Conservation Law of the People's Republic of China (2008),<sup>68</sup> and Labor Contract Law of the People's Republic of China (2008)<sup>69</sup> were all promulgated, at least in part, to promote CSR. In particular, after the Milk Powder Scandal in 2008 and the frequent coal mine accidents of recent years, the Food Safety Law of the People's Republic of China (2009) and Measures for the Administration of Contingency Plans for Work Safety Incidents (2009) were passed in order to regulate areas of need in a more detailed manner.<sup>70</sup> In sum, the Chinese government has been devoted to the improvement of CSR. The promulgation of these laws, regulations, and measures has substantially improved the recognition of CSR standards in China.

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66. Zhonghua Renmin Gongheguo Anquan Shengchan Fa (中华人民共和国安全生产法) [Production Safety Law of the People's Republic of China] (promulgated by Standing Comm. Nat'l People's Cong., June 29, 2002, effective Nov. 1, 2002), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=2387&keyword=production+safety>.

67. Zhonghua Renmin Gongheguo Shuiwuran Fangzhi Fa (中华人民共和国水污染防治法) [Law of the People's Republic of China on the Prevention and Control of Water Pollution] (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 28, 2008, effective June 1, 2008), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=349&keyword=water+pollution>.

68. Zhonghua Renmin Gongheguo Jieyue Nengyuan Fa (中华人民共和国节约能源法) [Energy Conservation Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Nov. 1, 1997, and amended by the Standing Comm. Nat'l People's Cong., Oct. 28, 2007, effective Apr. 1, 2008), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=6467&keyword=energy>.

69. Zhonghua Renmin Gongheguo Laodong Hetong Fa (中华人民共和国劳动合同法) [Labor Contract Law of the People's Republic of China] (promulgated by Order No. 65 of the President of the People's Republic of China, June 29, 2007, effective Jan. 1, 2008), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=6133&keyword=contract>.

70. Zhonghua Renmin Gongheguo Shipin Anquan Fa (中华人民共和国食品安全法) [Food Safety Law of the People's Republic of China] (promulgated by Order No. 9 of the President of the People's Republic of China, Feb. 28, 2009, effective June 1, 2009), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=7344&keyword=Food+Safety+Law>; Shengchan Anquan Shigu Yingji Yu'an Guanli Banfa (生产安全事故应急预案管理办法) [Measures for the Administration of Contingency Plans for Work Safety Incidents] (promulgated by Order No. 17 of the State Administration of Production Safety Supervision and Management, Apr. 1, 2009, effective May 1, 2009), available at LAWINFOCHINA, <http://www.lawinfochina.com/law/display.asp?db=1&id=7573&keyword=Measures+for+the+Administration+of+Contingency+Plans+for+Work+Safety+Incidents>.

## III. THE IMPROVEMENT OF CSR IN CHINA

A. *Current CSR Standards and Lack of Proper Enforcement*

Chinese companies are aware of the growing concerns regarding CSR, and the Chinese legislature has been incorporating CSR standards into the legal system.<sup>71</sup> Many Chinese companies, particularly state-owned enterprises and export-oriented companies, are actively implementing CSR standards.<sup>72</sup> Despite the overall improvement in CSR legislation, problems still exist in practice. Occupational accidents, food-poisoning incidents, and industrial pollution events are frequently in the headlines.<sup>73</sup> Regrettably, many Chinese companies still focus on profit maximization, and because of this, few of them voluntarily implement CSR principles.<sup>74</sup> In practice, workers are often required to work much more than forty hours per week and are paid below the minimum wage.<sup>75</sup> Unsurprisingly, dangerous working conditions, food safety incidents, and excessive industrial pollution remain common.<sup>76</sup> Even though China has incorporated CSR into its legislation, the continuing frequency of CSR failures results from the lack of proper enforcement. Consequently, further reforms are necessary to make substantial changes for the implementation of CSR standards in China.

B. *Recommendations on How to Promote CSR in China's Sustainable Economic Growth*

Despite promulgation of much CSR legislation, in many cases, enforcement in practice differs from the law as it appears on paper. Accordingly, it is important for the Chinese government to take measures to effectively enforce its laws. With respect to the implementation of CSR standards, there are two things that must be done. First, for those CSR standards that have been incorporated into the law, the government must ensure that local governments and officials understand the standards and the importance of their enforcement. Fines, administrative sanctions, imprisonment, and other punishments must be visible consequences to companies to be an effective tool to address CSR performance.<sup>77</sup> Second,

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71. See generally *infra* section II.B.7.

72. Han, *supra* note 3.

73. Zijun Li, *Lack of Corporate Social Responsibility Behind Recent China Accidents*, WORLD WATCH INSTITUTE, (Dec. 12, 2005), <http://www.worldwatch.org/node/3859>.

74. *Id.*

75. Han, *supra* note 3.

76. Dana C. Nicholas, Note, *China's Labor Enforcement Crisis: International Intervention and Corporate Social Responsibility*, 11 SCHOLAR 155, 170 (2009).

77. *Id.* at 187.

the government must encourage Chinese companies to implement standards not yet incorporated into law.

Because of China's specific economic, social, and political situations, several steps need to be taken to effectively enforce CSR standards. First, trade unions have to be reformed to allow more independence from the government. Second, understanding of corporate social accountability standards among workers must expand to achieve the goal of protecting labor rights. Chinese workers must be educated to know their rights so that they can claim these rights and prevent their employers from infringing upon them. Third, consumer awareness of CSR must be widely achieved. Only then can consumers play an important role in supervising companies' activities and their rights be better protected. Fourth, media disclosure and criticism of the failure of CSR in some companies is necessary. This can create a powerful incentive for companies to adopt CSR standards. Finally, to promote sustainable development, the Chinese government must also make a more concerted effort to strengthen environmental protection and reduce industrial pollution.

### *1. Reform Trade Unions in China*

China promulgated its Trade Union Law in 1992 and amended it in 2001. Read literally, it entitles workers to the right to participate in and organize trade unions.<sup>78</sup> Although the law guarantees the right to "participate in and organize trade unions[,]” it does not necessarily mean that workers can do so. In practice, workers are not allowed to independently organize unions without pre-approval from related government departments, and there is essentially only one organization, the ACFTU and its branches, that can represent workers in China.<sup>79</sup> With just one union representing all workers, there is less ability for workers to demand better labor conditions or meaningfully bargain with their employers.

For trade unions to better serve workers, substantial reforms must be made. Currently, the complete freedom of trade unions may not be easily achievable due to the political situation in China.<sup>80</sup> What can be done at present is the empowerment of the ACFTU to bargain with employers for better working conditions, fair wages, reasonable working hours, and other workers' rights. By doing this, the ACFTU can more effectively work to benefit workers. Ultimately, substantial changes and improvements must be made to successfully protect labor rights. Chinese trade unions must be made into free and independent unions without influence from political

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78. Trade Union Law, *supra* note 41 art. 3.

79. HUMAN RIGHTS WATCH, *supra* note 44.

80. See Nicholas, *supra* note 76, at 188.

authorities and other powerful entities.<sup>81</sup> Workers have to be enabled to participate in and organize trade unions freely and independently. Only then will Chinese workers be in a position to collectively bargain effectively in hopes of substantially improving labor conditions.<sup>82</sup>

## 2. *Raise Workers' Awareness of Their Own Rights*

Since implementation, many workers have come to enjoy the benefits of these aforementioned CSR standards. However, most do not truly understand the meaning, the purposes, or the goals of CSR.<sup>83</sup> Most workers are merely passive recipients of the benefits resulting from CSR standards. Despite the fairly high level of protection Chinese law provides for workers, it will be difficult to achieve success without workers' active participation.

Thus, possibly the best and most efficient way to adequately protect and promote labor rights is to make CSR standards, enforcement procedures, and relevant remedies widely known among workers.<sup>84</sup> The Chinese government should provide systematic and comprehensive education to workers regarding their rights so that they can know what they can do if their rights are infringed upon by their employers.<sup>85</sup> To achieve this goal, the government should disseminate information through brochures, posters, media, and any other effective means.<sup>86</sup>

Additionally, the flow of workers among companies and its impact on the implementation of CSR standards is important. Normally, export-oriented companies in China more readily and efficiently implement CSR standards than do domestic-oriented companies because of the CSR requirements established by their foreign partners. The improvement of export-oriented employees' awareness of CSR standards is likely to have a positive effect on workers in domestic-oriented companies because laborers who flow among companies may transmit the awareness of CSR to workers who are not covered by the standards.<sup>87</sup> In sum, labor conditions can be improved if the Chinese government takes measures to increase workers' awareness of CSR standards and available remedies if their rights are infringed upon.<sup>88</sup>

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81. *Id.*

82. *Id.*

83. Lin, *supra* note 7, at 369.

84. Nicholas, *supra* note 71, at 187.

85. Lin, *supra* note 7, at 369.

86. *Id.*

87. *Id.*

88. Nicholas, *supra* note 71, at 190.

### 3. *Raise Consumer Awareness in China*

Beyond government guidance, the promotion of CSR standards also needs public support. Consumer pressure calling for further CSR standards could play an important role in prodding Chinese companies to implement such standards. Because there is no apparent demand from Chinese consumers for the implementation of CSR standards, domestic-oriented companies in China are only minimally affected by CSR. This stands in stark contrast to the export-oriented companies that are impacted by their trading partners' CSR obligations.

In the modern world, consumption is not only an individual activity, but also one that may influence the consumption preferences of the whole society. If a company is exposed by a reliable consumer association or the media for violations of the law, abuses of human rights, environmental pollution, or the waste of natural resources, consumers may refuse to buy products or services from them. In this way, companies are compelled to implement CSR standards, or at least follow minimal CSR norms. Currently, although there is no apparent demand from Chinese consumers that companies implement CSR practices, these consumers are increasingly "becoming more rights-oriented."<sup>89</sup> The government should make reasonable efforts to continue this trend so that CSR standards will be substantially incorporated into everyday business operations.<sup>90</sup>

### 4. *Media Supervision*

The promotion of CSR must be a combined effort. In addition to government guidance and consumer action, the mass media, such as television, radio, newspapers, and the Internet, should be widely used to publicize CSR ideas and highlight the importance of meeting CSR standards. This can lead to close supervision and awareness of CSR-related problems.<sup>91</sup> The recent exposure of coal mine accidents and the Milk Powder Scandal have fostered increasing public interest in CSR. The media can and should act as a supervisor for the enforcement of CSR standards in business operations. When the media disclose and criticize corporations' failures to meet CSR standards, the public is notified of the inappropriate activities of the company. In many cases, some consumers will respond by boycotting the companies for their failures of social or environmental responsibility. In addition, media supervision of corporate social responsibility attracts more attention from local governments and even the Chinese Central Government. The government is then able to take

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89. Han, *supra* note 3.

90. *Id.*

91. *Id.*

measures to prevent business activities from harming the society, the people, and the environment.

*5. Strengthen Environmental Protection and Reduce Resource Consumption*

Although China may seem to be a large country with adequate natural resources, China also has the largest population in the world.<sup>92</sup> China has relatively insufficient land, water, energy, and various natural resources necessary for sustainable development.<sup>93</sup> Environmental protection is for the benefit of both the natural environment and human beings and has become one of the most important tasks of the Chinese government.

Industrial pollution and the waste of natural resources are two important concerns in CSR. One of the goals of CSR is environmental protection, accomplished by controlling industrial pollution and reducing natural resource consumption as much as possible.<sup>94</sup> In recent years, the Chinese government has advocated for “clean production and green consumption[,]”<sup>95</sup> and Chinese companies are making progress toward protecting the environment and saving resources. Nevertheless, more action is needed to make China a resource-conserving and environmentally-friendly society.

Once again, the Chinese government plays an important role. The government should take measures to raise society’s environmental awareness. More money should be allocated to technological innovation for pollution control and the reduction of resource consumption. In addition to government guidance and assistance, it is also companies’ responsibility to protect the environment and reduce resource consumption. To uphold this environmental responsibility, corporations must make sure that the impacts of their activities on the environment are minimal.<sup>96</sup> They should make strategic plans and carry out measures to minimize energy consumption, reduce industrial pollution, and safely dispose of waste material.<sup>97</sup>

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92. CIA WORLD FACTBOOK, CENTRAL INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html> (follow “People” hyperlink) (last visited Jan. 20, 2011).

93. Han, *supra* note 3.

94. *Id.*

95. *Id.*

96. *Best Practices, Corporate Social Responsibility in China*, THE US-CHINA BUSINESS COUNCIL (2006), <http://www.uschina.org/public/documents/2006/10/uscbc-csr-best-practices.pdf>.

97. Han, *supra* note 3.

## IV. CONCLUSION

Globalization both forces China to be more integrated into the world economy and grants China more power to affect the world than ever before. On the other hand, globalization means that to increase its global competitiveness, China has to adjust its domestic policies to adapt to global market demands.<sup>98</sup>

Worldwide, and in growing numbers, companies are embracing CSR standards in their business operations, and many transnational corporations require their international partners to meet CSR standards.<sup>99</sup> Therefore, there is growing demand in China to develop and enforce CSR standards. Despite the progress made by many companies, the implementation of CSR standards in China is still in its early stages for most companies. To comply with the expectations and demands of foreign companies and to maintain and improve Chinese companies' competitiveness in the global market, Chinese companies are encouraged to adopt high levels of social and environmental standards and to actively implement these standards.<sup>100</sup>

The promotion of CSR in China should emphasize the following: first, the improvement of working conditions and the protection of workers' safety and other rights; second, the promotion of product safety and the protection of consumers' rights; and third, the control of industrial pollution and the reduction of resource consumption.<sup>101</sup> Strengthening sustainable development is necessary to the improvement of Chinese national power and would help promote stable and healthy economic development. CSR standards can also contribute to sustainable economic growth; therefore, it is extremely important for Chinese companies to meet CSR standards in their everyday business operations.

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98. Lin, *supra* note 7, at 353.

99. Li, *supra* note 68.

100. Nicholas, *supra* note 6, at 166.

101. Han, *supra* note 3.



# RECENT EUROPEAN UNION INITIATIVES & THE DANISH EXPERIENCE

Peter Gjørtler\*

Corporate Social Responsibility (CSR) is a concept that has developed over the last twenty years, with rapid and accelerating growth in public awareness and application during the last ten years.<sup>1</sup> Currently, it is a major concern for many companies and has become increasingly visible as front-page news in professional newsletters.<sup>2</sup> However, it remains a field that is to a large extent unregulated, or regulated only by soft law. The purpose of this paper is to examine the latest developments in European Union (EU) policy on CSR and to present the experience of Denmark in supporting soft law targets with hard law measures. This paper is based on a presentation made on March 26, 2010, to a symposium arranged by the Indiana International & Comparative Law Review<sup>3</sup> held at Indiana University School of Law–Indianapolis. The symposium reflected on the application of CSR in different regions and cultures across the globe.

## THE DEVELOPMENT OF POLICY GOALS IN THE EUROPEAN UNION

The EU rests upon a principle of delegated competences. The adoption of the Lisbon Treaty on December 1, 2009, clarified this principle. This treaty modified the existing EU treaties and clarified the distribution of competences between the EU and its Member States, including areas with shared competence.<sup>4</sup> These provisions do not address CSR, directly or indirectly. Accordingly, a competence falling outside the scope of EU competence remains with the each Member State.<sup>5</sup>

However, the interpretation of whether an area is within EU competence has some flexibility, even with a reserve provision setting the legislative procedure for areas that are not covered by more specific

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1. See *Communication from the Commission Concerning Corporate Social Responsibility: A Business Contribution to Sustainable Development*, at 6, COM (2002) 347 final (July 2, 2002).

2. See, e.g., Trine Beckett, *Madame CSR*, DJØFBLADET, THE MAGAZINE FOR MEMBERS OF THE LAWYERS & ECONOMISTS TRADE UNION IN DENMARK, Djøf Sheet No. 12, June 23, 2010, available at <http://www.djoef.dk/djoefbladet/Arkiv/DJOeFBladet2010/DJ-OE-F-Bladet-nr-12-2010/Madame-CSR.aspx>.

3. *Indiana International & Comparative Law Review*, INDIANA UNIVERSITY SCHOOL OF LAW, <http://indylaw.indiana.edu/iiclr/symposium.htm> (last visited Jan. 11, 2011).

4. Consolidated Version of the Treaty on the Functioning of the European Union art. 4, Sept. 5, 2008, 2008 O.J. (C 115) 47 [hereinafter TFEU]; see also *id.* arts. 2–6 (specifying the areas and competences in more detail).

5. *Id.* art. 2.

provisions.<sup>6</sup> The European Court of Justice (ECJ) has rarely overruled the assessment of the EU legislator about whether an area fell within EU legislative competence.<sup>7</sup> This flexibility is even wider in relation to non-legislative measures. The Lisbon Treaty codified competences to support Member State actions in broad fields of policy, including that of industry.<sup>8</sup> Thus, it seems clear that the EU has the competence to adopt non-legislative or soft law supporting measures concerning CSR. Further, arguably, hard law regulation of CSR is possible under the powers delegated to the EU regarding regulation of the Internal Markets.<sup>9</sup> Following the logic of one of the founding cases on gender discrimination,<sup>10</sup> one could argue that if CSR is not regulated in a similar manner in all Member States, the competition between companies will be upset when these companies come from Member States with differing levels of CSR regulation.

While this argument has an immediately convincing appeal, it also has an inherent danger. This would negate the principle of delegated competences. Accordingly, it has not become a main argument for the ECJ, except in the more limited form, where any national legislation that may have an impact on the internal market will be subject to EU limitations.<sup>11</sup> Thus, this argument is used to expand judicial, as opposed to legislative, competence.

In relation to CSR, the European Council seems to have followed the same conservative approach as the ECJ. This is illustrated by the conclusions of the Lisbon Meeting in 2001. The European Council has no legislative powers but has the task of setting the political and legislative strategy of the EU, which is subsequently implemented in coordination between the Council of Ministers, European Parliament, and European Commission.<sup>12</sup> The conclusions include the following statement in relation to CSR: “The European Council *makes a special appeal to companies’ corporate sense of social responsibility* regarding best practices on *lifelong learning, work organisation, equal opportunities, social inclusion and sustainable development.*”<sup>13</sup>

Evidently, the EU treats CSR as an industry-driven initiative for self-regulation. The EU wishes to support and urge the industry to pursue CSR,

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6. *See id.* art. 352.

7. *See, e.g.,* Opinion 2/94, Accession by the Community to the European Convention for the Protection of Human Rights and Fundamental Freedoms, 1996 E.C.R. I-1763.

8. TFEU, *supra* note 4, art. 6(b).

9. *Id.* art. 4(2)(a).

10. Case 43/75, Defrenne v. SA Belge de Navigation Aeriennne (SABENA), 1976 E.C.R. 455.

11. Case 299/86, Comm’n v. Drex1, 1988 E.C.R. 1213.

12. *See* TFEU, *supra* note 4, art. 15.

13. Presidency Conclusions, Lisbon European Council (Mar. 23–24, 2000), *available at* [http://www.europarl.europa.eu/summits/lis1\\_en.htm](http://www.europarl.europa.eu/summits/lis1_en.htm) (last visited Jan. 11, 2011) (emphasis added).

but it does not intend to submit the industry to EU legislation. This supporting approach is further pursued in the 2001 Green Paper on CSR from the European Commission.<sup>14</sup> Green papers are normally used for presenting new legislative initiatives, so as to form the basis for a public hearing prior to the formal presentation of the legislative draft. However, it is clear that the intention of the European Commission is not to develop CSR legislation, but instead, to provide a framework to promote an industry consensus on the application of CSR. The Green Paper mentions the following goals of the Commission: “*Developing an overall European framework, in partnership with the main corporate social responsibility actors, aiming at promoting transparency, coherence and best practice in corporate social responsibility practices[]*”<sup>15</sup> and “[*p*]romoting consensus on, and supporting, best practice approaches to *evaluation and verification of corporate social responsibility practices[.]*”<sup>16</sup>

These targets are further developed in the 2006 Communication on CSR from the European Commission.<sup>17</sup> The European Commission often uses communications to inform the public about its interpretation of the state of law. But, in this case, the communication is clearly aimed at the EU legislator to set the strategy of the European Commission. The main position taken by the Commission is that CSR is “*not a substitute for public policy, but [] can contribute to a number of public policy objectives.*”<sup>18</sup>

However, the European Commission has also intended to address the industry, whose active participation in achieving the targets is clearly intended. The targets include:

- More *integrated labour markets* and higher levels of social inclusion, as enterprises actively seek to recruit more people from disadvantaged groups;
- Investment in *skills development, life-long learning and employability*, which are needed to remain competitive in the global knowledge economy and to cope with the ageing of the working population in Europe;
- Improvements in *public health*, as a result of voluntary initiatives by enterprises in areas such as the marketing and labelling of food and non-toxic chemicals;

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14. *Commission Green Paper on Promoting a European Framework for Corporate Social Responsibility*, at 7, COM (2001) 366 final (July 18, 2001).

15. *Id.* at 25 (emphasis added).

16. *Id.* (emphasis added).

17. *See generally Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee - Implementing the Partnership for Growth and Jobs: Making Europe a Pole of Excellence on Corporate Social Responsibility*, COM (2006) 136 final (Mar. 22, 2006).

18. *Id.* at 4 (emphasis added).

- Better *innovation performance*, especially with regard to innovations that address societal problems, as a result of more intensive interaction with external stakeholders and the creation of working environments more conducive to innovation;
- A more rational use of *natural resources* and reduced levels of pollution, notably thanks to investments in eco-innovation and to the voluntary adoption of environmental management systems and labelling;
- A more *positive image of business* and entrepreneurs in society, potentially helping to cultivate more favourable attitudes towards entrepreneurship;
- Greater respect for *human rights*, environmental protection and core labour standards, especially in developing countries; and
- *Poverty reduction* and progress towards the Millennium Development Goals.<sup>19</sup>

The ultimate goal is active participation of industry. This becomes clear when looking at the description of instruments that the European Commission intends to employ to reach the aforementioned targets. These instruments are described as actions; they are supporting measures, not legislative regulations. They include:

- Awareness-raising and best practice exchange with *an emphasis on Small and Medium-sized Enterprises (SMEs)*<sup>20</sup> and on Member States where CSR is a less well-known concept;
- Support to *multi-stakeholder initiatives*, including social partners and Non-Governmental Organizations (NGOs);
- Consumer information and transparency including *clear information on the social and environmental performance of goods and services* and information on the supply chain; and
- Research and education;<sup>21</sup>

With the Maastricht Treaty in 1992, the EU introduced the principle of subsidiarity, which requires that in areas outside of exclusive EU

19. *Id.* (emphasis added).

20. See Report from the European Expert Group on Corporate Social Responsibility & Small and Medium-sized Enterprises, *Opportunity and Responsibility - How to Help More Small Businesses to Integrate Social and Environmental Issues into What They Do*, (May 2007), available at [http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/sme/european-expert-group/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/sme/european-expert-group/index_en.htm) (last visited Jan. 11, 2011).

21. *Id.* at para. 6–10 & 15.

competence, the EU shall act only where it is not more relevant for Member States to act.<sup>22</sup> Although this principle has remained more of a political guide than a hard law provision subject to jurisdiction, it seems clear that the European Commission had this in mind when drafting the proposed actions. The communication clearly demonstrates the cross-border implications and perspectives of CSR. These implications include the following:

- International dimension of CSR – United Nations (UN) Millennium Development Goals, International Labour Organization Tripartite Declaration of Principles concerning Multinational Enterprises (MNEs) and Social Policy, the Organisation for Economic Co-operation and Development Guidelines for MNEs, and the UN Global Compact;
- Cooperation with Member States – a group of high-level national representatives on CSR; and
- European Alliance for CSR – a political umbrella for new or existing CSR initiatives by large companies, SMEs, and their stakeholders.<sup>23</sup>

The European Alliance (Alliance) is an example of the implicit reach of the 2006 communication to the industry. The Alliance was formed as an industry initiative in the same year with strong backing from the European Commission. The Alliance aims to harness the resources of industry and its stakeholders thereby promoting the multi-stakeholder philosophy. The more specific target of the Alliance is to support sustainable development, economic growth, and job creation. The Alliance includes three business organizations, which are already active in promoting CSR in Europe: CSR Europe; BUSINESSEUROPE, an association of business federations; and the European Association of Craft, Small and Medium-sized Enterprises (UEAPME).<sup>24</sup>

At the request of the European Commission, various members of industry founded CSR Europe in 1995.<sup>25</sup> It was established as a network with a membership that includes seventy-five multinational corporations

22. See TFEU, *supra* note 4, art. 4.

23. See generally Commission Decision Setting up a High Level Group on Competitiveness, Energy and the Environment, 2006 O.J. (L 36) 43 (EC). Find subsequent reports of the High Level Group on Competitiveness, Energy and the Environment at [http://ec.europa.eu/enterprise/policies/sustainable-business/documents/high-level-group/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sustainable-business/documents/high-level-group/index_en.htm).

24. See *What is the Alliance?*, CSR EUROPE, <http://www.csreurope.org/pages/en/aboutalliance.html> (last visited Jan. 19, 2011).

25. About CSR Europe, CSR EUROPE, [http://www.csreurope.org/pages/en/about\\_us.html](http://www.csreurope.org/pages/en/about_us.html) (last visited Jan. 12, 2011).

and twenty-seven national partner organizations.<sup>26</sup> Thus, an umbrella perspective of the Alliance continues throughout its membership. CSR Europe, in turn, has many national organizations as members and reaches the SMEs that form the core target for the European Commission. CSR Europe's objective is to facilitate a sharing of best practices on CSR. One of the chosen methods for sharing best practices includes running projects for the industry and its stakeholders, where focus is kept on the twin objects of maintaining competitiveness and sustainability.<sup>27</sup>

In summary, the EU agenda on CSR, as outlined by the European Council in 2001 and filled out by the European Commission in 2006, has one main objective: to support the implementation of CSR by the European industry. Because SMEs constitute the predominant form of industry in Europe, CSR in SMEs is a core priority for the European Commission. At the same time, there are ongoing efforts aimed at eliminating the apparent dilemma between CSR and competitiveness by underlining the advantages for competitiveness that may result from a correct implementation of CSR. According to the Directorate General for Enterprise and Industry of the European Commission, the advent of the current economic crisis has only made CSR more important in countering the implications of the crisis.<sup>28</sup> In order to make the initiative more efficient, its implementation has been focused on three industry sectors: chemicals, textiles, and construction.

One of the aspects of CSR that has recently come into focus is human rights in business. The change is not intended to create new sets of rights but to facilitate the correct application and respect for human rights in business operations. The underlying intention is to achieve legal certainty and access to justice for both individuals and industry. As a reflection of the importance of this aspect of CSR, the UN in 2005 appointed Professor John G. Ruggie as Special Representative to the Secretary General on issues concerning business and human rights. In 2008, Professor Ruggie submitted a report on the issue.<sup>29</sup> In 2009, the European Commission

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26. *The European Network on CSR - Driving Change*, CSR EUROPE, (2006), [http://www.csreurope.org/data/files/csr\\_europe\\_npo\\_brochure\\_2006.pdf](http://www.csreurope.org/data/files/csr_europe_npo_brochure_2006.pdf); see also *CSR Europe - Working with You (2009 - 2010)*, CSR EUROPE, (Jan. 2009), [http://www.csreurope.org/data/files/csr\\_europe\\_working\\_with\\_you\\_20092010.pdf](http://www.csreurope.org/data/files/csr_europe_working_with_you_20092010.pdf); *A Guide to CSR in Europe - Country Insights by CSR Europe's National Partner Organisations*, CSR EUROPE, (Oct. 2009), [http://www.csreurope.org/data/files/20091012\\_a\\_guide\\_to\\_csr\\_in\\_europe\\_final.pdf](http://www.csreurope.org/data/files/20091012_a_guide_to_csr_in_europe_final.pdf) (last visited Jan. 12, 2011).

27. *European Competitiveness Report*, at 106, COM (2008) 774 final (Nov. 28, 2008).

28. See Günter Verheugen, Vice-President, European Comm'n Responsible for Enter. & Indus., *Corporate Social Responsibility Essential for Public Trust in Business* (Feb. 10, 2009), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/09/53&format=PDF&aged=0&language=EN&guiLanguage=en> (last visited Jan. 12, 2011); see also Lene Espersen, *CSR in a Time of Crisis*, CSRGOV.DK (Mar. 31, 2009), <http://blog.csrgov.dk/?p=3> (last visited Jan. 12, 2011).

29. See Report of the Special Representative of the Secretary General on the Issue of

initiated a follow-up study of the legal framework on human rights and the environment applicable to European enterprises operating outside the EU.<sup>30</sup> Concurrently, the UN Global Compact, Global Reporting Initiative, and Realizing Rights published a new guide on CSR and human rights in 2009.<sup>31</sup>

#### IMPLEMENTATION IN DENMARK

In Denmark, the Danish Ministry of Economic and Business Affairs acting through the Danish Commerce and Companies Agency (DCCA) undertakes the public administration of CSR.<sup>32</sup> In 2007, the DCCA established the Danish Government Centre for CSR (Centre).<sup>33</sup> This was a follow-up to the establishment of the Copenhagen Centre in 1998.<sup>34</sup> The Centre functions also as the secretariat for the National Network of Business Leaders, and, in this connection, it is a member of the European Academy of Business in Society (EABis).

These developments may be seen as following the European Commission policies of supporting industry initiatives and facilitating networks, while involving all stakeholders. However, a new initiative evolved in 2008 to underpin the voluntary implementation of CSR with certain legislative measures. This was based on a government Action Plan for Corporate Social Responsibility adopted earlier in 2008.<sup>35</sup> The legislative initiative was in the form of an amendment to the existing law on Annual Reports.<sup>36</sup> The amendment has since been incorporated into the law

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Human Rights and Transnational Corps. and Other Bus. Enters., U.N. Human Rights Council, 8th Sess., U.N. Doc. A/HRC/8/5 (Apr. 7, 2008) (by John Ruggie).

30. See European Comm'n, *Enter. & Indus. Directorate-Gen., Study of the Legal Framework on Human Rights and the Environment Applicable to European Enterprises Operating Outside the EU*, ENTR/09/45, 2009 O.J. (S 131).

31. See U.N. GLOBAL COMPACT ET AL., *A RESOURCE GUIDE TO CORPORATE HUMAN RIGHTS REPORTING* (2009), available at [http://www.globalreporting.org/NR/rdonlyres/4C5DB4C6-5084-4A84-BE51-0D134B3B5A2E/3583/HR\\_ReportFINAL\\_Resource\\_Guide.pdf](http://www.globalreporting.org/NR/rdonlyres/4C5DB4C6-5084-4A84-BE51-0D134B3B5A2E/3583/HR_ReportFINAL_Resource_Guide.pdf).

32. *Corporate Social Responsibility*, DANISH COMMERCE AND COMPANIES AGENCY, <http://www.dcca.dk/sw63091.asp> (last visited Jan. 12, 2011).

33. *The Danish Commerce and Companies Agency for Corporate Social Responsibility*, CSRGOV.DK, <http://www.csrgov.dk/sw49166.asp> (last visited Jan. 12, 2011).

34. *The Copenhagen Centre*, CSR-DIRECTORY.NET, <http://csr-news.net/directory/the-copenhagen-centre> (last visited Jan. 12, 2011).

35. *Action Plan for Corporate Social Responsibility*, CSRGOV.DK, <http://www.csrgov.dk/sw49167.asp> (last visited Jan. 12, 2011).

36. *Amendments and Supplements to the Law on Annual Accounts and the Law on Consolidated Accounts*, INFOLEX.LT (June 26, 2008), <http://www.infolex.lt/portal/ml/start.asp?act=legupd&lang=eng??&biulid=160&srld=71&strid=991> (discussing amendment 1403/2008 on statements of social responsibility in larger companies).

by means of a consolidated law.<sup>37</sup> This is a normal procedure in Denmark, so as to make the consolidated law the official legal reference. Since the Treaty of Amsterdam in 1997, it is also slowly becoming a custom within the EU.

It is clear from the preparatory work that the purpose of this latest Danish initiative was to encourage industry to take an active position on the issue of CSR.<sup>38</sup> As such, it would seem to focus on different targets than the EU because of its concentration on larger companies rather than SMEs. However, this would appear to be a distinction creating little difference because, by EU standards, most Danish companies may be considered SMEs. In designing tools for promoting CSR, it is also clear that the aim of the Danish government is SMEs.<sup>39</sup>

The core obligation of the law relates to the management report, which is part of the annual accounts. This law stipulates that any management report must specify whether the company applies a code of corporate governance, and in such case, where that code is publicly available.<sup>40</sup> However, this only applies to companies that have securities admitted to trading on a regulated market in an EU or European Economic Area (EEA) country<sup>41</sup> and who are required to submit such a report under Danish law. For companies that do not have securities admitted to trading, the obligation only applies to state-owned companies.<sup>42</sup> For all companies covered that do not apply a codex, the companies are obliged to make a statement on how they otherwise administer corporate governance. However, corporate governance is a broader concept than CSR, which is dealt with specifically in another provision of the law that applies only to large companies.<sup>43</sup> But, as set out below, this applies to companies that either have securities traded or are state-owned.<sup>44</sup> The concept of CSR is defined in the law as follows: “[C]orporate social responsibility means that companies voluntarily *integrate areas such as human rights, social*

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37. ANNUAL ACCOUNTS ACT - CONSOLIDATED ACT No. 395 (2009) (Den.), available at <https://www.retsinformation.dk/Forms/R0710.aspx?id=125071> [hereinafter CONSOLIDATED ACT].

38. See DRAFT LAW AMENDING THE FINANCIAL STATEMENTS ACT 1 LF 5 (2008) (Den.) (amendment law adopted in 2008 after consideration in a parliamentary committee as part of the normal legislative procedure); see also DANISH COMMERCE AND COMPANIES AGENCY, REPORTING ON CORPORATE SOCIAL RESPONSIBILITY - AN INTRODUCTION FOR SUPERVISORY & EXECUTIVE BOARDS (2009).

39. *New CSR Tool Launched*, CSRGOV.DK, <http://www.csrgov.dk/sw58189.asp> (last visited Jan. 19, 2011).

40. CONSOLIDATED ACT, *supra* note 37, § 107(b).

41. Iceland, Lichtenstein, and Norway are included as part of the EEA.

42. *Id.* § 107(c).

43. *See Id.* § 99.

44. *Id.* § 102.

*conditions, environmental and climatic conditions as well as fighting corruption* in their business strategy and business activities.<sup>45</sup>

As for corporate governance, the law also imposes an obligation on companies that do not have a CSR policy because it requires a lack of CSR policy to be disclosed in its management report. This creates an element of pressure because a company's lack of a CSR policy can only be seen as bad for public relations.<sup>46</sup> The qualification as a large company, to which the CSR statement obligations apply, is a general concept used for other purposes in the law. It is generally defined in the opening articles of the Consolidated Law.<sup>47</sup> The definition is quite simple: large companies are those that are not small or medium.<sup>48</sup> In turn, small and medium companies have more specific definitions. The definition is based on three thresholds. A company is considered small or medium if it does not exceed any two of the three thresholds for two consecutive years.<sup>49</sup> It may, however, exceed any one of the three thresholds.<sup>50</sup> The three thresholds for medium size companies are (small size thresholds added in parentheses): 1) balance sheet total of 143 million DKK (36 million DKK); 2) net turnover of 286 million DKK (72 million DKK); and 3) average number of full-time employees during the financial year of 250 (50 employees).<sup>51</sup>

In addition to large companies, the obligation to make CSR statements also applies to companies included in accounting class D.<sup>52</sup> This concept is defined in the opening articles as a state-owned company or one that has securities traded on an EU or EEA market.<sup>53</sup> However, the obligation to make CSR statements in the management report is not absolute but is subject to exemptions and legal conditions. Thus, a company that has submitted a progress report in connection with the UN Global Compact or UN Principles for Responsible Investment does not need to make a CSR statement but will have to state in its management report that it has availed itself of this exemption.<sup>54</sup> For companies in a group with consolidated accounts, it is sufficient that a CSR statement is made for the group as a whole.<sup>55</sup> A subsidiary within a group may choose not to make a CSR statement if the parent company has either made such

45. *Id.* § 99(a) (emphasis added).

46. *Statutory Requirements on Reporting CSR*, CSRGOV.DK, <http://www.csrgov.dk/sw51190.asp> (last visited Jan. 19, 2011).

47. CONSOLIDATED ACT, *supra* note 37, § 7, ¶ 2(3).

48. *Id.* § 7, ¶ 2.

49. *Id.* § 4.

50. *Id.* § 7.

51. *Id.*

52. *Id.* § 102.

53. *Id.* § 7, ¶ 4.

54. *Id.* § 99(a), ¶ 7.

55. *Id.* § 99(a), ¶ 5.

statement or availed itself of the UN progress report exemption.<sup>56</sup> A subsidiary company is not obligated to make any statement if it uses of this option.

While no listing of companies exists, an estimated total of 1,100 companies are covered by the obligation to make CSR statements.<sup>57</sup> The law provides that a CSR statement must indicate the following: 1) the *company's policies on social responsibility*, including any standards, guidelines or principles for community responsibility, which it uses; 2) *how the company translates its policies of social responsibility into action*, including any systems or procedures evidence; and 3) *the company's assessment of what has been achieved* as a result of its work with community responsibility in the financial year, and the company's expectations for any future work.<sup>58</sup>

Furthermore, the Danish legislative system applies a system of delegation of powers similar to the EU, where the Council of Ministers and the European Parliament may delegate to the European Commission the power to adopt implementing measures.<sup>59</sup> In Denmark, such powers are normally granted to the ministers concerned, who may then adopt executive orders.

In 2009, the Minister for Economic and Business Affairs issued an executive order under the amended law, which regulates the publication of CSR statements on websites as an alternative to including them in the management report.<sup>60</sup> One advantage to companies choosing this option is easier website updating, as opposed to the yearly management reports. The CSR statement may also be made in a separate document, to which reference is made in the management report.<sup>61</sup> This option applies, in relation to CSR, to companies covered by accounting class C, as well as companies covered by accounting class D of the consolidated law. The opening provisions state that medium and large companies are at least subject to accounting class C.<sup>62</sup> The scope of class D is explained above.<sup>63</sup> In this circuitous manner, apparently all companies with a CSR statement obligation may avail themselves of the web publication option. However, those using this alternative must expressly mention within the management

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56. *Id.* § 99(a), ¶ 6.

57. *FAQ*, CSRGOV.DK, <http://www.csrgov.dk/sw51582.asp> (last visited Jan. 12, 2011).

58. CONSOLIDATED ACT, *supra* note 37, § 99(a), ¶ 2.

59. TFEU, *supra* note 4, art. 290.

60. NOTICE FOR DISCLOSURE OF CORPORATE GOVERNANCE STATEMENT AND EXPLANATION OF CORPORATE SOCIAL RESPONSIBILITY ON THE COMPANY WEBSITE, ETC., EXEC. ORDER NO. 761 (2009) (Den.), *available at* <https://www.retsinformation.dk/Forms/R0710.aspx?id=126096> [hereinafter EXECUTIVE ORDER].

61. *Id.* art. 18.

62. CONSOLIDATED ACT, *supra* note 37, § 7, ¶ 1.3.

63. *Id.* § 102.

report that they have chosen this option and they must include the Internet address where the CSR statement can be found.<sup>64</sup>

Finally, the consolidated law specifies the audit obligations in relation to the corporate governance and CSR statements. As a point of departure, the management report is not subject to audit on its own, but the auditor must confirm that the report is in accordance with its annual accounts.<sup>65</sup> More explicitly, the executive order stipulates that the corporate government statement, on application of any code, is not subject to audit, unless it has been agreed between the company and the auditor that it should be included.<sup>66</sup> Again, this provision must be viewed as an effort to promote transparency by pointing towards such audit agreements.

In relation to CSR, however, the executive order does stipulate a general obligation for the auditor to actually verify that the required statement has been made in the management report or that the website has been correctly identified and labelled.<sup>67</sup> In relation to updating the website, the executive order makes clear that while such updates are acceptable, they must be clearly separated from the original information posted to qualify as an alternative to inclusion in the management report.<sup>68</sup>

#### CONCLUSIONS

Currently, there is no basis for the EU to regulate CSR by legislative measures; it does not form a clear part of the powers delegated to the EU in the treaties on the EU. While it would be possible in principle to construct an interpretation of the delegated powers that would allow for such legislative measures, both the European Council and the European Commission have instead opted for a strategy based on supportive measures. These measures constitute support for the industry to develop and apply CSR norms.

The Danish government has also followed this strategy by setting up public institutions with the specific purpose of supporting the development of CSR. Separately, the Danish government has mandated an element of transparency by requiring companies to publicize their position on CSR in their management reports that form part of the annual accounts. As annual accounting is to a large extent harmonized at the EU level, it would seem feasible for such transparency obligations to be adopted as part of EU law. However, the system is still very new in Denmark. An EU initiative in this field should only be expected to be considered after additional experience has been gathered from the Danish initiative.

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64. EXECUTIVE ORDER, *supra* note 60, art. 10.1–2.

65. CONSOLIDATED ACT, *supra* note 37, § 135, ¶ 5.

66. EXECUTIVE ORDER, *supra* note 60, art. 3.4.

67. *Id.* arts. 16–17.

68. *Id.* art. 15.

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Abigail McWilliams, et. al, *Corporate Social Responsibility: International Perspectives*, 23 *J. Bus. Strategies* 1 (1-7) (2006), available at [https://web.cba.uic.edu/mscv/cv/Abigail\\_McWilliams.pdf](https://web.cba.uic.edu/mscv/cv/Abigail_McWilliams.pdf).

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# CLIMATE CHANGE MITIGATION AND ADAPTATION POLICY OPTIONS: REDUCING AUSTRALIA'S DEPENDENCE ON COAL, NATURAL GAS, AND OTHER NONRENEWABLE ENERGY RESOURCES

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## I. INTRODUCTION

The global financial crisis (GFC) adversely affected some of the world's strongest economies with many of them slipping into negative growth. However, Australia not only experienced positive economic growth, but also maintained a rate above the average growth rate of other members of the Organization of Economic Cooperation and Development (OECD).<sup>1</sup> Australia's Gross Domestic Product (GDP), an important indicator of economic growth, has steadily increased since 2005.<sup>2</sup> Several reasons have been put forward to explain why Australia has remained largely unscathed by the GFC. According to the Australian government, timely policy interventions that provided economic stimulus to vulnerable sectors of its economy played an important role in protecting Australia's economy from the negative effects of the GFC. As policy responses, the government provided support through direct government investments, developed a financial credit scheme for purposes of funding guarantees of deposits held, and increased supervision in the financial sector.<sup>3</sup> All of these measures helped maintain financial confidence, which explains why, despite the international turmoil, banks in Australia have not only

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1. *Australia in Brief: A Stable and Competitive Economy*, AUSTRALIAN GOVERNMENT DEPARTMENT OF FOREIGN AFFAIRS & TRADE, June 2008, available at [http://www.dfat.gov.au/aib/competitive\\_economy.html](http://www.dfat.gov.au/aib/competitive_economy.html). [hereinafter *Australia in Brief*]. Twenty countries originally signed the Convention on the Organization for Economic Co-operation and Development (OECD) on December 14, 1960. Subsequently, thirteen additional countries have ratified the convention. *List of OECD Member countries - Ratification of the Convention on the OECD*, [http://www.oecd.org/document/58/0,3343,en\\_2649\\_201185\\_1889402\\_1\\_1\\_1\\_1,0.html](http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,0.html) (last visited Apr. 9, 2011).

2. *Indicators: GDP Growth (annual %)*, WORLD BANK, <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG> (last visited Apr. 9, 2011).

3. *Australia: 2009 Article IV Consultation-Staff Report; and Public Information Notice on the Executive Board Discussion*, IMF COUNTRY REPORT NO. 09/268 (Aug., 2009).

maintained access to capital funding, but have experienced strong growth in deposits.<sup>4</sup>

Additionally, the Australian Prudential Regulation Authority (APRA) provided robust oversight of the financial services industry in Australia. Since its establishment in 1998, the APRA has played a significant role in ensuring that the Australian investment banking sector has had minimal exposure to similar types of sub-prime securities that were at the heart of the credit crisis in the United States and elsewhere.

More important than the structural reforms and timely government interventions, Australia survived the crisis due to a lengthy period of sustained economic growth prior to the GFC. The government's sustained budget surplus facilitated the elimination of Australia's net government debt by the 2005–2006 financial year.<sup>5</sup> Prior to the GFC, the healthy state of Australia's economy ensured that the government had the resources to respond, which in many cases involved direct investments. However, the government's 2008–2009 budget indicated that the surpluses had ended. The Australian government's net debt is expected to peak at 6% of GDP in 2011–12.<sup>6</sup> In 2009, the treasurer forecasted that Australia's net debt would peak at 13.8% of GDP in 2014. However, the current strength of Australia's GFC recovery suggests that budget surpluses may return earlier than forecasted.<sup>7</sup> The budget deficit was blamed on the economic downturn in China,<sup>8</sup> which highlights Australia's dependency on China and offers insight into Australia's sterling economic performance over the last few years.

Coal plays an important role in the Australian economy. Australia is the world's largest coal exporter. Its 2008 net exports account for approximately thirty-two percent of the world's total coal exports.<sup>9</sup> Coal is ranked first among the country's exported goods and services, accounting for A\$39.2 billion in revenue in 2009. Australia's other major exports include minerals, such as iron ore, aluminum, and gold, and other sources of energy, such as crude petroleum and natural gas.<sup>10</sup> Thus, Australia's export trade is largely dependent on minerals and nonrenewable energy

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4. Patrizia Tumbarello, *Australian, New Zealand Banks Remain Sound During Global Crisis*, IMF SURV. MAG.: COUNTRIES & REGIONS, Jan. 22, 2010.

5. *Australia in Brief*, *supra* note 1.

6. *Overview: Australian Government Budget 2010-2011*, AUSTRALIAN GOVERNMENT, [http://www.budget.gov.au/2010-11/content/economic\\_statement/html/economic\\_statement-02.htm](http://www.budget.gov.au/2010-11/content/economic_statement/html/economic_statement-02.htm) (last visited Apr. 9, 2011).

7. Budget Speech 2009–10 on the Second Reading of the Appropriation Bill (No.1) by Wayne Swan, Treasurer, Commonwealth of Australia, (May 12, 2009).

8. *Defending Australia from the Financial Crisis?*, CSDS, available at <http://cpds.apana.org.au/Teams/Articles/Fortress.htm> (last visited Apr. 11, 2011).

9. INT'L ENERGY AGENCY, KEY WORLD ENERGY STATISTICS, (2009) available at [http://www.iea.org/textbase/nppdf/free/2009/key\\_stats\\_2009.pdf](http://www.iea.org/textbase/nppdf/free/2009/key_stats_2009.pdf).

10. *Id.*

sources. China is currently Australia's largest export market. Minerals and fuels account for more than sixty percent of Australia's total merchandise exports to China.<sup>11</sup> The three largest importers of Australian coal are Japan, Korea, and China.<sup>12</sup> This relationship is likely to continue because of increasing demand for energy, as evidenced by the recent US\$60 billion contract between China Power International Development (CPI) and an Australian mining company, Resourcehouse.<sup>13</sup> This increased demand for coal and other nonrenewable sources of energy has also contributed to the health of Australia's economy.

Nonrenewable fuels are also an important source of energy within Australia. Most of the nation's energy is generated from nonrenewable fuels including oil, natural gas, and coal.<sup>14</sup> For instance, over ninety-six percent of the fuel used to generate electricity in 2006 and 2007 was nonrenewable.<sup>15</sup> Coal contributes to the provision of electricity to consumers and industry at a relatively cheap cost, making it internationally competitive.<sup>16</sup> Nonrenewable fossil fuels provide employment opportunities for a significant number of Australians, particularly rural Australians. By 2007, about 117,500 people were working in mines, not including the significant number of people indirectly employed by the mining industry.<sup>17</sup>

The importance of coal and other fossil fuels to the Australian economy explains the current political focus on carbon emission reduction and helps contextualize the current debate regarding the Emissions Trading Scheme (ETS) proposed by Kevin Rudd's Labor Government. Australia's heavy reliance on nonrenewable sources of energy poses a threat to the environment and raises sustainability concerns. Apart from imprudent exploitation possibly depleting these exhaustible resources, fossil fuels also contain carbon and contribute to carbon emissions when consumed. Carbon emissions have been shown to contribute to the greenhouse gas effect. Notwithstanding the current scientific controversy surrounding the possible

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11. *Trade and Investment*, AUSTRALIAN EMBASSY, CHINA, <http://www.china.embassy.gov.au/bjng/relations2.html> (last visited Apr. 11, 2011).

12. *SMH: King Coal Will Be Dethroned, and BJP Should Align Itself with Carbon Revolt*, BEYOND ZERO EMISSIONS, <http://beyondzeroemissions.org/media/newswire/smh-king-coal-will-be-dethroned-and-bhp-should-align-itself-carbon-revolt-110127> (last visited Apr. 10, 2011).

13. Amy Coopes, *Australia's Resourcehouse Signs China Coal Deal*, AFP, Feb. 5, 2010.

14. *Australia's Environment: Issues and Trends, Jan. 2010*, AUSTL. BUREAU STAT. (Feb. 5, 2010), available at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4613.0Chapter30Jan+2010>.

15. *Id.*

16. *The Australian Coal Industry*, AUSTL. COAL ASS'N, <http://www.australiancoal.com.au/the-australian-coal-industry.aspx> (last visited Apr. 20, 2011).

17. *Mining Operations Australia 2006-07*, AUSTL. BUREAU OF STAT., (2008).

effect of these emissions on the earth's climate and the magnitude of such climate change,<sup>18</sup> the negative effect of carbon emissions into the atmosphere is not in dispute.<sup>19</sup> Thus, the need for climate change mitigation continues to be a policy priority for the Australian government.

The current government has failed to pass its much-touted Carbon Pollution Reduction Scheme (CPRS)<sup>20</sup> after two valiant attempts. This highlights Australia's dilemma in its quest to reduce dependence on fossil fuels, while the country faces a restructuring of its industrial and mining sectors that are themselves subject to increasing demand for their nonrenewable and carbon intensive resources. Australia is not alone in this quagmire. For countries around the world, the collapse of recent climate negotiations in Copenhagen and the international community's failure to reach a meaningful agreement with fixed and verifiable targets for carbon emission have significantly undermined public support to combat climate change.

The recent serious allegations and admissions impugning the integrity of the United Nations' Intergovernmental Panel on Climate Change (IPCC) undermined the scientific consensus that had, after many years, finally managed to penetrate the conscience of the global commons.<sup>21</sup> The unfortunate convergence of the global financial crisis robbed the international community of the momentum to take immediate action and placed efforts to mitigate global warming in a holding pattern.

This article explores the role of industry in enabling Australia to move toward a less carbon intensive economy. It then examines how technological innovation and the adoption of appropriate adaptive strategies will ensure that this country's economy is firmly on the path to a sustainable future.

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18. Olive Heffernan, *Climategate Scientist Speaks Out*, NATURE.COM (2010), <http://www.nature.com/news/2010/012345/full/news.2010.71.html>.

19. Quirin Schiermeier, *The Real Holes in Climate Science*, 463 NATURE 284 (2010), available at <http://www.nature.com/news/2010/100120/pdf/463284a.pdf>

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21. *Climategate & IPCC Scandals Undermine Public Trust in Science*, ASSOCIATED PRESS, Mar. 4, 2011, available at <http://www.thegwpf.org/science-news/612-climategate-scandal-undermines-public-trust-in-science.html>. [hereinafter *Climategate*].

## II. POST COPENHAGEN AND CLIMATE CHANGE MITIGATION: AN ABANDONED AGENDA?

Mitigation of climate change caused by human activities, and particularly by greenhouse gas (GHG) emissions, has been a concern for more than a decade. However, this is one of the areas of international environmental governance where consensus has proved difficult to achieve as evidenced by the very first attempt, the United Nations Framework Convention on Climate Change (UNFCCC).<sup>22</sup> The UNFCCC, adopted in 1992 and enforced in 1994, constituted a framework in which countries recognized the adverse effect of GHG emissions and voluntarily pledged to reduce them. The passage of time required a second phase in order to elaborate and concretize the measures that governments would be required to take to reduce GHG emissions. The Kyoto Protocol,<sup>23</sup> adopted by the third Conference of Parties (COP 3), set quantitative targets for reduction of GHG emissions between 2008 and 2012 for Annex I (Developed) countries.<sup>24</sup>

In the recent past, two events have seriously threatened the future of global climate change mitigation: the Climate Change Conference at Copenhagen and the allegations against the IPCC. First, the Climate Change Conference in December 2009 failed to produce its expected output, which was a legally binding instrument to govern climate change for the post-2012 period. Second, the recent allegations and accusations made against the IPCC jeopardized not only the credibility of the leading scientific body in the assessment of climate change, but also the very science behind climate change.<sup>25</sup>

Deeper analysis highlights the fallacy of abandoning human-induced climate change mitigation efforts. At first glance, the Copenhagen Conference may appear to have been a total collapse as the accord,<sup>26</sup> produced after hurried political negotiations between a few countries, was not exactly the expected legally binding successor to the Kyoto Protocol. When the Bali Action Plan<sup>27</sup> established the Ad Hoc Working Group on

22. *U.N. Framework Convention on Climate Change*, 1771 U.N.T.S. 107, (1992).

23. *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, 37 I.L.M. 22 (1997) [hereinafter *Kyoto Protocol*].

24. GLOBAL WARMING: LOOKING BEYOND KYOTO; ERNESTO ZEDILLO ED. CENTRE FOR THE STUDY OF GLOBALIZATION, Yale University (Brookings Institution Press, 2008) at p.2.

25. See *infra*, note 45.

26. *Draft Decision: Copenhagen Accord*, United Nations Climate Change Copenhagen Conference, Copenhagen, Den., Dec. 7–18, 2009, -/Cp. 15, U.N. Doc. FCCC/CP/2009/L.7 (Dec. 18, 2009), <http://unfccc.int/resource/docs/2009/cop15/eng/107.pdf> [hereinafter *Copenhagen Accord*].

27. *Bali Action Plan Decision*, United Nations Framework Convention on Climate Change: Conference of the Parties, Bali, Indon., Dec. 3–7, 2007, 1/Cp.13, U.N. Doc. FCCC/CP/2007/6/Add.1, (Mar. 14, 2008).

Long Term Cooperative Action (AWG-LCA) under the UNFCCC, its intended mandate was to develop a comprehensive outcome. The AWG-LCA was to achieve cooperation in the areas of mitigation, adaptation, finance, and technology, with the deadline of COP<sub>15</sub> in Copenhagen.<sup>28</sup> However, from the onset, there was lack of clarity as to the accord's intended outcome. There was the question of whether the establishment of a second track negotiation meant that there were to be two separate outcomes: 1) one under the AWG-LCA and another under the Ad Hoc Working Group on Further Commitments for Annex I parties under the Kyoto Protocol (AWG-KP), or 2) a single outcome integrating both negotiation processes. Also, there was no clear agreement that the outcome of the accord would be legally binding.<sup>29</sup> Thus, it was not a surprise that the Copenhagen Conference was characterized by disagreements in the course of negotiation and that it resulted in a largely political agreement with no clear targets instead of a legally binding instrument.

The Copenhagen Accord may not have met the high and arguably unreasonable expectations that were placed on it. However, it demonstrated the parties' commitments to cap global temperature rise by significantly reducing emissions and to raise money for mitigation efforts in developing countries.<sup>30</sup> The accord is founded on the scientific view of the need to ensure that the global temperature increase is less than two degrees Celsius in order to mitigate the adverse effects of anthropogenic global climate change.<sup>31</sup> Consequently, climate change mitigation remains a key policy objective for a large number of countries.

The recently revealed flaws in the methodology and operation of the IPCC and the Climatic Research Unit (CRU) at the University of East Anglia, particularly in the context of its peer review processes, have been used by the media and climate change skeptics to question scientific consensus regarding the effects of anthropogenic climate change. For example, in 2007, the IPCC stated in a comprehensive report that that the Himalayan Glaciers would completely melt by 2035.<sup>32</sup> The IPCC has come under harsh criticism over this statement. That one of the lead authors of the report was among those questioning the accuracy of the assertion did

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28. *Id.* at 5.

29. Daniel Bodansky, *The Copenhagen Climate Change Conference: A Post-Mortem*, 104 AM. J. INT'L L. 230, 238 (2010).

30. *Copenhagen United Nations Climate Change Conference Ends with Political Agreement to Cap Temperature Rise, Reduce Emissions and Raise Finance*, U.N. FRAMEWORK CONVENTION ON CLIMATE CHANGE-SECRETARIAT, U.N. Press Release (Dec. 19, 2009).

31. *Copenhagen Accord*, *supra* note 33, at art. 2.

32. R.V. Cruz et al., *Asia in Climate Change 2007: Impacts, Adaptations and Vulnerability*, in CONTRIBUTION OF WORKING GROUP II TO THE FOURTH ASSESSMENT REPORT OF THE INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE 469, (M.L. Parry et al. eds., 2007).

not help.<sup>33</sup> The IPCC's recent admission of the statement's inaccuracy and its published public apology<sup>34</sup> have only fueled further media attacks on the IPCC. Climate change skeptics have capitalized on the situation and are now questioning the entire science behind anthropogenic climate change suggesting that it has become a "dead issue."<sup>35</sup> These disturbing revelations have led the head of the CRU, Professor Phil Jones, to agree to stand down pending the outcome of a full investigation of the theft of sensitive e-mails.<sup>36</sup> Additionally, Ivo de Boer, United Nations' Executive Secretary of the UNFCCC, resigned effective July 2010, and intense pressure is being placed on Rajendra Pachauri, chair of the IPCC, to follow suit.<sup>37</sup> The threat to the credibility of the science behind climate change has exacerbated the already bleak prospect presented by the Copenhagen conference. The result is a loss of momentum in the adoption of policies to mitigate human induced climate change.

Though members of the IPCC and the CRU conceded that there may have been a failure to adopt best practices in some of their research projects,<sup>38</sup> this does not justify the condemnation of the scientific findings of the various research projects on climate change over the years. The errors committed revealed the need to reconsider the processes of the IPCC to ensure best practices are followed.<sup>39</sup> Besides adherence to best practices, scientific advances are helping scientists understand the complexity of factors involved in explaining the variability of the earth's climate systems and the uncertainties prevalent in determining the future effects of carbon emissions.<sup>40</sup> However, the effects of climate change on the environment and society will ultimately depend on "how humankind responds through

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33. Quirin Schiermeier, *Glacier Estimate is on Thin Ice*, 463 NATURE 276 (2010).

34. *Intergovernmental Panel on Climate Change, IPCC Statement on the Melting of the Himalayan Glaciers*, INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE (Jan. 20, 2010), available at <http://www.ipcc.ch/pdf/presentations/himalaya-statement-20january2010.pdf>.

35. Roger L. Simon, *Post Copenhagen: Is Man-Made Global Warming a Dead Issue?*, PAJAMAS MEDIA (Dec. 22, 2009), available at <http://pajamasmedia.com/rogerlsimon/2009/12/22/post-copenhagen-is-man-made-global-warming-a-dead-issue/>.

36. Climategate, *supra* note 27.

37. Ben Webster, *IPCC Chairman Rajendra Pachauri Under Pressure To Go Over Glacier Error*, TIMES (Feb. 4, 2010), <http://www.timesonline.co.uk/tol/news/environment/article7014203.ece>.

38. Heffernan, *supra* note 20.

39. On March 10, 2010, the Secretary-General of the United Nations and the Chair of the IPCC announced an independent review by the InterAcademy Council (IAC) of the IPCC's processes and procedures to further strengthen the IPCC's reports on climate change. See *Scientific Academy to Conduct Independent Review of IPCC's Processes and Procedures at Request of United Nations and IPCC*, INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, (Mar. 10, 2010), available at <http://www.ipcc.ch/pdf/press/pr-1003210-UN.pdf>.

40. Richard H. Moss et al., *The Next Generation of Scenarios for Climate Change Research and Assessment*, 463 NATURE 747 (2010).

changes in technology, economies, lifestyle, and policy.”<sup>41</sup>

Overall, the science has not changed; anthropogenic activities affect the earth’s climate systems though the extent and magnitude of this effect on future climatic systems is uncertain. However, as a precautionary principle, governments must adopt policies that will help ensure that the adverse effects of these activities are moderated as scientists further investigate them.

### III. AUSTRALIA’S CLIMATE CHANGE MITIGATION EFFORTS

Despite exporting the largest amount of coal in the world, Australia is not the highest emitter of carbon. Outranked by China, the United States, Russia, and India among others, Australia contributes only 1.4% of global emissions.<sup>42</sup> This low rate does not necessarily mean that Australia is not a major source of emissions. Despite Australia’s large physical size, it has a relatively small population compared to these other countries. Thus, Australia’s total emissions are likely to be low despite high reliance on fossil fuels. Nevertheless, according to a recent report, Australia is ranked as the world’s highest carbon dioxide emitter per capita.<sup>43</sup>

Globally, Australia’s carbon emission rate is relatively low due to the accounting rules established by the Kyoto Protocol. Under these rules, emissions from fossil fuels such as coal and natural gas (including sequestered carbon in trees and other vegetation) count toward a country’s total emissions only if they are burned or decomposed in that country.<sup>44</sup> This means that carbon emissions from Australia’s coal and natural gas exports are credited to the country in which they are burned or decomposed, as opposed to the country of origin. China, whose largest coal supplier is Australia, ranked first among the 2007 list of countries with the highest carbon emissions.<sup>45</sup> This implies a connection between China’s high carbon emissions and Australia’s coal, though the current Kyoto Protocol accounting rules prevent establishing a direct link.

Australia’s total fossil fuel emissions have increased in the last few years. Between 2004 and 2005 there was a 7.4% increase in total carbon

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41. *Id.*

42. *Top 20 Emitting Countries by Total Fossil-Fuel CO2 Emissions for 2007*, CARBON DIOXIDE INFO. ANALYSIS CENTER, [http://cdiac.ornl.gov/trends/emis/tre\\_tp20.html](http://cdiac.ornl.gov/trends/emis/tre_tp20.html) (last visited Apr. 11, 2011) [hereinafter *Top 20*].

43. *Australia Overtakes USA as Top Polluter, Reveals Maplecroft CO2 Emissions from Energy Index*, MAPLECROFT (Sept. 9, 2009), [http://www.maplecroft.com/about/news/australia\\_overtakes\\_usa\\_as\\_top\\_polluter\\_09.html](http://www.maplecroft.com/about/news/australia_overtakes_usa_as_top_polluter_09.html) (last visited Apr. 11, 2011).

44. <http://www.aph.gov.au/library/pubs/bn/sci/KyotoAccRules.htm> (last visited 11 Feb 2011)

45. *Top 20*, *supra* note 50.

dioxide emissions.<sup>46</sup> By 2006, Australia's carbon dioxide emissions rose to 101 million metric tons.<sup>47</sup> Emissions from coal consumption accounted for nearly fifty-seven percent of the 2006 total fossil fuel emissions, which indicates Australia's economic dependency on coal.<sup>48</sup> Natural gas is also a major source of carbon emissions in Australia accounting for fourteen percent of the 2006 carbon dioxide emissions.<sup>49</sup> Cognizant of its increasing GHG emissions, Australia has sought ways to reduce its carbon dioxide release.

The high ratings in both total GHG emissions and per capita emissions, as well as the increasing rate of total GHG emissions in Australia, has increased pressure on the government to implement emission reduction. Further, Australia's current government seems to be convinced of a need to provide international moral leadership in the adoption of policies to combat climate change.<sup>50</sup>

Debate over the direction of Australia's climate change policy has brought the delicate balance between environmental protection and economic considerations to the forefront. The initial debate surrounding the housing of climate change policy issues, either in the Ministry of Environment or the Ministry of Energy, demonstrated the difficulty of balancing these apparently conflicting interests. The Ministry of Environment identified climate change as an environmental issue and, thus, within its mandate. The Department of Energy argued that given how central exports of coal, natural gas, and uranium are to the Australian economy, the issue of GHG emissions reduction was better placed in its ministry, which would adopt strategies focused on energy systems.<sup>51</sup> Eventually, the matter was settled when the Labor government, then in power, decided to implement only mitigation measures that would not have net adverse economic impacts both nationally and on Australia's trade competitiveness in the absence of similar action by major greenhouse gas producing countries.<sup>52</sup>

To ensure the protection of Australia's economy, industry must be

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46. Tom Boden et al., *National CO<sub>2</sub> Emissions from Fossil Fuel Burning, Cement Manufacture, and Gas Flaring: 1751-2007*, CARBON DIOXIDE INFO.ANALYSIS CENTER (June 8, 2010), available at <http://cdiac.ornl.gov/ftp/trends/emissions/aus.dat>.

47. *Id.*

48. *Id.*

49. *Id.*

50. Wayne Swan & Penny Wong *Foreword to AUSTL., AUSTRALIA'S LOW POLLUTION FUTURE: THE ECONOMICS OF CLIMATE CHANGE MITIGATION* at iv (2008), available at [http://www.treasury.gov.au/lowpollutionfuture/summary/downloads/Australias\\_Low\\_Pollution\\_Future\\_Summary.pdf](http://www.treasury.gov.au/lowpollutionfuture/summary/downloads/Australias_Low_Pollution_Future_Summary.pdf).

51. Michael I. Jeffery, *Beyond Kyoto: Climate Change Including a Discussion of the AP6 Initiative from the Australian Perspective*, in *CRUCIAL ISSUES IN CLIMATE CHANGE AND THE KYOTO PROTOCOL: ASIA AND THE WORLD* 505 (Kheng-Lian Koh et al. eds., 2010).

52. *Id.* at 507.

included when determining the direction of climate change policy. The Australian Business Roundtable on Climate Change Group was formed to help understand the business risks associated with climate change and to participate in the development of policy frameworks and marketing conditions for a low carbon future.<sup>53</sup> The group included six of Australia's largest corporations.<sup>54</sup> Their recommendations, contained in the report *Business Case for Early Action*, reiterated the caution expressed by both political sides that Australia should adopt policies referent to international action so as not to reduce the competitiveness of the nation's products.<sup>55</sup>

In keeping with this recommendation, the Australian government sought to enter strategic regional alliances with other major producers and consumers of coal and other fossil fuels. The Asia Pacific Partnership on Clean Development and Climate (AP6) was one such multilateral and multi-stakeholder alliance also initiated by the former John Howard government. The AP6 brings together some of the world's largest stakeholders in carbon and fossil fuel industries: the United States, China, India, Japan, South Korea, and Australia.<sup>56</sup> The objective of the AP6 is to establish a forum in which these countries work together alongside the private sector to "meet goals for energy security, national air pollution reduction, and climate change in ways that promote sustainable economic growth and poverty reduction."<sup>57</sup> The AP6 initiative intends to build on the already existing multilateral climate initiatives, which involve initiatives for developing renewable energy technologies, energy efficient technologies, and market mechanisms to reduce GHG emissions.<sup>58</sup>

The AP6 was also regarded as a possible alternative framework for negotiating the post-2012 climate change commitments.<sup>59</sup> Former U.S. President George W. Bush proposed that the major developed and developing countries come together to forge a post-2012 agreement on

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53. *The Business Case for Early Action*, AUSTL. BUS. ROUNDTABLE ON CLIMATE CHANGE, THE BUSINESS CASE FOR EARLY ACTION, (April 2006), available at <http://www.businessroundtable.com.au/pdf/F078-RT-WS.pdf>.

54. *Id.* The members include BP Australia, Insurance Australia Group, Origin Energy, Swiss Re, Visy Industries, and Westpac, which joined with the Australian Conservation Foundation. *Id.*

55. *Australian Business Roundtable on Climate Change*, ORIGIN, <http://www.originenergy.com.au/1825/Business-roundtable> (last visited Dec. 27, 2010).

56. *About the Asia-Pacific Partnership*, AUSTL. GOV'T DEP'T ENERGY, RESOURCES, & TOURISM, <http://www.ret.gov.au/Documents/app/about.html> (last visited Apr. 11, 2011).

57. ASIA PAC. PARTNERSHIP ON CLEAN DEV. & CLIMATE, <http://www.asiapacificpartnership.org/english/default.aspx> (last visited Apr. 10, 2011).

58. Peter Lawrence, *The Asia Pacific Partnership on Clean Development and Climate (AP6): A Distraction to the Kyoto Process or a Viable Alternative?*, 10 ASIA PAC. J. ENVTL. L. 1 (2007).

59. *Id.*

GHG emissions.<sup>60</sup> This proposal seems to have been the preferred option of President Barack Obama at the 2009 Copenhagen Summit.<sup>61</sup> The Copenhagen Accord was the result of negotiations among the world's large stakeholders in coal and fossil fuel trade. However, Australia was absent from the negotiations that altered climate change strategies, which followed the change in government in both Australia and the United States prior to the Copenhagen Summit.<sup>62</sup>

#### *A. Australia's Carbon Pollution Reduction Scheme: Doomed to Fail?*

In December 2007, Kevin Rudd was sworn in as the twenty-sixth Australian Prime Minister. Among the policy goals in his electoral campaign package was to ratify the Kyoto Protocol, create a national carbon trading scheme by 2010, set a carbon emission reduction target of sixty percent by 2050, provide A\$500 million to fund development of clean coal technology, and promote other impressive policies on environmental protection.<sup>63</sup> Since the change in government, Australia has ratified the Kyoto Protocol and introduced CPRS legislation, which has created an emissions reduction scheme utilizing a cap and trade mechanism.<sup>64</sup>

The current government's CPRS is arguably an attempt to implement the recommendations of Australia's most comprehensive government enquiry into climate change: the Garnaut Review. In 2007, Professor Ross Garnaut was commissioned by the Commonwealth and the State and Territory governments of the Australian Federation to examine the effects of climate change on Australia and recommend a policy framework to ensure sustainability.<sup>65</sup> In September 2008, Garnaut presented his final

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60. See Anita Talberg, *The Kyoto Protocol Accounting Rules*, SCIENCE, TECHNOLOGY, ENVIRONMENT AND RESOURCES SECTION, available at <http://www.aph.gov.au/library/pubs/bn/sci/KyotoAccRules.htm> (last visited Apr. 11, 2011).

61. See *President Obama's Address at the Copenhagen Summit*, HUFFINGTON POST, Mar. 18, 2010, available at [http://www.huffingtonpost.com/2009/12/18/obama-in-copenhagen-speech\\_n\\_396836.html](http://www.huffingtonpost.com/2009/12/18/obama-in-copenhagen-speech_n_396836.html).

62. See commentary Hugh Bartling, Associate Professor of Public Policy at DePaul University, Chicago, <http://hughbartling.com/?cat=10> (last visited Apr. 10, 2011).

63. N.S.W. BUS. CHAMBER, THE RUDD GOVERNMENT: OVERVIEW OF BUSINESS POLICIES (Nov. 2007), available at [http://www.nswbusinesschamber.com.au/reference/influence\\_government/REP\\_1450\\_New\\_Govt\\_Policies\\_for\\_Business.pdf](http://www.nswbusinesschamber.com.au/reference/influence_government/REP_1450_New_Govt_Policies_for_Business.pdf).

64. First introduced to Parliament on May 14, 2009; for an outline of CPRS history see CPRS history, AUSTL. GOV'T DEP'T CLIMATE CHANGE & ENERGY EFFICIENCY, <http://climatechange.gov.au/en/government/initiatives/cprs/cprs-progress.aspx> [hereinafter CPRS history] (last visited Apr. 10, 2011).

65. ROSS GARNAUT, THE GARNAUT CLIMATE CHANGE REVIEW: FINAL REPORT xii (2008) available at <http://www.garnautreview.org.au/index.htm>.

report.<sup>66</sup> Garnaut found that the rate of Australia's GHG emissions was increasing and that there is need to reduce these emissions to prevent the possible adverse effects of climate change.<sup>67</sup> One of the main findings of the review, and perhaps the most controversial, was its proposal that Australia's climate change response be built around obtaining an international consensus on stabilizing the concentration of atmospheric greenhouse gases at 550 parts per million (ppm) of carbon dioxide equivalents (CO<sub>2</sub>-e).<sup>68</sup> The report proposed that Australia's climate change policy focus on a carbon pollution reduction scheme with two options for reduction targets based on the possible outcomes of the global negotiations for a legally binding agreement. If an international binding agreement was reached in which other major emitters committed to significant reductions, then Australia ought to adopt a target of ten percent reduction by 2020 and an eighty percent reduction by 2050.<sup>69</sup> On the other hand, if the global community did not agree on a legally binding agreement, then Australia ought to set reduction targets at five percent by 2020 and sixty percent by 2050.<sup>70</sup> Apart from the CPRS, the report also advocated complementary measures involving a broad mix of adaptation policy options including flexible markets, information, and direct assistance.<sup>71</sup>

After the release of the Garnaut Review's final report, the government proposed a set of laws to implement an ETS. Under the CPRS, the government would set an annual cap on the amount of carbon pollution Australia may emit. The government would then gradually reduce this cap to help the country meet its reduction targets for 2020.<sup>72</sup> The national target would be between five percent and fifteen percent below year 2000 levels by the year 2020.<sup>73</sup> Companies and groups operating within Australia that emit carbon would need permits that could be issued or purchased to allow such emissions. The total number of permits issued would have to be within the government cap. Businesses could trade permits if they find they have less need for them than required or more than anticipated.<sup>74</sup> This

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66. Andrew Macintosh, *The Garnaut Review's Targets and Trajectories: A Critique*, 26 ENVTL. & PLAN. L. J. 88 (2009) available at [http://law.anu.edu.au/CCLP/WP4\\_2008\\_Garnaut\\_critique.pdf](http://law.anu.edu.au/CCLP/WP4_2008_Garnaut_critique.pdf).

67. GARNAUT, *supra* note 74.

68. Macintosh, *supra* note 75.

69. GARNAUT, *supra* note 74, at xxx.

70. *Id.*

71. *Id.*

72. *Carbon Pollution Reduction Scheme*, AUSTL. GOV'T DEP'T CLIMATE CHANGE & ENERGY EFFICIENCY, <http://www.climatechange.gov.au/government/initiatives/cprs.aspx> (last updated May 7, 2010).

73. *National Targets*, AUSTL. GOV'T DEP'T CLIMATE CHANGE & ENERGY EFFICIENCY, <http://www.climatechange.gov.au/government/reduce/national-targets.aspx> (last updated Nov. 29, 2010).

74. *Carbon Pollution Reduction Scheme*, *supra* note 81.

trading scheme is intended to reduce GHG emissions at the lowest cost.

The Coalition, the Greens, and two independent Senators vociferously opposed attempts by the current government to enact the CPRS. The CPRS bill was first introduced into Parliament in May 2009 and rejected by the Senate in August 2009.<sup>75</sup> A second attempt to reintroduce the bill was made in October 2009 and contained amendments agreed to by Malcolm Turnbull, the former Leader of the Coalition, but without the endorsement of his Party Room. However, just before the Copenhagen Conference, the Senate also rejected the reintroduced bill in December 2009.<sup>76</sup> This divisive issue within the Coalition opposition party triggered a leadership spill resulting in the surprise election of a new Leader, Tony Abbott.<sup>77</sup> The Labor Government, apparently undaunted by the depth of the opposition to the CPRS, reintroduced the bill into Parliament in February 2010 for the third time. But it was withdrawn by the Rudd government in April 2010 when he announced that implementation of a CPRS in Australia would be delayed until 2013 at the earliest.<sup>78</sup>

The Greens, the Coalition, and the two independent Senators have faulted the CPRS on many grounds. Perhaps the most wide sweeping criticism directed at the CPRS has been its alleged complexity, which has contributed to its lack of popularity.<sup>79</sup> Specifically, the Greens consider the proposed target of five percent unambitious and instead propose twenty-five to forty percent reductions below 2000 levels of GHG emissions by 2020.<sup>80</sup>

The Coalition government opposed the CPRS on grounds that it failed to meet the least cost test.<sup>81</sup> Whereas the Coalition agrees with the Labor government's target to reduce the GHG emissions by five percent by 2020, it argues that this can be achieved using their direct action plan, which is more cost effective than the CPRS.<sup>82</sup> The Coalition plan radically departs from the current government policy approach because it is based on direct

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75. *Supra* note 70.

76. *Id.*

77. Tony Abbot won the leadership of the Coalition Opposition party by a single vote on December 1, 2009. See Lincoln Archer, *Liberal Leadership Spill: Tony Abbott Wins*, NEWS.COM.AU (Dec. 1, 2009), available at <http://www.news.com.au/national/liberal-leadership-spill-tony-abbott-wins/story-e6frfkvr-1225805630744>.

78. CPRS history, *supra* note 70.

79. Richard Denis, *Time for a Breath of Fresh Air*, THE CANBERRA TIMES, Apr. 24, 2010.

80. THE GREENS, AUSTRALIAN GREENS POLICY: CLIMATE CHANGE AND ENERGY, para. 15 (Nov. 2009), available at <http://greens.org.au/sites/greens.org.au/files/C1%20Climate%20Change%20Nov%202009.pdf>.

81. THE COAL. PARTY AUSTL., THE COALITION'S DIRECT ACTION PLAN: ENVIRONMENT AND CLIMATE CHANGE, (2010), available at <http://www.liberal.org.au/~media/Files/Policies%20and%20Media/Environment/The%20Coalitions%20Direct%20Action%20Plan%20Policy.ashx>.

82. *Id.* at 2.

government intervention in the form of incentives to Australian families and businesses as a means of reducing emissions.<sup>83</sup> The government would provide incentives to existing industries seeking to reduce their emissions by adopting more efficient systems.<sup>84</sup> The government would also give incentives to other direct action measures required to reduce emissions, such as direct action on forestry, energy efficiency, recycling, and other necessary measures.<sup>85</sup> Furthermore, the government would make incentives available for renewable energy initiatives.<sup>86</sup> Like the 2007 election, climate change policy appeared to be a major, if not decisive, factor in the 2010 federal election.

The Australian business sector has also expressed concern over the CPRS. The Business Council of Australia and the Australian Chamber of Commerce and Industry oppose implementing a reduction scheme ahead of the rest of the world.<sup>87</sup> Indeed, a major concern of those opposed to the CPRS legislation was the Government's insistence that it be enacted into law before Copenhagen in order to provide the Australian Prime Minister with the moral authority to persuade other world leaders to follow Australia's lead and agree to far-reaching binding targets. In hindsight, these concerns appear well placed, for none of the three largest emitters—the United States, China, and India—was prepared to commit to binding reduction targets at Copenhagen. Thus, it is doubtful that other countries would feel compelled to follow Australia's lead given its relatively small percentage of global emissions (1.4%) and that under the CPRS, almost all trade-exposed industries, including coal, natural gas, iron ore, and cement, were either exempted entirely or heavily subsidized. As noted earlier, industry supports climate change policy as long as it does not result in actions that may negatively impact the competitiveness of Australia's products. The implementation of the CPRS in Australia would increase the price of carbon and, in the absence of similar increases in the carbon price in markets of other countries, result in the loss of competitiveness of Australian coal and other resource commodities.

An analysis of the merits and demerits of emission trading schemes in general may help provide objective input into the capacity of the CPRS to

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83. *Id.* at 13–15.

84. *Id.* at 13–22.

85. *Id.* at 16–21.

86. *Id.* at 23–26.

87. CASTALIA, LTD., SECURING SMEs IN AUSTRALIA'S LOW CARBON FUTURE: THE COST OF THE CARBON POLLUTION REDUCTION SCHEME FOR AUSTRALIA'S SMALL AND MEDIUM SIZED BUSINESSES, REPORT TO THE AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY 49 (June 2009), available at <http://www.acci.asn.au/getattachment/dbcff2d1-6301-4dd8-9efa-336af0f4e5e7/Securing-SMEs-in-Australia-s-Low-Carbon-Future.aspx>; *BCA Emissions Reduction*, BUS. COUNCIL AUSTR., <http://www.bca.com.au/Content/101469.aspx> (last visited Apr. 11, 2011).

achieve emission reduction targets. Emission trading schemes (ETSs) are internationally recognized as useful tools in climate change policy.<sup>88</sup> The origin of ETS has been traced to the United States where emission schemes were used to regulate the release of noxious gases into the atmosphere.<sup>89</sup> More recently, various countries have implemented emission schemes to mitigate climate change.<sup>90</sup> The growing popularity of these schemes suggests that they have some merit.

Two reasons for the growing popularity are that ETSs are both self-perpetuating and flexible. The more widespread the use of the trading schemes at a regional and international level, the more the international carbon market grows. This provides opportunities for individual countries and regions to benefit from economies of scale, thereby reducing their cost of GHG emission reduction.<sup>91</sup> This is particularly attractive for countries like Australia where buying emissions reduction on the international carbon market would be cheaper than implementing local reductions.<sup>92</sup> However, the Copenhagen Conference did not produce a legally binding agreement that would have created the framework for a strong international carbon market. Thus, the cost effectiveness of emission trading schemes will not be as high as anticipated. One of the other inherent strengths of these schemes is that they provide regulated industries with flexibility. Unlike direct intervention policy options, ETSs are very flexible after the caps are set.<sup>93</sup> This flexibility, assuming a properly functioning market, ensures that businesses choose the most cost effective means of reducing their GHG emissions.

Perhaps the most important advantage of ETSs is that they tackle the tragedy of the commons problem. Some argue that emissions trading internalizes environmental externalities, thus achieving one of the principles

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88. The Kyoto Protocol makes provisions for the use of ETS. Kyoto Protocol, *supra* note 29.

89. A. DENNY ELLERMAN, PAUL L. JOSKOW & DAVID HARRISON, JR, EMISSIONS TRADING IN THE U.S.: EXPERIENCE, LESSONS, AND CONSIDERATIONS FOR GREENHOUSE GASES (2003), available at [http://www.pewclimate.org/docUploads/emissions\\_trading.pdf](http://www.pewclimate.org/docUploads/emissions_trading.pdf) [hereinafter ELLERMAN, JOSKOW & HARRISON, JR.].

90. Countries and regions that have implemented emission schemes include the United States, the European Union, New Zealand, Japan and South Korea.

91. The most comprehensive emissions trading system has been implemented by the EU. The EU ETS now operates in 30 countries (the 27 EU Member States plus Iceland, Liechtenstein and Norway). It covers CO<sub>2</sub> emissions from installations such as power stations, combustion plants, oil refineries and iron and steel works, as well as factories making cement, glass, lime, bricks, ceramics, pulp, paper and board; See Emissions Trading System (EU ETS), EUROPEAN COMMISSION CLIMATE ACTION, [http://ec.europa.eu/clima/policies/ets/index\\_en.htm](http://ec.europa.eu/clima/policies/ets/index_en.htm) (last visited Apr. 10, 2011).

92. Michael Power, *Emissions Trading in Australia: Markets, Law and Justice Under the CPRS*, 27 ENVTL. & PLAN. L. J. 131 (2010).

93. ELLERMAN, JOSKOW & HARRISON, JR., *supra* note 101.

of environmentally sustainable development.<sup>94</sup> The economic value attached to carbon pollution is envisaged as a negative incentive to polluters and a positive incentive to green technology and industry.<sup>95</sup> However, there is evidence to challenge the assumption that an increase in the cost of carbon will create a positive incentive to develop green technology and industry.<sup>96</sup>

Despite ETSs' perceived strengths, experience demonstrates that the system is not perfect. First, the entire system revolves around an artificially created market for a non-conventional commodity. The objective of this market, unlike others, is not only to sell the commodity, but also to sell it at a specific price. This artificial environment makes the emissions market particularly prone to distortion,<sup>97</sup> as evidenced by the EU-ETS experience.<sup>98</sup> When the EU-ETS was rolled out, businesses were given permits on the basis of self-generated emission level estimates.<sup>99</sup> Some businesses used this as an opportunity to increase their market edge by over-estimating their emission levels.<sup>100</sup> When subsequently accurate carbon dioxide emission levels were determined, the price of carbon plummeted.<sup>101</sup> Design flaws in the duration of the permits also undermined the EU-ETS's effectiveness.<sup>102</sup> Experience with emissions trading systems demonstrates that they may be more effective for bringing about widespread incremental change over a long period of time as opposed to a short period of time.<sup>103</sup>

Most ETSs are faulted for enabling the government to dilute the impact of carbon price. For example, Rudd's ETS contains provisions that allow the government to protect the worst affected industries.<sup>104</sup>

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94. ELLERMAN, JOSKOW & HARRISON, JR., *supra* note 101, at 1.

95. *Id.* at 34.

96. JOSHUA S. GANS, INNOVATION AND CLIMATE CHANGE POLICY (2009), *available at* <http://works.bepress.com/cgi/viewcontent.cgi?article=1023&context=joshuagans>.

97. ELLERMAN, JOSKOW & HARRISON, JR., *supra* note 101.

98. A. DENNY ELLERMAN & PAUL L. JOSKOW, THE EUROPEAN UNION'S EMISSIONS TRADING SYSTEM IN PERSPECTIVE (2008), *available at* <http://www.pewclimate.org/docUploads/EU-ETS-In-Perspective-Report.pdf>.

99. A. Danny Ellerman and Barbara K Buchner, *The European Union Emissions Trading Scheme: Origins, Allocation, and Early Results*, 1 REVIEW OF ENVIRONMENTAL ECONOMICS AND POLICY 66–87.

100. *Id.*

101. *Id.* at 14–15.

102. *Id.*

103. James Prest, *A Dangerous Obsession with Least Cost? Climate Change, Renewable Energy Law and Emissions Trading*, in CLIMATE CHANGE LAW: COMPARATIVE, CONTRACTUAL & REGULATORY CONSIDERATIONS (Wayne. Gumley & Trevor Daya-Winterbottom eds., 2009).

104. These included, for example, the cement and aluminium industries. The CPRS would also grant billions of dollars worth of free permits to industry. The Emissions Intensive Trade Exposed (EITE) assistance program would give large emitters exposed to international markets up to 94.5 percent of their permits for free. *See* Aaron Cook, *Carbon*

Additionally, ETSs around the world tend to establish very generous caps for certain industries or provide them with free permits.<sup>105</sup> Australia's CPRS runs the risk of resorting to this practice known as "grandfathering."<sup>106</sup> The most effective way to avoid this risk would be for the industries likely to be the beneficiaries of such government protection to voluntarily commit to carbon reduction.

One of the greatest ETS challenges is that it is an economic mechanism that works like a blanket tax on all individuals regardless of their income level and capacity to pay. The establishment of a carbon price would impact the price of basic goods such as fuel, electricity, and groceries.<sup>107</sup> Since demand for such goods is inelastic, it would result in a disproportionate burden on low-income households. Further, carbon alternative technologies require high costs of installation, which may make them inaccessible to the low-income households.<sup>108</sup>

Apart from its inherent weaknesses, the Australian ETS also depends on the adoption of similar market mechanisms in the global coal market. As noted earlier, all reviews and recommendations on climate change policy in Australia indicate that success of an ETS depends on its adoption by trading partners and other stakeholders in the global coal market.<sup>109</sup> The success of Australia's ETS thus depends on the adoption of cap and trading schemes by other large producers and consumers of coal such as the United States, India, and China.

The Copenhagen Accord demonstrated that the world is still far from developing a global mechanism for carbon trade as the means of reducing GHG emissions. China and India do not support the development of the ETS. President Obama's government initially supported a cap and trade scheme, but recent trends indicate that the government's position is likely to shift. Furthermore, the Obama administration did not pursue the passage of the ETS before the mid-term elections in November 2010. Both Democrats and Republicans were wary of anything that might impede the recovery of the U.S. economy and increase energy costs in an election year. Moreover, the Australian government conceded that it might remove the emissions trading scheme from its climate change bill before it goes to the Senate.<sup>110</sup>

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*reduction schemes explained*, ABC Environment, Feb. 23, 2010, available at <http://www.abc.net.au/environment/articles/2010/02/23/2827485.htm>.

105. Ellerman and Buchner, *supra* note 109.

106. Power, *supra* note 104.

107. See THE COAL PARTY AUSTL., *supra* note 90, at 3.

108. GARNAUT, *supra* note 75.

109. GARNAUT, *supra* note 71.

110. James Murray, *Senator Graham: US Cap and Trade Plan is 'Dead,'* BUS. GREEN (Mar. 3, 2010), <http://www.businessgreen.com/business-green/news/2258845/graham-cap-trade-plan-dead>.

If Australia's CPRS depends on similar policy action by other large economies, then the future of an emission trading scheme is bleak.<sup>111</sup>

Recently, the Rudd administration's CRPS policy faced a considerable setback when one of its major climate change initiatives resulted in more than 100 homes burning to the ground. The climate change initiative was intended to provide heavily subsidized home insulation to homeowners. Ignoring numerous warnings over safety concerns, the lack of properly trained installers, and inadequate regulatory safeguards, the government rolled out the program as part of its financial stimulus package to counter the GFC.<sup>112</sup> The A\$2.5 billion insulation scheme was part of a government plan to provide insulation to 2.7 million houses across Australia.<sup>113</sup> So far more than a million homes have been insulated. However, more than 100 homes have caught fire as a result of improperly installed aluminum foil insulation. The insulation caught fire after being exposed to electrical wiring in roof cavities.<sup>114</sup> Thousands more homes remain at risk. The situation was exacerbated when four young, improperly trained electricians were electrocuted.<sup>115</sup>

Facing intense political pressure, the government publicly admitted its responsibility, and cancelled the entire program. It ordered inspections of the hundreds of thousands of existing homes where insulation had been installed.<sup>116</sup> The estimated cost of the cleanup could be as high as A\$100 million.<sup>117</sup> The Prime Minister has since demoted the Environment Minister responsible for the program and appointed a junior minister to handle the aftermath.<sup>118</sup> The failed insulation program has only served to reduce the popularity of the government's entire climate change policy and raise questions as to the Rudd government's ability to properly administer

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111. Brad Norington, *Obama's Cap-and-Trade Scheme Faces Defeat*, AUSTRALIAN (Mar. 2, 2010), <http://www.theaustralian.com.au/national-affairs/climate/obamas-cap-and-trade-scheme-faces-defeat/story-e6frg6xf-1225835821898>.

112. Roger Wettenhall, *Global Financial Crisis: The Australian Experience in International Perspective*, 11 PUB. ORG. REV. 77 (2011).

113. Brian Dollery & Martin Hovey, *Australian Federal Government Failure: The Rise and Fall of the Home Insulation Program*, 29 ECON. PAPERS 251, 342, (2010).

114. See Sid Maher & Matthew Franklin, *Peter Garrett Resists Call for his Resignation over Roof Insulation Debacle*, AUSTRALIAN (Feb. 12, 2010), <http://www.theaustralian.com.au/politics/peter-garrett-resists-call-for-his-resignation-over-roof-insulation-debacle/story-e6frgczf-1225829696127>.

115. Calls for firing the Federal Environment Minister have been rebuffed so far by the Prime Minister. See Maher & Franklin, *supra* note 131.

116. Brian Dollery & Martin Hovey, *supra* note 126.

117. See Andrew Probyn & Andrew T. Canberra, *Insulation Debacle Bill Breaks \$100m Mark*, W. AUSTL. (Feb. 25, 2010), available at <http://au.news.yahoo.com/thewest/a/-/newshome/6850442/insulation-debacle-bill-breaks-100m-mark/>.

118. See CHRIS AULICH ET AL., *THE RUDD GOVERNMENT – AUSTRALIAN COMMONWEALTH ADMINISTRATION 2007 - 2010* (Chris Aulich & Mark Evans, eds., 2010), available at <http://epress.anu.edu.au/anzsog/rudd/pdf/whole.pdf#page=191> (last visited Mar. 16, 2011).

large-scale programs.<sup>119</sup> In the wake of this debacle, the opposition succeeded in putting off the discussion of the CPRS until May 2010.

The challenges faced by the EU-ETS demonstrate that the most effective way to ensure that the systems work properly is not the development of tightly regulated ETSs by governments but rather commitment by industry to reduce GHG emissions. If industry players are convinced of the need to reduce GHG emissions, they would not seek to frustrate the market.

### *B. Other Technological Innovations to Reduce Emissions*

Australia has included investment in environmentally friendly technologies in its climate change policies. These technologies fall within three main categories: technologies that offset or abate carbon pollution; technologies that increase the efficiency of fossil fuel production; and technologies that utilize renewable energy sources.<sup>120</sup> These technologies include: (1) carbon capture and storage; (2) biofuels; (3) (natural) carbon sequestration; (4) biochar technology; and (5) renewable energy sources.

#### *1. Carbon Capture and Storage (CCS)*

Carbon capture and storage (CCS) is a clean coal technology that offsets or abates carbon pollution. Its viability in the reduction of GHG emissions is being explored. As its name suggests, the technology involves the capture of carbon dioxide and its accumulation or storage in deep geological formations.<sup>121</sup> This technology is particularly attractive in the efforts to reduce GHG emissions because of its projected success in significant short-term reduction of GHG emissions.<sup>122</sup> Some argue that CCS can reduce GHG emissions to almost zero.<sup>123</sup> According to the PRISM analysis, a study performed by the Electric Power Research Institute (EPRI) in the United States, wide deployment of CCS after the year 2020 could reduce carbon dioxide emissions in the United States power sector alone by about 350 million tons of carbon dioxide per year (Mt CO<sub>2</sub>/yr) by 2030.<sup>124</sup> This reduction rate is higher than the Kyoto

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119. *Id.*

120. GANS, *supra* note 108, at 2.

121. *What is CCS?*, GLOBAL CCS INST., <http://new.globalccsinstitute.com/ccs/what-is-ccs> (last visited Mar. 16, 2011).

122. *Why Do We Need CCS*, GLOBAL CCS INST., <http://new.globalccsinstitute.com/ccs/why-do-we-need-ccs> (last visited Mar. 16, 2011).

123. *Id.*

124. ELEC. POWER RESEARCH INST. ENERGY TECH. ASSESSMENT CTR., *THE POWER TO REDUCE CO<sub>2</sub> EMISSIONS - THE FULL PORTFOLIO* (2007).

Protocol target for reduction of EU emissions in the five-year period between 2008 and 2012.<sup>125</sup>

Apart from its impressive potential to reduce GHG emissions, CCS is particularly attractive to the coal industry<sup>126</sup> because it best maintains the status quo. CCS allows industries that rely heavily on fossil fuels to continue to do so, provided they can capture their carbon dioxide emissions and safely store these away. This may explain the Australian government's support for CCS, given the country's heavy reliance on fossil fuels for its energy production. Regardless of the motive in support for CCS, it is important to objectively determine the merits of CCS in GHG emissions reduction. Government and industry must ask the difficult questions in order to determine whether CCS is merely wishful thinking or a meaningful part of the climate change solution.<sup>127</sup>

CCS is a fairly new technology. According to a 2010 report commissioned by the Global CCS Institute, as of 2009 there were a total of 275 CCS projects at different stages around the world.<sup>128</sup> This appears to be a fairly large number; however, only sixty-two of these projects may be considered active or planned, of a commercial scale, and integrated, demonstrating the entire CCS process chain of carbon dioxide capture, transport, and storage.<sup>129</sup> Not one of the sixty-two integrated projects is completed. Furthermore, there were about thirty-four completed projects, but none of these could be considered integrated.<sup>130</sup>

In terms of total projects, regardless of state of completion and integration, the most active region is the United States, followed by Europe. Australia and New Zealand are ranked third, accounting for ten percent of the total number of identified CCS projects.<sup>131</sup> This is because over the last six years, the Australian government has shown commitment and support for research initiatives on the development of CCS technologies and

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125. *Id.*

126. The Australian Coal Association has described CCS as "one of the most promising long term solutions" for reducing GHG emissions. See *Coal and the Environment*, AUSTL. COAL ASS'N, <http://www.australiancoal.com.au/coal-and-the-environment.aspx> (last visited Dec. 27, 2010).

127. Michael Jeffery, *Carbon Capture and Storage: Wishful Thinking or a Meaningful Part of the Climate Change Solution*, 27 PACE ENVTL. L. REV. 1 (2009), available at <http://digitalcommons.pace.edu/envlaw/572>.

128. GLOBAL CARBON CAPTURE & STORAGE INST., STRATEGIC ANALYSIS OF THE GLOBAL STATUS OF CARBON CAPTURE AND STORAGE PROJECTS 41 (2010), available at [http://new.globalccsinstitute.com/sites/default/files/Report%201-Status%20of%20Carbon%20Capture%20and%20Storage%20Projects%20Globally\\_2.pdf](http://new.globalccsinstitute.com/sites/default/files/Report%201-Status%20of%20Carbon%20Capture%20and%20Storage%20Projects%20Globally_2.pdf) [hereinafter STRATEGIC ANALYSIS OF THE GLOBAL CCS PROJECTS].

129. *Id.* at 41.

130. *Id.* at 43–44.

131. *Id.* at 42.

supporting regulatory framework.<sup>132</sup> Included in the sixty-two projects regarded as integrated are the following projects from Australia: the Lassie in Victoria; the FuturGas in Southern Australia; ZeroGen and Wandoan Power in Queensland; and Browse LNG, Gorgon Project, and Coolimba in Western Australia.<sup>133</sup> These projects indicate Australia's significant progress in the area of CCS research and development. However, none of the seven projects is in the stage of execution or operation. Thus, adequately assessing the technical feasibility and large-scale commercial viability of the CCS projects is difficult.

The confirmation of the technological feasibility or commercial viability of a project does not necessarily guarantee its success in achieving the impressive GHG emission reductions anticipated.<sup>134</sup> The Global CCS Report confirms this, recognizing that, though many CCS projects have been launched, thus meeting the first objective of the G8, only a few of these projects are likely to reach the operational stage. The failure rate is attributed to a "constellation of challenges" associated with CCS.<sup>135</sup> The report points out that the exact nature of these difficulties is not easy to determine.<sup>136</sup> This is because proponents of failed projects are reluctant to disclose any information that would provide insight on reasons for the failure. Additionally, general deployment challenges can be inferred from analyzing similar technological projects.

The report makes an important observation regarding the risks associated with transport and carbon storage. Of the sixty-two projects analyzed, almost half have been classified as dependent. This classification indicates that these projects are integrated in capture, transport, and storage; however, although the functions are integrated into one CCS system, transportation and storage are in reality carried out by an entity separate from the entity carrying out capture.<sup>137</sup> The dependence on a separate entity to organize storage introduces new risks related to capacity of that entity to transport and store captured carbon, as well as increased risks of lag time due to the current emphasis on capture component development.<sup>138</sup>

Apart from the challenges identified by the Global CCS Institute Report, there is literature on general challenges associated with CCS projects. This literature indicates that, as with all other novel technologies,

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132. *Copenhagen Accord*, *supra* note 33.

133. STRATEGIC ANALYSIS OF THE GLOBAL CCS PROJECTS, *supra* note 146, at 8, 11, 65, 67.

134. Varun Rai, David G. Victor & Mark C. Thurber, *Carbon Capture and Storage at Scale: Lessons from the Growth of Analogous Energy Technologies* 38 ENERGY POL'Y 4089 (2009), available at <http://ssrn.com/abstract=1400163>.

135. Power, *supra* note 104, at 82.

136. STRATEGIC ANALYSIS OF THE GLOBAL CCS PROJECTS, *supra* note 146.

137. *Id.* at 87.

138. *Id.*

the success of CCS is dependent on a whole array of factors, which include the development of regulatory and incentive policies to support its adoption as a business model.<sup>139</sup> At present, no one has any actual CCS experience, which prevents a thorough analysis of the adequacy of Australia's regulatory framework.

The uncertainty and risk of failure in CCS suggests that it may not be the most effective policy option for the reduction of GHG emissions. The Australian government and corporations within the coal industry are currently investing significantly in CCS. Given the analysis above, such investment may not be justified and perhaps should be redirected to more certain and long term GHG emission reduction technologies.

## 2. *Biofuels*

Predicted global shortages of fossil fuels encouraged the search for better and more viable options for energy to be used in transportation, such as biofuels.<sup>140</sup> Biofuels are liquid, solid, or gaseous fuels derived from renewable biological sources. Sourced from biomass, primarily renewable biological plant matter, or from products derived from plant matter, biofuels can be burned directly for thermal energy or converted to other high-value energy sources including ethanol, biodiesel, methanol, hydrogen, or methane.<sup>141</sup> Currently, ethanol from corn grain and biodiesel are the only biofuels produced on an industrial scale in the United States.<sup>142</sup> Countries such as the United States, Canada, and Brazil, where consumers seeking cheaper alternative fuels have increasingly accepted biofuels, offer massive agricultural subsidies to farmers producing biofuel crops.<sup>143</sup>

In Australia, research into second-generation biofuels has expanded significantly. Unlike first generation biofuels that are limited by agronomic characteristics of annual crops and production on arable land, second generation biofuels can be sourced from lignocelluloses, which is a collective term for lignin, cellulose, and hemicellulose components of plant and woody materials with a particular focus on conversion processes.<sup>144</sup>

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139. *Id.*

140. Angelo C. Pinto et al., *Biodiesel: An Overview*, 16 J. BRAZ. CHEMICAL SOC'Y 1313 (2005).

141. *See id.*

142. U.S. DEP'T OF ENERGY, FACT SHEET: GAS PRICES AND OIL CONSUMPTION WOULD INCREASE WITHOUT BIOFUELS (2008), available at [http://www.energy.gov/media/FactSheet\\_Biofuels\\_Lower\\_Gas\\_Prices.pdf](http://www.energy.gov/media/FactSheet_Biofuels_Lower_Gas_Prices.pdf).

143. Laura J. Loppacher & William A. Kerr, *Can Biofuels Become a Global Industry?: Government Policies and Trade Constraints*, CENTRE FOR ENERGY, PETROLEUM & MIN. L. & POL'Y, June 2005, [http://www.dundee.ac.uk/cepmlp/journal/html/Vol15/article15\\_10.html](http://www.dundee.ac.uk/cepmlp/journal/html/Vol15/article15_10.html) (last visited Mar. 16, 2011).

144. ANDREW C. WARDEN & VICTORIA S. HARITOS, RIRDC, FUTURE BIOFUELS FOR AUSTRALIA - ISSUES AND OPPORTUNITIES FOR CONVERSION OF SECOND GENERATION

However, in recent years both scientists and the environmental movement have increasingly criticized the benefits of biofuels because of their huge environmental cost. Apart from raising serious food security issues, biofuels are also suspected of emitting higher levels of GHGs than previously thought.<sup>145</sup> Producing biofuels to be used in the United States, Canada, or the EU exacts a high cost to the natural ecosystems of Brazil and other South American and Asian countries, as biofuel production adds to the depletion of rainforest and grasslands.<sup>146</sup> The U.S. Environmental Protection Agency (EPA) recently acknowledged that ethanol can lower air quality and increase smog.<sup>147</sup> According to a study recently published in *Science*, co-author Joe Fargione, a regional scientist for the Nature Conservancy, found that “converting rainforests, peatlands, savannas, or grasslands to produce biofuels in Brazil, Southeast Asia, and the United States creates a ‘biofuel carbon debt’ by releasing 17 to 420 times more carbon dioxide than the fossil fuels they replace.”<sup>148</sup> Corn and soybean based biofuels also negatively impact the environment because they cause eutrophication; biodiversity loss, and elevated nitrogen levels in the environment.<sup>149</sup> However, there are still mixed and conflicting opinions about the impact of biofuels on the environment. The active and passive impacts of biofuels can be ecosystemic (on biodiversity, water, and carbon) and/or social (including economic and political) in ecosystems across the globe.<sup>150</sup>

Responding to recent concerns surrounding biofuels-based research, Indian scientists have focused on a new plant named *Jatropha* (*Jatropha curcas* L.), euphemistically named “Seeds of Hope,” that can be grown almost anywhere with almost no requirement of water, fertilizer, or fertile soil conditions.<sup>151</sup> Furthermore, it is not edible, posing little or no threat to present or future food supplies. Even the production cost of *Jatropha* is half

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LIGNOCELLULOSICS (2008), available at <https://rirdc.infoservices.com.au/downloads/08-117.pdf>.

145. *Climate Change and Energy: The True Cost of Biofuels*, NATURE CONSERVATORY, <http://www.nature.org/initiatives/climatechange/features/art23819.html> (last visited Dec. 27, 2010) [hereinafter *Climate Change and Energy*].

146. *Id.*

147. See Robert K. Nevin, *Ethanol in Gasoline: Environmental Impacts and Sustainability Review Article*, 9 RENEWABLE AND SUSTAINABLE ENERGY REVIEWS 535 (Dec. 2005).

148. See *Climate Change and Energy*, *supra* note 161.

149. See Jason Hill et al., *Environmental, Economic, and Energetic Costs and Benefits of Biodiesel and Ethanol Biofuels*, 103 PROCEEDINGS OF THE NAT'L ACAD. OF SCI. 11206 (2006). See also Pinto et al., *supra* note 162.

150. Donald Sawyer, *Climate Change, Biofuels and Eco-social Impacts in the Brazilian Amazon and Cerrado*, 363 PHILOSOPHICAL TRANSACTIONS OF THE ROYAL SOC'Y. 1747 (2008).

151. See Patrick Barta, *Jatropha Plant Gains Steam In Global Race for Biofuels: Hardy Shrub Is Tapped For Energy-Rich Seeds; Indian Farmers' Big Bet*, WALL ST. J., Aug. 24, 2007, at A1, available at [http://online.wsj.com/article/SB118788662080906716.html?mod=hps\\_us\\_pageone](http://online.wsj.com/article/SB118788662080906716.html?mod=hps_us_pageone).

that of corn and one third that of rapeseed and other major sources of alternative energy.<sup>152</sup> Considering the relative advantages of Jatropha, Australian based company Mission Biofuels Ltd. has raised A\$80 million from investors and commenced contract farming 66,000 acres of the plant with a target to reach up to 250,000 acres by 2010.<sup>153</sup>

Despite the initial optimism of GHG emission reduction through biofuels, recent research has uncovered two potentially serious concerns: (1) adverse effects on food security in countries that can least afford instability and (2) whether biofuels contribute to a net reduction of GHG emissions.<sup>154</sup> These reservations have refocused further research on other strategies such as carbon sequestration (through agroforestry) and biochar technology (storing carbon in soil) as commercially viable options to mitigate and address climate change through the involvement of Australia's corporate sector.

### 3. (Natural) Carbon Sequestration

Carbon sequestration is the generic term used to describe the capture and storage of carbon dioxide. Capture can take place at the point of emission (e.g. power plants) or through natural processes (e.g. photosynthesis), which removes carbon dioxide from the atmosphere and transforms trees and other forms of vegetation into carbon sinks.

Through photosynthesis, plants use sunlight to convert carbon dioxide from the atmosphere to carbohydrates for their growth. Natural terrestrial system sinks already sequester one third of the carbon dioxide emissions from fossil fuel combustion.<sup>155</sup> Though the uptake of carbon dioxide decreases with time as plants grow to their full capacity and become limited by other resources, sequestration still provides a viable method of relatively short-term climate change mitigation.<sup>156</sup> Australian energy giants like Woodside Petroleum, Eraring Energy, BHP Billiton, and Rio Tinto can play a substantive role in sequestration advancement by investing in the GHG emission-offsetting program that establishes carbon sinks. "[T]ropical reforestation has the potential to serve as a carbon offset mechanism"<sup>157</sup> both above ground and underground for a period of forty to eighty years,

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152. *Id.*

153. *Id.*

154. See Max Rutherford, *Biofuels: Pros and cons*, BIOFUELSWATCH.COM, <http://www.biofuelswatch.com/biofuels-pros-and-cons/> (last visited Mar. 16, 2011).

155. Walker, B., & W. Steffen. *An Overview of the Implications of Global Change for Natural and Managed Terrestrial Ecosystems*, ECOLOGYANDSOCIETY.ORG (1997), <http://www.consecol.org/vol1/iss2/art2> (last visited Mar. 16, 2011).

156. *Id.*

157. W. L. Silver et al., *The Potential for Carbon Sequestration Through Reforestation of Abandoned Tropical Agricultural and Pasture Lands*, 8 RESTORATION ECOLOGY 394 (2000).

which may be beneficial for long term carbon sequestration to mitigate the impacts of climate change.<sup>158</sup> Contemporary changes in the amount of carbon stored in forests and grasslands are influenced both by the land management and environmental conditions of the area. Furthermore, the emerging growth of the biofuels industry will likely have a substantial impact on carbon storage issues.<sup>159</sup>

Large private and public corporate players in the energy sector have made significant moves toward implementing GHG abatement strategies.<sup>160</sup> Woodside Petroleum, which currently produces approximately forty percent of Australia's gas and oil, is participating in a GHG emission reduction program through technical and other means.<sup>161</sup> Under this initiative, Woodside signed a contract with CO2 Group Limited to establish a permanent carbon sink by planting mallee eucalyptus in Western Australia.<sup>162</sup> The project will cost A\$100 million over a period of fifty years.<sup>163</sup> Even in the United Kingdom, the issue of forest footprints is gaining momentum. Leading companies have demonstrated their commitment to the "Disclosure Request," which makes companies accountable to both investors and consumers for their impact on the world's forest.<sup>164</sup>

Eraring Energy, a large, state-owned, coal-based power generation company in New South Wales,<sup>165</sup> also initiated a sequestration project in support of reducing its carbon footprint. Eraring Energy's active cooperation with CO2 Group Limited will establish 1,100 hectares of mallee eucalyptus plantation in Western Australia.<sup>166</sup>

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158. *Id.*

159. Christine Negra et al., *Indicators of Carbon Storage in U.S. Ecosystems: Baseline for Terrestrial Carbon Accounting*, 37 J. ENVTL. QUALITY 1376 (2008).

160. See CO2 Group Limited, *Submission to the Senate Standing Committee on Economics Committee Inquiry into the Carbon Pollution Reduction Scheme Bill 2009*, SENATE STANDING COMMITTEE ON ECON. (June 4, 2009), available at [http://www.aph.gov.au/Senate/committee/economics\\_ctte/cprs\\_2\\_09/submissions/sub37.pdf](http://www.aph.gov.au/Senate/committee/economics_ctte/cprs_2_09/submissions/sub37.pdf). [BB 18.2.3, T2.2 – Not sure about this one. Seems since it's a PDF and website is an "official" Aussie site, that this may not be the correct format]

161. S.A. RYAN ET. AL., WOODSIDE ENERGY, LTD., , RESPONSIBLE ENVIRONMENTAL MANAGEMENT LEADS TO IMPROVED RESOURCE RECOVERY - THE LAMINARIA / CORALLINA GAS RE-INJECTION PROJECT (SOC'Y OF PETROLEUM ENGINEERS 2001), available at <http://www.onepetro.org/mslib/servlet/onepetroreview?id=00072101&soc=SPE>.

162. See CO2 AUSTRALIA, <http://www.co2australia.com.au/index.php?sectionID=6718&pageID=7306> (last visited Mar. 16, 2011).

163. *Reducing Greenhouse Gas Emissions*, WOODSIDE, <http://www.woodside.com.au/Sustainable+Development/Climate+Change/Emissions+Reduction.htm> (last visited Mar. 16, 2011).

164. *Annual Review*, FOREST FOOTPRINT DISCLOSURE, <http://www.forestdisclosure.com/page.asp?p=4714> (last visited Mar. 16, 2011).

165. ERARING ENERGY, <http://www.eraring-energy.com.au> (last visited Mar. 16, 2011).

166. See CO2 AUSTRALIA, *supra* note 179.

#### 4. Biochar Technology

Biochar technology, a new way of storing carbon in soil, is gaining momentum with its initial promising outcomes. Biochar is a type of charcoal that results from heating organic materials such as crop residues, wood chips, and municipal waste.<sup>167</sup> Where complete burning is prohibited, it can replace slash and burn with slash and char techniques. This technology is chemically stable and can help with the long-term mitigation of climate change through the storage of carbon dioxide for hundreds to thousands of years.<sup>168</sup> This biomass-derived charcoal came to light with the availability of charcoal rich soil in the Amazon basin known as *terra preta*.<sup>169</sup>

The International Biochar Initiative (IBI), formed in 2006, promotes the research, development, demonstration, deployment and commercialization of biochar technology.<sup>170</sup> According to the IBI, the benefits of biochar technology are massive. It would remove about 1.2 billion metric tons of carbon from the atmosphere each year, which would offset the current twenty-nine percent net rise in atmospheric carbon.<sup>171</sup> Furthermore, biochar, along with chemical fertilizer (NPK), can increase the growth of the yield of a crop up to fifty percent.<sup>172</sup>

Though biochar technology is still at a nascent stage in its development, it raises the possibility of providing large-scale carbon storage than carbon sequestration through afforestation and expanding tree coverage.<sup>173</sup> Forests are able to capture and sequester carbon only while growing, and there is always the risk of total destruction of forest or plantations due to catastrophe or infestation. Soil borne charcoal (i.e. biochar) is potentially more stable.<sup>174</sup> It is therefore attracting widespread interest from the corporate sector as a possible investment vehicle of the future. As with other forms of mitigation/abatement

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167. *What is Biochar?*, INT'L BIOCHAR INITIATIVE, <http://www.biochar-international.org/biochar> (last visited Mar. 16, 2011).

168. *Environmental Benefits of Biochar: Global Warming*, INT'L BIOCHAR INITIATIVE, <http://www.biochar-international.org/biochar/benefits> (last visited Mar. 16, 2011).

169. *Biochar Use in Soils: Biochar and Terra Preta Soils*, INT'L BIOCHAR INITIATIVE, <http://www.biochar-international.org/biochar/soils> (last visited Mar. 16, 2011).

170. *About Us: IBI History*, INT'L BIOCHAR INITIATIVE, <http://www.biochar-international.org/about> (last visited Mar. 16, 2011).

171. *See How Much Carbon Can Biochar Systems Offset - and When?*, INT'L BIOCHAR INITIATIVE, [http://www.biochar-international.org/images/final\\_carbon.pdf](http://www.biochar-international.org/images/final_carbon.pdf) (last visited Mar. 16, 2011).

172. *Id.*

173. *See* CSIRO, BIOCHAR, <http://www.csiro.au/files/files/pnzp.pdf> (last visited Mar. 16, 2011).

174. *Id.*

strategies, biochar needs to be carefully examined from environmental, social, and technological perspectives.

In the post-Kyoto period after 2012, biochar technology could be the preferred solution over other carbon sequestration initiatives because Australian industries may be able to buy certified emission reductions (CERs) to offset their emissions of GHG. If biochar is recognized as an efficient clean development mechanism (CDM), there will also be enormous opportunities for developing countries to benefit from this new technology. Despite its benefits, Friends of the Earth (Australia) have expressed their concern that the introduction of biochar technology may further erode the rights of indigenous peoples through their displacement from traditional lands.<sup>175</sup>

### 5. Renewable Energy Sources

Renewable energy is derived from sources that can be replenished. The main types of renewable energy sources include solar, water, wind, geothermal, and biomass. Given the finite nature of fossil fuels and the adverse environmental effects of burning fossil fuels, the most effective long-term solution to carbon pollution would be a switch to renewable energy sources. Renewable energy results in either fewer carbon dioxide emissions than fossil fuels (as with biomass), or in some cases, zero emission of carbon dioxide (as with solar, wind, and hydro power). Unfortunately, the efficient generation of energy from these renewable sources in a cost effective manner remains a challenge, discouraging the adoption of renewable energy as a primary climate change solution.

Australia has great potential for establishing a renewable energy industry. One study concluded that, assuming a single grid supplied the world's energy, all energy could be supplied by eight large-scale solar generation plants, with Australia providing twenty-one percent of this energy.<sup>176</sup> Despite this potential, Australia's renewable energy industry has not been vibrant. The slow development of the renewable energy industry is attributable to the lack of coordination between federal and state governments, which undermines renewable energy development.<sup>177</sup> Further, lack of a framework to offset the market price against environmental savings that resulted from the use of renewable sources

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175. See Rye Senjen, *Biochar—Another Dangerous Technofix*, 106 CHAIN REACTION (Aug. 2009), available at <http://www.foe.org.au/resources/chain-reaction/editions/106/biochar-2212-another-dangerous-technofix>.

176. Quanhua Liu et al., *Solar Radiation as Large-Scale Resource for Energy-Short World*, 20 ENERGY & ENV'T 319 (2009).

177. *Id.*

contributed to the stunted growth of the industry.<sup>178</sup>

The absence of coordination and framework, coupled with a general perception that renewable energy increases the cost of electricity, has held back the development of renewable energy technology in Australia. The previous government's apparent lack of conviction in the feasibility of renewable energy did not help. John Howard, the former Prime Minister, reportedly stated, "You can't run power stations on solar and wind [...] [L]et's be realistic, you can only run power stations in a modern Western economy on fossil fuel, or in time, nuclear power."<sup>179</sup> Such a position by the head of government may explain why the period recorded such little success in overcoming the barriers that inhibit the growth of the renewable energy industry.<sup>180</sup>

Despite its current focus on an ETS, Australia's climate change and environmental policies recognize the importance of renewable energy.<sup>181</sup> The government has established the Australian Centre for Renewable Energy (ACRE). The objective of the center is to "promote the development, commercialization, and deployment of renewable energy and enabling technologies."<sup>182</sup> The center is a component of the Clean Energy Initiative, which receives significant government funding.<sup>183</sup>

Notwithstanding current government investment in renewable energy, the percentage of energy generated from these sources continues to be minimal. According to a 2009 report by the Australian Bureau of Agricultural and Resources Economics (ABARE), the majority of Australia's electricity supply continues to come from coal, which accounted for eighty-one percent of fuel inputs into electricity generation in the year 2007-2008.<sup>184</sup> In contrast, fuel inputs from renewable sources amounted to only three percent.<sup>185</sup> However, recently the number of new projects for the generation of electricity from renewable energy sources has increased.

178. August Schläpfer, *Hidden Biases in Australian Energy Policy*, 34 RENEWABLE ENERGY 456 (2009).

179. *PM Pushes Nuclear Power Case*, SYDNEY MORNING HERALD, Feb. 3, 2007.

180. Stephen Jones, *The Future of Renewable Energy in Australia: A Test for Cooperative Federalism?*, 68 AUSTL. J. PUB. ADMIN. 1 (2009).

181. *Renewable Energy*, AUSTL. GOV'T DEP'T CLIMATE CHANGE & ENERGY EFFICIENCY, <http://www.environment.gov.au/settlements/renewable/index.html> (last updated Aug. 13, 2010).

182. *Australian Centre for Renewable Energy*, AUSTL. GOV'T DEP'T RES., ENERGY & TOURISM, <http://www.ret.gov.au/energy/energy%20programs/cei/acre/Pages/default.aspx> (last updated Dec. 7, 2010).

183. See DEP'T OF RES., ENERGY AND TOURISM, CLEAN ENERGY INITIATIVE (2009), available at [http://www.ret.gov.au/Department/Documents/CEI%20Fact%20Sheet%20\(13%20May%2009\).pdf](http://www.ret.gov.au/Department/Documents/CEI%20Fact%20Sheet%20(13%20May%2009).pdf).

184. ALAN COPELAND, AUSTL. BUREAU AGRIC. & RES. ECON., ELECTRICITY GENERATION MAJOR DEVELOPMENT PROJECTS - OCTOBER 2009 LISTING 4 (2009), available at [http://www.abareconomics.com/publications\\_html/energy/energy\\_09/EG09\\_Oct.pdf](http://www.abareconomics.com/publications_html/energy/energy_09/EG09_Oct.pdf).

185. *Id.*

Between April and October 2009, there were thirty new electricity generation projects.<sup>186</sup> Of these projects, twenty-three are wind driven, three are coal fired, and one is fuelled by geothermal energy.<sup>187</sup> The largest of the completed projects is the 140-megawatt Capital Wind Farm located in New South Wales.

Despite their high cost, the output of these projects is small compared to that of the fossil fuel power plants.<sup>188</sup> Such output is to be expected because research shows that even the capacity generated from mature renewable energy technology would still be significantly less than that from coal fired plants.<sup>189</sup> However, this is to be expected considering the novelty of the technology and the resulting market imperfections. The role of renewable energy policy should be to correct the imperfections so as to boost the new technologies.

In August 2009, Australia enacted the Renewable Energy Target Scheme (RET), an expansion of the Mandatory Renewable Energy Target Scheme (MRET).<sup>190</sup> Under the RET, the government pledged that by 2020, twenty percent of Australia's electricity supply will come from renewable energy sources.<sup>191</sup> Though the Australian target of twenty percent seems high and is similar to that of the European Union, the Australian target, unlike that of the EU, is not entirely a percentage target. If Australian demand for electricity increases, the actual target would be adjusted to be less than twenty percent.<sup>192</sup> Apart from expanding renewable energy targets, the RET will provide incentives to encourage the use of renewable sources of energy such as solar, wind, biomass, and geothermal energy.<sup>193</sup> The RET is based on a market for Renewable Energy Certificates (RECs). The RECs also extend to non-generating activities such as solar water heaters.<sup>194</sup> Reservations remain as to whether solar and wind renewable energy sources are in a position to supply the country's base-load requirement with cheap coal as competition. These reservations appear to be supported in part by the Australian Geothermal Energy Association.<sup>195</sup> So far, most existing RECs have been from the use of solar heaters, rather

186. *Id.* at 11.

187. *Id.*

188. *Id.* at 7.

189. *Id.*

190. *Renewable Energy Target*, AUSTL. GOV'T DEP'T CLIMATE CHANGE & ENERGY EFFICIENCY, <http://www.climatechange.gov.au/en/government/initiatives/renewable-target.aspx> (last updated Dec. 24, 2010).

191. *Id.*

192. Prest, *supra* note 117, at 184.

193. *Id.*

194. *Id.*

195. See *Submission to the Senate Economics Committee's Inquiry into the Renewable Energy (Electricity) Amendment Bill 2009*, AUSTL. GEOTHERMAL ENERGY ASS'N (July 24, 2009), [http://www.agea.org.au/media/docs/senate\\_inquiry\\_into\\_the\\_ret.pdf](http://www.agea.org.au/media/docs/senate_inquiry_into_the_ret.pdf).

than from actual electricity generation.<sup>196</sup> The capacity of the government to meet the twenty percent target by 2020 is dependent on an array of factors. Time will tell if the RET encourages derivation of energy from renewable sources.

The current government seems to be adopting a mix of policy options in the mitigation of climate change. Therefore, renewable energy policies are not operating within a vacuum but rather in the context of other policies such as the CPRS. They are influenced by technologies seeking to abate or offset carbon pollution in the course of power generation from fossil fuels. Whereas each of these policies considered on its own may be effective in reducing GHG emissions, combining policies may have the effect of stalling investment in other policy options. This may be the case with the mix of CCS and renewable energy policies. Thus, the government should consider redirecting resources to the more effective long-term policy option, as opposed to the more cost effective short-term option.

Calls for a national debate in Australia on the nuclear energy option are becoming more frequent, as many other countries rely on this technology for a significant proportion of their energy requirements.<sup>197</sup> Current government policy has ruled out the use of nuclear power.<sup>198</sup> After Copenhagen, public opinion appeared to shift from outright opposition to a realization that, in the face of climate change, all realistic options should at the very least be debated. The fact that Australia is the third largest exporter of uranium (after Canada and Kazakhstan),<sup>199</sup> and President Obama's announcement on February 16, 2010, of funding for the construction of the United States' first new nuclear power plant in nearly three decades, has been noticed in Australia as it seeks reliable, less polluting ways to meet its energy requirements and international commitments.<sup>200</sup> A serious national nuclear debate will very likely take place in Australia at some point in the near future.<sup>201</sup>

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196. Craig Froome, *Renewable Energy in Australia: 20 Per Cent by 2020: Can this be Achieved?*, 21 MGMT. ENVTL. QUALITY: AN INT'L J. 177 (2010).

197. Calls for a nuclear power debate in Australia have intensified and include members of the Gillard Labour government. See Steve Lewis, *Julia Gillard faces nuclear power push*, PERTH NOW (Dec. 1, 2010, 6:24 AM), <http://www.perthnow.com.au/news/julia-gillard-faces-nuclear-power-push/story-e6frg12c-1225963729540>.

198. This policy has stood for many years despite Australia's position as one of the world's largest exporters of uranium for peaceful purposes.

199. *Australia Slides Down List of Uranium Exporters*, ABC NEWS (June 12, 2009), <http://www.abc.net.au/news/stories/2009/06/12/2596025.htm>.

200. Anne Marie Riha, *President Obama Announces Money for Nuclear Power Plant*, FOX NEWS (Feb. 16, 2010), <http://politics.blogs.foxnews.com/2010/02/16/president-obama-announces-money-nuclear-power-plant>.

201. On February 23, 2010, the Federal Resources and Energy Minister revealed that the proposed location of Australia's first national nuclear waste depository site is to be near Tennant Creek in the Northern Territory. See Jano Gibson & Kirsty Nancarrow, *Nuclear*

#### IV. POST-KYOTO NATIONAL EMISSION REDUCTION TARGETS, TAXES, AND OTHER MARKET-BASED INCENTIVES

In the absence of a global, legally binding agreement on reduction targets for GHG emissions, governments must reconsider their policy options. In the face of the current difficulties experienced by the United States and Australia in passing cap and trade legislation, fossil fuel industries are experiencing a reprieve. However, as governments are well aware, the industry sector is unlikely to reduce GHG emissions without some form of mandatory national reduction target. Governments should and will seek other ways apart from the cap and trade scheme to achieve the same objective. It is thus in the best interest of industry to be a step ahead of government regulation and to begin thinking of new ways of moving towards security, which ultimately lies in energy efficient technologies.

The Copenhagen summit and the recent controversy surrounding the working of the IPCC have not resulted in an overnight loss of global consensus on the need to mitigate anthropogenic climate change, nor have they undone the science behind climate change. They have undoubtedly led to decreased momentum in climate change mitigation efforts. Regardless, it would be folly for the industry sector to continue to rely on fossil fuels and other GHG emitting technologies to generate energy.

In the long term, the adverse effects of climate change will affect the public and lead to increased pressure on government and industry to find sustainable sources of energy. A recent survey in Australia indicates that despite the apparent loss of popularity of Rudd's CPRS, a majority of the public (84.3%) is still convinced that global climate change is real, and an equally high majority (82.6%) believes a plan should be adopted to reduce GHG emissions.<sup>202</sup> The survey concludes that there is broad agreement among political parties and the public on the need to substantially decrease GHG emissions by at least sixty percent by 2050 and market mechanisms should play the role in achieving these reductions.<sup>203</sup> Thus, the debate currently centers on the details necessary to implement this objective.<sup>204</sup> The survey indicates that even though government pressure on GHG emission reduction may reduce consumer preferences, it may eventually lead to a market-driven greening of industry, in which case it is in their interest to begin to make the switch.

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*Waste Likely to be Dumped in NT*, ABC NEWS (Feb. 24, 2010), <http://www.abc.net.au/news/stories/2010/02/23/2827837.htm>.

202. Richard T. Carson et al., *Alternative Australian Climate Change Plans: The Public's Views*, 38 ENERGY POL'Y 902 (2010).

203. *Id.* at 909.

204. *Id.*

## V. CONCLUSION

The success of an ETS in Australia, as pointed out by the Garnaut Review, depends upon the adoption of a global legally binding agreement in which the other major carbon producing economies are bound to GHG reduction targets. Either in the absence or presence of such an agreement, CPRS implementation in Australia would have limited effect on the global reduction of GHG emissions; despite high per capita carbon emissions, Australia's contribution to global totals is almost insignificant. Consequently, even if the five percent reduction target in the proposed CPRS is achieved, it would not result in a significant reduction of global carbon emissions in the absence of similar action by other major emitting countries such as the United States, China, and India. Following the outcome of the Copenhagen Conference, Australia may need to reconsider the effectiveness of legislating and implementing the CPRS.

Further, even at the national emissions level, the effectiveness of the proposed CPRS is not certain. As discussed in the foregoing sections, the success of an ETS in Australia is dependent on the existence of a larger global carbon market. In the absence of such a market, the cost to the economy of implementing an ETS would far outweigh its benefits.

Australia's other climate change policy priorities are CCS and other carbon abatement technologies. In addition to the risks and uncertainty discussed above, CCS and other carbon abatement technologies are not long-term solutions to the reduction of GHG emissions, particularly if they are implemented alongside CPRS. When such technologies engage in cleaning carbon, they reduce the price of coal and thus encourage Australia's reliance on coal. Further, the identification of CCS as a policy priority transfers funds that would otherwise be used for pursuing renewable energy options.

In the current circumstances, it would appear more effective for Australia to redirect the resources invested in CPRS and CCS to the development of renewable energy technologies. Despite the initial high cost associated with renewable energy, Australia has a natural advantage over other countries, particularly in the case of solar and wind sources. To stimulate the successful shift to renewable energy, the government may have to consider subsidies that are likely to encourage consumer demand for renewable energy and reduce generation costs.

The current government may also have to reconsider its policy options with respect to the use of nuclear energy. Nuclear energy would undoubtedly introduce the high risks associated with its use, although there is evidence from other countries that shows these risks can be managed and mitigated.

Given the present state of global governance with respect to climate change mitigation, total GHG emissions into the atmosphere are likely to continue to increase, or, in the best case, decrease by insignificant margins.

In such a situation, Australia should consider including climate change adaptation measures in its policy options.

The role of industry in the implementation of the above policy direction is essential. Apart from being the primary drivers of economic development, corporations have the financial and technological resources, as well as the institutional capacity, to implement policy options identified by government.<sup>205</sup> The success of government policy options depends on the cooperation of industry and its quick response to government policy direction. Industry can facilitate the proposed government policy shift by ensuring that a skilled work force is available to support the required technological change.

It is in the interest of industry to consider a shift towards more renewable energy sources, which are likely to be the emphasis if GHG emissions continue at the current rates, as well as to identify business opportunities in climate change adaptation. Due to climate change awareness campaigns over the last few years, consumer trends indicate a greater demand for energy efficient products. Thus industries may be forced to move to energy efficient products to secure the consumer market.

#### ADDENDUM

2010 witnessed some extraordinary political events in Australia including a sitting Prime Minister, Kevin Rudd (elected in December 2007 with a solid parliamentary majority in the House of Representatives) removed from office on May 24, 2010, by his own Labour Party and replaced by Deputy Prime Minister, Julia Gillard. At a general election held on August 21, 2010, Labour and the Coalition Opposition each won 72 seats in the 150-seat House of Representatives resulting in the first hung parliament since the 1940s.<sup>206</sup> Labour under Gillard formed a minority government and secured the support of the only Greens MP ever elected to the House of Representatives and three Independents. On July 1, 2011, the Greens will hold the balance of power in the 76-seat Senate with a total of nine seats.<sup>207</sup> In the Senate, the Coalition will hold 34 seats to Labour's 31. An Independent and a newly elected Senator from Victoria will hold the two remaining Senate seats.

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205. Helen Borland, *Conceptualising Global Strategic Sustainability and Corporate Transformational Change*, 26 INT'L MARKETING REV. 554 (2009).

206. The complete election results are available from the Australian Electoral Commission's website, <http://results.aec.gov.au/15508/Website/default.htm>

207. Under the Australian electoral system, senators are elected for six year terms that end on June 30. See *Elections: Constitutional complexities and consequences*, PARLIAMENT OF AUSTRALIA – SENATE (Sept. 21, 2007), <http://www.aph.gov.au/senate/pubs/elections/15626.htm>.

The results of the August 2010 election have significant implications on almost all major initiatives put forward by the Gillard minority government. One of the principal reasons leading to Rudd's political demise was his decision to withdraw the CPRS legislation from Parliament in April 2010 and postpone any further consideration of his twice-defeated CPRS until 2013, a position at the time endorsed and since re-affirmed by his successor, Julia Gillard.

Although she gave an undertaking on two occasions prior to the August 2010 election that there would be no "carbon tax" if elected, she has since reversed her position under pressure from the Greens and has now vowed to enact a carbon tax to take effect by July 1, 2012. The Opposition vociferously opposes this measure<sup>208</sup>

This will operate until 2015–2016 when the regime will move to an emissions trading scheme. Whether the Greens will decide whether or not to bring down the government and force early elections remains the subject of intense speculation because the Prime Minister has made it clear that compensation for energy-intensive industries, such as electricity generation, and trade-exposed industries, such as coal, cement, and aluminum, will be provided at levels that mirror what the Rudd government had offered and had been rejected by the Greens when they voted against the CPRS on the two earlier occasions when the Bills were before Parliament.<sup>209</sup>

Policy positions taken by all parties are subject to change as party leaders try to ensure that they are not caught off guard should the government fall and the country heads to an early election. Therefore, it is difficult in such a volatile political cauldron to intelligently comment on the extent to which current government policy on a host of issues under debate, including energy production, GHG reduction, and strategies to effectively confront climate change and climate variation, will successfully be transformed into legislation and, more importantly, successfully implemented.

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208. *Gillard vows to pursue consensus*, THE AUSTRALIAN (Oct. 1, 2010, 12:00 AM), <http://www.theaustralian.com.au/national-affairs/gillard-vows-to-pursue-consensus/story-fn59niix-1225932572333>.

209. *Id.*

# THE CONCEPT OF CORPORATE SOCIAL RESPONSIBILITY IN ISLAMIC LAW

Salma Taman\*

## INTRODUCTION

This Article analyzes whether the concept of corporate social responsibility (CSR) is consistent with Islamic law (Sharia). The goal is to survey the primary sources of Sharia in an attempt to find any Islamic notions, Quranic verses, or Prophetic Hadiths that are related to CSR and that show that it is supported by and consistent with Islamic law.

Part I discusses the concept of CSR and what it represents in the West by comparing the most widely accepted definitions of CSR. After determining what constitutes CSR, the Article explores whether CSR exists in Islamic law. The analysis of whether CSR is consistent with Islamic law is done via a discussion of two jurisprudential tools. Eminent Muslim jurists, who were confronted with questions relating to Sharia that had no direct answers in the primary sources, created these tools. They came up with jurisprudential solutions to make Islamic law more flexible, capable of accommodating the rapidly changing world, and able to provide answers to any new notions that were not existent during the legislation process of Sharia.

After showing that CSR is consistent with Sharia, in Parts II–IV, the Article looks more closely at Islamic law to extract any ideas, notions, or concepts that indicate CSR is required by the Sharia. The Article then briefly explains these notions and shows the Quranic verses and Prophetic Hadiths that embody them. Part V discusses prohibited commercial activities in Islamic law, including usury, gambling, gharar, and others. This section provides definitions for each activity as well as the reasons for its prohibition. Part VI introduces Islamic financial institutions (IFIs), the reasons for their existence, and the services they offer as alternatives to the prohibited activities in Islamic law. Part VII discusses some implications of the prohibitions for doing business in and with Islamic countries in the 21<sup>st</sup> century. Part VIII offers concluding remarks.

## I. THE CONCEPT OF CSR

The definition of CSR is a work in progress. There is not a perfect definition upon which everyone would agree. However, several attempts

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\* The author is fluent in both Arabic and English. She is also a devout Muslim. All Quranic verses and citations to Bahkari within this article are the author's personal translations. The editors of the *Indiana International & Comparative Law Review* relied upon the accuracy of the author's translations.

provide a good idea of what CSR is truly about. The European Commission defines CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stake holders on a voluntary basis.”<sup>1</sup> Others define CSR as “the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.”<sup>2</sup> Although there are many other definitions, these two definitions give a good overview of what CSR is generally thought to be.

CSR, a concept that is generally assumed to have been born in the West, is nothing more and nothing less than a measure of the civilization and development of a nation. It is a notion about which third world countries have little idea and over which first world countries compete. Milton Friedman’s opinion that corporations have no responsibility toward society other than legally maximizing their profits<sup>3</sup> is no longer valid. Many corporations now have financial resources that are as vast as those of some entire societies. They control the markets and the wealth of the nations in which they operate. Exempting them from responsibilities other than making profits for their shareholders would mean that real development of those nations would be marginalized and the circulation of wealth would be forever limited to the higher levels of society. Without a commitment to CSR, corporations would operate in a deteriorating natural environment with rising levels of poverty, ultimately causing declining purchasing power of their own customers. Can corporations function, let alone thrive, in an environment where everything else is stagnating or collapsing? Obviously not. It is, indeed, in the interest of all corporations to be socially responsible and to give back to society in a measure equal to what they are taking, if not more.

Even from a business perspective, it makes sense for corporations to be socially responsible. With the growing importance of CSR, it has become a factor in the competitive race; it has become a way of outsmarting the competition. Corporations can get away with making high profits and paying little in taxes—even with products that are not necessarily very good—if they are socially responsible and environmentally friendly.

## I. CSR IN ISLAM

Although the term corporate social responsibility was coined in the

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1. *Commission Green Paper Promoting a European Framework for Corporate Social Responsibility*, at ¶ 20, COM (2001) 366 final (July 18, 2001).

2. PHIL WATTS ET AL., WORLD BUSINESS COUNCIL FOR SUSTAINABLE DEVELOPMENT, MEETING CHANGING EXPECTATIONS: CORPORATE SOCIAL RESPONSIBILITY 3 (1999), <http://www.wbcd.org/DocRoot/hbdf19Txhmk3kDxBQDWW/CSRmeeting.pdf>.

3. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (40th Anniv. ed. 2002).

West, CSR is not an exclusively Western notion. It is true that there is nothing in the Islamic faith or law that dictates that “corporations” should be “socially responsible” in those terms. But, what does it mean to be socially responsible? From the two previously mentioned definitions and other similar ones, CSR means conducting your business while preserving the environment, treating your workers well, being fair to your competitors, being honest and just in your dealings, caring about society and its less fortunate members, and looking after all stakeholders’ interests without undermining those of the shareholders.

If this is what CSR is, then the notion of CSR lies at the very heart of the Islamic faith and law. Properly understood, CSR is not a recommendation, but rather an obligation for every Muslim. It is fascinating how Sharia, although quite ancient, includes detailed rules about commerce and the appropriate conduct of traders and other business persons. Before going into the details of CSR under Sharia, it is useful to briefly explain what is considered Sharia and what is not.

A brief discussion of the sources of law and their hierarchy is necessary. Sharia refers to “the sum of legal rules that God has legislated and sent to the people through Muhammad (P).<sup>[4]</sup> Sharia is incorporated in Quran<sup>[5]</sup> and Sunnah.”<sup>6</sup> The legislative process of Islamic law took place only during the lifetime of Muhammad (P). Only he was allowed to legislate because only he was divinely inspired by God. The only sources of Sharia are the Quran and Sunnah. Any scholarly opinions or rules provided by the companions or followers of Muhammad (P) are not part of Sharia. The rules and opinions of scholars, legislators, and leaders after Muhammad (P), no matter how eminent such scholars and leaders are or were, are not part of Sharia. In the Islamic faith, scholars and religious leaders—let alone worldly leaders—are not considered divinely inspired. They may be wise. They may be well intentioned; but they are as fallible as other human beings. Their rules are worldly rules and not Sharia.<sup>7</sup>

Scholarly opinions about Islamic law fall under the category of Fiqh, which is different from Sharia. Fiqh literally means knowledge or comprehension. In the context of Islamic law, Fiqh means knowledge of the practical legal rules that enable Muslims to conduct their lives according to the teachings of Islam. This knowledge is based on the Quran and

4. “(P)” is an abbreviation for “pbuh,” which means “peace be upon him.”

5. The *Quran* is the record of the revelations that were sent to Mohamed from God through the Angel Gabriel. Muslims believe that the *Quran* is the actual word of God; thus, the *Quran* is the first and most important source of Islamic Law.

6. RAMADAN EL SHOROUMBASSY, *AL MADKHAL LE DIRASSAT AL FIQH AL ISLAMY* [THE INTRODUCTION TO ISLAMIC JURISPRUDENCE] 5 (2003) (explaining that the Sunnah is the collection of sayings and actions of the Prophet Muhammad and that sayings of the Prophet Muhammad are also known as Hadith(s)).

7. *Id.* at 12.

Sunnah but is different from these legislative sources.<sup>8</sup> In sum, Sharia is the divine law, and Fiqh is the human interpretation and attempt at application of Sharia.<sup>9</sup>

Whereas Sharia sets general limits, Fiqh supplements the details to the more general rules stipulated in Sharia. Logically, any detailed rules provided by Fiqh cannot be inconsistent with any general principle set by Sharia. However, while Sharia is static, Fiqh is dynamic, evolving over time. Therefore, one can say that Fiqh is not only the way Sharia can be understood. It is also applicable to more issues and situations in life and is able to accommodate change to keep Sharia timely and comprehensible in different eras and places.<sup>10</sup>

This author emphasizes the distinction between Sharia (law) and Fiqh (jurisprudence) because it is supremely important to clarify that scholarly opinions about the correct interpretation and application of Sharia, although often well respected and appreciated, are not binding on Muslims. The sole exception is in the case of Ijma, when there is a consensus of opinion of all well-respected scholars of a certain time and age on a certain matter that was left unresolved by the Quran and Sunnah. Since scholars base their opinions on their knowledge and understanding of the Quran and Sunnah, if they unanimously agree on a matter, it is not likely that all of them are wrong. After all, they are the people with the best knowledge of the law and its two divine sources. However, Ijma is quite rare. So, this Article remains focused on CSR in the law that is binding on all Muslims; that is, the Quran and Sunnah, rather than the non-binding Fiqh.

The next section examines the Quran and Sunnah to identify the most important Quranic verses and Prophetic sayings (Hadiths) and activities that reflect the concept of CSR. It will explore the obligations of Muslims that reflect the notion of CSR as it has been previously defined.

### III. CSR AND THE QURAN

For Muslims, the Quran is the code of ethics that each must follow in his or her personal life as well as in business dealings. Different interpretations of some verses, however, frequently cause confusion and misunderstanding. The following verses are not exhaustive; they are merely examples of the verses that deal with business ethics in Islam.

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8. *See id.* at 5.

9. *Id.* Fiqh also provides the more specific substantive legal rules in areas such as: issues related to the proper worship of God (rules for prayer, fasting, etc.); criminal law (details about crimes and punishments); contract law (rules for sales and purchase transactions, settling of debts, etc.); family and personal law (rules about marriage, divorce, child support, etc.); and peace and war issues, including rules on international agreements.

10. Arskal Salim, *Challenging the Secular State: The Islamization of Law in Modern Indonesia* 12 (2008).

Interpretations are provided along with the most significant passages from the Quran and Sunnah.

*“Righteousness is not turning your faces towards the east or the west (in Prayers). Righteous are those who believe in GOD, the Last Day, the angels, the scripture, and the prophets; and they give the money, cheerfully, to the relatives, the orphans, the needy, the travelers (strangers), the beggars, and to free the slaves; and they observe the Contact Prayers (Salat) and give the obligatory charity (Zakat); and they keep their word whenever they make a promise; and they steadfastly persevere in the face of persecution, hardship, and war. These are the truthful; these are the righteous.” Quran [2:177]*

*“The believing men and women are allies of one another. They advocate righteousness and forbid evil, they observe the Contact Prayers (Salat) and give the obligatory charity (Zakat), and they obey GOD and His messenger. These will be showered by GOD's mercy. GOD is Almighty, Most Wise.” Quran [9:71]*

*“GOD advocates justice, charity, . . . . And He forbids evil, vice, and transgression. He enlightens you, that you may take heed.” Quran [16:90]*

*“Do you know who really rejects the faith? That is the one who mistreats the orphans. And does not advocate the feeding of the poor. And woe to those who observe the contact prayers (Salat)—who are totally unmindful of their prayers. They only show off. And they prevent charity.” Quran [107:1-7]*

#### *A. CSR in the Sunnah*

The Prophet said of himself, “I have been sent only for the purpose of perfecting good morals” (Bukhari). The use of the term “only” shows the great importance placed on good morals in Islam.

#### *B. Maquasid Al Sharia (The Purposes of Sharia)*

The Prophet Muhammad’s (P) death completed the legislative process in Islamic law. Thus, it is impossible to find clear and certain answers to legal questions that appeared after that period. Once Muhammad (P) died and no more Quranic verses were forthcoming, the only way to figure out how to deal with new challenges and problems has been for Muslim scholars to create new tools that help them discover what the Quran was intended to convey and what the Prophet Muhammad (P) would have advised. Such tools are all based upon general principles provided for in the Quran but not directly addressed by its verses or by the Prophetic Sunnah.

Maquasid Al Sharia is one tool that helps solve many legal questions in Islamic law. In practice, when facing a new legal question, such as whether the concept of CSR is consistent with Islamic law, a Muslim

checks whether the concept is consistent with the purposes of Sharia. If it is, then CSR would have been encouraged by the Quran and Sunnah, had the question come up during the time of Islamic legislation. This notion of Maqasid Al Sharia, no doubt, is an essential ingredient for making Islamic law flexible and capable of accommodating the rapid change in our modern societies.<sup>11</sup>

But what are the purposes of Sharia, and how do we know whether a certain notion is allowed or even encouraged under Islamic law? Over time, Muslim scholars have surveyed the Quran and Sunnah and concluded that there is a set of main purposes that God intended for Sharia. These underlying purposes include providing for the well-being of humans, diminishing hatred and disputes, and setting limits to human freedom, which generally ends where the freedoms of others start.<sup>12</sup> The purposes of Sharia also include eliminating hardship and protecting the Earth's population. Last, but most important, is the purpose of promoting justice. Justice is the main pillar of Islamic law. The Quran repeatedly emphasizes that there is no justification for Muslims ever to turn away from justice.<sup>13</sup> One of the main Muslim convictions is that the pursuit of justice is the only way to eternal peace.<sup>14</sup>

*"O believers! Be steadfast for the sake of Allah and bear true witness and let not the enmity of a people incite you to do injustice; do justice; that is nearer to piety. Fear Allah, surely Allah is fully aware of all your actions."* Quran [5:8]

*"God commands you [people] to return things entrusted to you to their rightful owners, and, if you judge between people, to do so with justice."* Quran [4:58]<sup>15</sup>

CSR and Sharia agree that while a corporation has the freedom to pursue profits, such freedom ends at the point where the freedom of others and the well-being of the environment conflict with this pursuit. Therefore, if CSR promotes the welfare of humankind and the reduction of hardship by a wider circulation of the wealth of nations to include all levels of society, it is consistent with Sharia. If CSR promotes good morals in commercial dealings as part of its promotion of justice between all members of society, then it is, without any doubt, consistent with Sharia and, in fact, central to it.

11. Asyraf Wajdi Dusuki & Nurdianawati Irwani Abdullah, *Maqasid al-Shari'ah, Maslahah, and Corporate Social Responsibility*, 24:1 AM. J. ISLAMIC SOC. SCI. 25, 31 (2007).

12. Jawed Akhtar Mohammed, *Corporate Social Responsibility in Islam 60* (2007) (unpublished Ph.D. dissertation, Auckland University of Technology) (on file with the Auckland University Library).

13. Id.

14. See Gurpreet Singh & Shiv Sharma: *Philosophy of Islam* 48–50 (2002).

15. Additional verses from the Quran discussing justice are found at: 4:135, 57:25, 4:112, and 5:42.

*C. Al Masaleh al Mursala (Considerations of Public Interest)*

Another tool Muslim scholars use to answer new questions is the notion of “Al Masaleh al Mursala.” Literally, Masaleh means “interests” or “benefits,” and Mursala means “free of restrictions.” Al Imam Al Ghazali, a very well respected Islamic scholar, established the doctrine of Masaleh Mursala in his quest for solutions to new economic, social, and political questions that arose with the development of Islamic society. Masaleh Mursala refers to all new ideas that have neither been permitted nor prohibited by one or more of the agreed-upon sources of Islamic law. In judging whether an idea or solution is approved according to Masaleh Mursala, scholars look to whether it promotes social welfare. If a certain idea brings benefits to society, it is permitted. If it does more harm than good, it is prohibited.<sup>16</sup> Of course, benefit, social welfare, and public interest are all soft terms. In many ways, they are relative, not absolute. So what constitutes the public interest?

To overcome this problem, Imam Ghazaly<sup>17</sup> established what are today known as The Five Essentials (*Al Daruriat Al Khams*). These became the objective criteria for scholars to determine whether an idea or solution promotes the public interest. According to Imam Ghazaly, Masaleh (benefits) are only those that aim to protect one or more of the following five essentials: 1) Protecting Lives, 2) Protecting Lineage, 3) Protecting Religion, 4) Protecting Intellect, and 5) Protecting Property.<sup>18</sup>

Masaleh is one of the most essential vehicles for the development of Islamic law. It helps greatly with the resolution of new questions if a certain question arises and is not directly answered in the Quran or Sunnah or by Ijma. If there is a conflict between benefits to some and harm to others, the rule deduced through Masaleh Mursala should achieve a significant public interest or benefit to the majority of the people. Further, the rule must be logical and must not contradict the principles of the Quran, Sunnah, and the overall spirit of Sharia.

Muslim responses to concepts such as foreign investment, communism, and political or economic boycotts have all been developed according to the notion of Masaleh Mursala. Because it aims at accommodating changing times and societies, rules deduced through Masaleh Mursala can change when social needs and interests change. Since

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16. S. M. Ghazanfar & A. Azim Islahi, *Economic Thought of an Arab Scholastic: Abu Hamid al-Ghazali (AH450–505/1058–1111AD)*, in *MEDIEVAL ISLAMIC ECONOMIC THOUGHT: FILLING THE “GREAT GAP” IN EUROPEAN ECONOMICS* 23–44 (S. M. Ghazanfar ed., 2003).

17. See generally JAMES NAIFY, *Al-Ghazali*, in *THE PIMLICO HISTORY OF WESTERN PHILOSOPHY* 163 (Richard H. Popkin ed., 1999) (providing background information on this important Muslim scholar). See also W. MONTGOMERY WATT, *THE FAITH AND PRACTICE OF AL-GHAZALI* (1951).

18. See M. H. KAMALI, *PRINCIPLES OF ISLAMIC JURISPRUDENCE* 238 (3d ed. 2003).

the concept of CSR aims at developing the environment where corporations conduct their business, it follows that it “brings benefits and eliminates harm.” It is one of these Masaleh Mursla issues not mentioned in the Quran or Sunnah but consistent with Sharia because it achieves a certain benefit for society.

The conclusion to be drawn is that the concept of CSR is consistent with Sharia. Having established this, the next section demonstrates that CSR does not contradict but is central to Sharia. Although not mentioned in the Quran or Sunnah, the substance of CSR is really the essence of the Islamic faith and law. In fact, many, if not all, concepts and ideas represented by CSR lie at the heart of Sharia. CSR requires corporations to be good citizens, which is the essence of Sharia.

#### *D. Al Zakah*

The word Zakah literally means purification.<sup>19</sup> In practice, Zakah is an amount of money paid by Muslims at the end of the year as an obligatory donation to the needy, in particular orphans, widows, and the elderly, who can no longer work and provide for themselves.<sup>20</sup> Wealth is believed to be purified from the hatred and jealousy of the less fortunate on the one hand and the selfishness and arrogance of the wealthy on the other hand, after a percentage of it has been spent on good causes.<sup>21</sup> Zakah is one of the five fundamental pillars of Islam,<sup>22</sup> and its observance distinguishes true believers from mere nominal Muslims.

*“You shall observe the Contact Prayers (Salat) and give the obligatory charity (Zakat), and bow down with those who bow down.” Quran [2:43]*

*“You cannot attain righteousness until you give to charity from the possessions you love. Whatever you give to charity, GOD is fully aware of.” Quran, [3:92].*

Muslim society is divided into halves: one half is obligated to give Zakah and the other entitled to take it. What determines whether a Muslim belongs to the half that gives or the half that takes is whether he or she possesses the Nisab.<sup>23</sup> When a Muslim has enough to cover the essential

19. EGBERT HARMSSEN, *ISLAM, CIVIL SOCIETY AND SOCIAL WORK: MUSLIM VOLUNTARY WELFARE ASSOCIATIONS IN JORDAN BETWEEN PATRONAGE AND EMPOWERMENT* 174 (2008).

20. Among the common English translations of the word Zakah are alms, mandatory charity, and obligatory donation.

21. *Quran* 9:103 (“Take from their money a charity to purify them and sanctify them. And encourage them, for your encouragement reassures them. GOD is Hearer, Omniscient.”).

22. HARMSSEN, *supra* note 19.

23. VIRGINIA B. MORRIS & BRIAN D. INGRAM, *GUIDE TO UNDERSTANDING ISLAMIC INVESTING IN ACCORDANCE WITH ISLAMIC SHARIAH* 12 (2001).

needs for himself and his family over a year, he is in possession of the Nisab. If he has more, he is obliged to give Zakah on the excess. The requirement of the Nisab<sup>24</sup> was designed to prevent needy Muslims, who are not wealthy enough to provide for their families from burdening themselves with extra expenses to please God. Zakah is only paid from the extra wealth that has not been used or needed for a whole year.<sup>25</sup> Zakah is one of the clearest manifestations of CSR in Islam. The importance that God has placed on Zakah in the Quran demonstrates how strongly Islam is associated with CSR. Namely, there shall be no profit without paying back to society. Where there is excessive wealth, beyond the essential needs of an owner, there is an obligation to give and to share.

The Quranic verses also specify to whom Zakah shall be paid:

*“They ask you about giving: say, ‘The charity you give shall go to the parents, the relatives, the orphans, the poor, and the traveling alien.’ Any good you do, God is fully aware of.” Quran [2:215]*

It is important to point out that payment of Zakah is not restricted to individuals. Corporations are also expected to pay Zakah, and they must do so even if one or more of the partners in the corporation does not possess the Nisab. In the latter case, they are still required to pay Zakah if the assets of their jointly owned corporation exceed the Nisab. In this case, the partner not possessing the Nisab must pay Zakah in proportion with his share in the capital of the corporation.<sup>26</sup> In effect, Zakah not only takes care of the neediest members of society, it also circulates the wealth in the society and makes sure that the gap between the different classes is not as large as it otherwise would be.

This does not mean, however, that Muslims are not allowed to become wealthy and must give everything they do not use for their essential needs as constant payment of Zakah. Muslims believe that Zakah attracts God’s special blessing and their wealth will be multiplied after they have paid Zakah. That is why most Muslims are generally enthusiastic about giving.

*“Any charity you give will be repaid to you, without the least injustice.” Quran [2:272]*

At the same time, a Muslim who possesses the Nisab but is barely able to pay his or her own bills, calculates the amount for Zakah only after having fulfilled all of his or her own financial obligations.<sup>27</sup>

*“They ask you about intoxicants and gambling: say, ‘In them there is a gross sin, and some benefits for the people. But their sinfulness far*

24. See *id.* (explaining that if a Muslim’s wealth exceeds the Nisab, s/he becomes eligible to be a Zakah payer under Islamic Law).

25. *Id.* (noting that Zakah is given as a percentage of total wealth, usually 2.5% of the annual surplus income plus the total surplus assets).

26. MUHAMMAD TAQI USMANI, AN INTRODUCTION TO ISLAMIC FINANCE 106 (2002).

27. ANGELA WOOD, RELIGION FOR TODAY: ISLAM FOR TODAY 24 (1998).

*outweighs their benefit.' They also ask you what to give to charity: say, 'The excess.' GOD thus clarifies the revelations for you, that you may reflect." Quran [2:219]*

Zakah does not necessarily have to be paid in money. Zakah can be paid in the form of agricultural products, specifically in the form of food for the hungry.

*"O you who believe, you shall give to charity from the good things you earn, and from what we have produced for you from the earth. Do not pick out the bad therein to give away, when you yourselves do not accept it unless your eyes are closed. You should know that Allah is Rich, Praiseworthy." Quran [2:267]*

### *E. Sadaqah*<sup>28</sup>

Sadaqah can be defined as small daily acts of charity. This can be in the form of small amounts of money given to the poor but also practical acts, such as helping a foreigner find his way or carrying a load for an elderly person. Strictly speaking, there is no obligation to give Sadaqah. However, throughout the Quran, God encourages Muslims to give Sadaqah to the needy whenever they can, by stressing the generous multiplication of rewards for those who freely give of their assets and time.

*"The example of those who spend their monies in the cause of GOD is that of a grain that produces seven spikes, with a hundred grains in each spike. GOD multiplies this manifold for whomever He wills. GOD is Bounteous, Knower." Quran [2:261]*<sup>29</sup>

In contrast to Zakah, there is no specific time or amount required by the Quran for giving Sadaqah.<sup>30</sup> Although Sadaqah is only a modest gift for someone in need,<sup>31</sup> the prophetic Sunnah of Muhammed is filled with stories about rewards in the Hereafter for those who give Sadaqah. However, not every gift given to a needy person is a Sadaqah. There are requirements for Sadaqah to lead to a reward in the Hereafter. The one and only purpose of Sadaqah should be the desire to please God by helping someone in need. Therefore, giving Sadaqah in order to draw attention to one's wealth does not attract a reward. In fact, under Islam, simple kind words and just treatment of people is better than giving Sadaqah followed

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28. Sadaqah also appears as Sadaka and Sadakah (plural: Sadaquat or Sadakat). Sadaqah is derived from the Arabic root (S-d-q). Derivations of the root include Sadiq (honest), Siddiq (virtuous), and Sidk (honesty and sincerity). The hallmark of a sincere Muslim is sharing one's wealth with the needy.

29. Rashad Khalifa, *The Authorized English Translation of the Quran*, SUBMISSION.ORG, <http://www.submission.org/suras/sura2.htm> (last visited Mar. 24, 2011).

30. HARMSSEN, *supra* note 19.

31. There is no obligation to restrict Sadaqah to Muslims; it can be given to Jews or Christians as well.

by humiliation or insult to its recipient.<sup>32</sup>

Embarrassing the recipient of a Sadaqah by reminding him of the Sadaqah that he has been given, or by somehow implying that he now owes something in return, immediately cancels any chance of reward.

*“Oh you who believe, do not nullify your charities by inflicting reproach and insult (on the receivers of your charity), like him who spends his wealth to be seen by others, and he believes not in God and the Last Day.” Quran [2:264]*

*“They, who spend their wealth for the cause of God, then do not follow up what they have spent with taunt or injury, for them is their reward with their Lord, and they shall have no fear, nor shall they grieve.” Quran [2:262]*

For this reason, the Quran encourages Muslims to give their Sadaqah anonymously to ensure that the Sadaqah was made with the pure intention of helping the needy and pleasing God rather than to seize the attention of others.

*“If you announce your charities, they are still good. But if you conceal them, and give them to those who really need them, it is better for you and God remits more of your sins. GOD is fully aware of everything you do.” Quran [2:271]*

Similarly, the Prophet Muhammad (P) said: “Seven people Allah will shade in His shade on the day when there is no shade except His.” Among the seven he mentioned was “a man who gave something in charity secretly such that his left hand did not know what his right hand had given” (Bukhari).

A Sadaqah does not have to be a financial gift.<sup>33</sup> The Prophet Muhammad (P) said, “To smile in the company of your brother is a Sadaqua” (Bukhari). If a Muslim does not have enough money to give a financial Sadaqah, he or she can give a Sadaqah by helping others or simply by refraining from evil doing.<sup>34</sup> Thus, visiting orphanages and retirement homes merely to share the joy and misery of the less fortunate is also a Sadaqah that guarantees a reward in the Hereafter.

Some opponents of early Islam, in an attempt to justify their miserliness, argued that usury increases one’s wealth while Sadaqah only

32. *Quran 2:263* (“A kind word with forgiveness is better than almsgiving followed by an insult.”).

33. TALLAL ALIE TURFE, *UNITY IN ISLAM: REFLECTIONS AND INSIGHTS* 132 (2004).

34. *Sahih Al-Bukhari, Volume 2, Hadith 524* (Abu Musa narrated that the Prophet said, “Every Muslim has to give in Sadaqah.” The people asked, “But what if someone has nothing to give?” He said, “He should work with his hands and benefit himself and also give Sadaqah (from what he earns).” The people further asked, “If he cannot do even that?” He replied, “Then he should help the needy who appeal for help.” Then the people asked, “If he cannot do that?” He replied, “Then he should perform all that is good and keep away from all that is evil and these will be regarded as charitable deeds.”).

diminishes it. But the Quran emphasizes that although usury increases one's wealth in life, it does not bring any benefit in the Hereafter, and what increases one's credit in the Hereafter is paying charities or Sadaqah.<sup>35</sup>

### 1. *Caring for Orphans and for the Needy*

Although adoption is prohibited in Islam, taking care of orphans and children who have been abandoned by their parents is highly encouraged. "Taking care" of orphans does not only refer to financial care; it also refers to emotional care and support. Many prophetic Hadiths encourage taking care of orphans and promise Muslims huge rewards from God in return. One example is the Hadith transmitted by Sahl ibn Sa'd (may Allah be pleased with him) that the Prophet Muhammad (P) said, "Myself and the one who takes care of an orphan, will be together in Paradise like this," and he raised his forefinger and middle finger together, leaving little space between them (to show how close they will be in Paradise) (Bukhari).

Not just orphans, but anyone who is needy, regardless of race, religion or gender, should be taken care of. There is an obligation on every Muslim to look after any member of the society who is less fortunate. The Prophet Muhammad (P) said, "[A] person is not a true Muslim if he or she eats to his or her fill while knowing that the neighbor is hungry" (Bayhaqi).

### 2. *Fair Trade, Fulfilling Covenants, and Free Competition*

'Abdullah bin 'Umar (may Allah be pleased with him) narrated that the Prophet Muhammad (P) said, "Do not urge someone to return what he has already bought from another seller in order to sell him your own goods instead" (Bukhari). These are the ethics of doing business in Islam. Muslims are not allowed to snare customers away from their competitors after the completion of a deal. It is different if there is free competition and one business is making better offers than another. The customers are freely choosing to do business with the one who makes the best offers. But, once a deal has been made, Islam prohibits Muslim traders from overturning the deals concluded by their competitors in order to claim the business and the profits for themselves.

*"O, you who believe, do not eat up each others' properties in vanities, but let there be amongst you traffic and trade by mutual consent, nor kill or destroy yourselves, verily God has been most merciful to you."*  
*Quran [4:29]*

*"... Observe fully the measure and the balance, and do not cheat the people of their goods, and do not cause corruption on the earth after its*

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35. *Quran* 30:39 ("The usury that is practiced to increase some people's wealth, does not gain anything at GOD. But if you give to charity, seeking God's pleasure, these are the ones who receive their reward manifold.").

*restoration. That is better for you, if you are faithful.” Quran [7:85]*

The Prophet Muhammad (P) further emphasized the previous Quranic verse in the following words: “[A] sale is a sale only if made through mutual consent” (Ibn Majah). Truthfulness in business dealings is central to doing business under Islamic Law. The Prophet Muhammad (P) said, “Truthfulness leads to righteousness and righteousness leads to Paradise . . . . Falsehood leads to wickedness and wickedness leads to the hell fires” (Bukhari). Hence, the fulfillment of one’s obligations and promises is one of the fundamental rules laid down by the Quran.

*“O you who believe, you shall fulfill your covenants . . . .” Quran [5:1]*

### 3. Fair Treatment of Workers

Abdallah bin ‘Umar (may Allah be pleased with him) narrated that the Prophet Muhammad (P) said, “Give the worker his wages before his sweat dries up” (Ibn Majah). Other Prophetic Hadiths in this context include: “I will foe to three persons on the day of judgment, one of them being the one who does not give him his due when he employs a person who has accomplished his duty,” and “Your workers/servants are your brothers. They should eat from what you eat and dress like you dress and let them not bear a burden that they cannot bear, then lend your help to them.” Generally, the concept of brotherhood is emphasized in the Quran as an indispensable principle in Islam.

*“The believers are but brothers, so make settlement between your brothers. And fear Allah that you may receive mercy.” Quran [49:10]*

### F. Baitul Mal<sup>36</sup>

One of the most interesting ideas in this regard is the idea of “Baitul Mal.” Literally, it means “the house of wealth.” Technically, Baitul Mal is the public treasury or “the Exchequer of an Islamic State.”<sup>37</sup> It was first established by the Prophet Muhammad (P) and was then further developed at the time of Caliph Omar Ibn el Kattab (May God be pleased with him). The idea of Baitul Mal is similar to that of an insurance company.<sup>38</sup> It was where the revenues of the state were collected and where any citizen facing a financial crisis found sanctuary. Baitul Mal constituted a pool where all taxes were collected and spent whenever a citizen needed financial help.

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36. See generally Holger Weiss, *Zakat and the Question of Social Welfare: An Introductory Essay on Islamic Economics and Its Implications for Social Welfare*, in *SOCIAL WELFARE IN MUSLIM SOCIETIES IN AFRICA* 7, 17–18 (Holger Weiss ed., 2002).

37. EDWIN E. HITTI, *BASIC MECHANICS OF ISLAMIC CAPITALISM IV* (2007).

38. MUHAMMAD AKRAM KHAN, *ISLAMIC ECONOMICS AND FINANCE: A GLOSSARY* 32 (2d ed. 2003).

The revenues of Baitul Mal included that from Al Zakah (mandatory charity), Al Sadaquat (voluntary charities), Al Ushr (the tithe or import tax), Al Khums (the fifth),<sup>39</sup> Al Jizyah (a poll tax),<sup>40</sup> Al Kharaj (a tax on land and agricultural products), Al Fay (spoils accruing to Muslim armies without a war),<sup>41</sup> and the wealth of those who have no heirs.

As for those who were entitled to receive money from the Baitul Mal, the Holy Quran defines them in the following verse:

*"[T]o the poor, the needy, the workers who collect (the charities), the new converts, to free the slaves, to those burdened by sudden expenses, in the cause of GOD, and to the traveling alien. Such is GOD's commandment. GOD is Omniscient, Most Wise." Quran [9:60]*

Accordingly, Baitul Mal also served for the redistribution of wealth to achieve a balance between the rich and the poor and to diminish the gaps between the classes of society. Most Muslims believed that money in Baitul Mal was God's property and the ruler was no more than its manager and protector.<sup>42</sup> To make sure that the property of God inside Baitul Mal was safe, Baitul Mal was subject to the supervision and control of *Diwan al Zimam*.<sup>43</sup> Thus, Baitul Mal was one of the first social solidarity institutions in the world. Unfortunately, the idea of Baitul Mal has vanished from most Islamic countries.

39. *Quran* 8:41 (These are the spoils of war that the Muslims won after actual fighting with an enemy. Four-fifths of the spoils go to the winning army and one-fifth goes to Baitul Mal as property of God and his Apostle. "And know that out of all the booty that ye may acquire (in war), one-fifth shall go to GOD and the messenger, and to his near relatives, the orphans, the needy, and the wayfarer, if ye do believe in God and in the revelation We sent down to our servant on the day of the decision, the day the two armies clash. For God hath power over all things.").

40. HISTORY OF HUMANITY: VOLUME IV: FROM THE SEVENTH TO THE SIXTEENTH CENTURY 321 (M.A. Al-Bakhit et al. eds., 2000). This is also known as the "protected people's tax." This tax was paid by the Christians and Jews and all other non-Muslims living in the Islamic State. While Muslims paid their taxes in the form of Zakah, the non-Muslims paid their taxes in the form of Jizyah. Not all non-Muslims were obliged to pay the Jizyah. Women, children, priests, elderly, slaves, the mentally ill, and all those who could not afford it were exempt from paying Jizyah.

41. *Quran* 59:7 (explaining that Al Fay is what the opponent left behind voluntarily, either in fear of being attacked or just for the impossibility of taking it along) (The revenues accruing from Fay were to be distributed according to the verses of the holy Quran as follows: "Whatever Allah has given to His Messenger as spoils from the people of the towns is for Allah and for the Messenger and for the near of kin and the orphans and the needy and the wayfarer, so that it may not circulate only among those of you who are rich.").

42. Weiss, *supra* note 36, at 17.

43. *Diwan Al Zimam* was the bureau responsible for the auditing and supervision of the different state departments and officials. It is also known as *Diwan Al Azimma*.

## IV. ISLAM AND THE ENVIRONMENT

The Prophet Muhammad (P) instructed Muslims to plant trees and regarded this act as a Sadaqah. Muslims were also instructed never to uproot the trees of the enemy during war.<sup>44</sup> The rules of war in Islam include many restrictions on Muslim armies. It is fascinating that among these prohibitions is the uprooting of trees and the burning of books. These rules were regarded as of equal importance to the rules prohibiting the killing of women, children, the elderly, and unarmed men or “non-combatants.” The fact that Muslims cannot uproot the enemy’s trees even in war emphasizes the sacredness and importance that Islam accords to plant life and the environment.

Islamic law also includes rules regarding animals. The Sunnah is rich with Hadiths encouraging gentleness with animals.<sup>45</sup> One of the Hadiths tells a story about a woman who was sent to the hell fires because of her cruelty to a cat, which she had locked up with no food or water until it died. Many Hadiths promise rewards to those who are gentle and compassionate to all of God’s creatures on one hand and warn against cruelty and violence towards animals on the other.<sup>46</sup> A verse in the Quran states that all the creatures that God has created are “nations” like humans, which means that their lives should be respected exactly as is human life.<sup>47</sup> Even if humans have to kill animals to eat or to defend themselves, Muslims are required to kill the animal without unnecessary cruelty or torture. The Prophet Muhammad (P) said, “[I]f you must *kill*, *kill* without *torture*” (Bukhari). This Hadith came with no exception for venomous or hostile animals.<sup>48</sup>

In the Quran, God emphasizes the beauty of the earth as one of his most fascinating creations. He speaks about its many wonders and how the same soil that is watered by the same water brings up different crops side by side. As one of His great creations, God expects humans to appreciate

44. See ISLAMIC ETHICS OF LIFE: ABORTION, WAR, AND EUTHANASIA 97–172 (Jonathan E. Brockopp ed., 2003) (detailing the ethics of war in Islam).

45. *Quran* 6:38 (“Prophet Muhammad (P) was asked by his companions whether kindness to animals was rewarded in the hereafter. He replied: ‘Yes, there is a meritorious reward for kindness to every living creature.’”).

46. Caging animals in inadequate environments, mutilating body parts of animals, and branding are all acts that are prohibited by Islamic Law. For example, this obviously prohibits poultry farming utilizing the notorious battery cages, as is widely practiced in many countries.

47. *Quran* 6:38 (“And there is not a creature on Earth, or a bird that flies with its wings, but are nations like you. We did not leave anything out of the record; then to their Lord they will be gathered.”).

48. See BESHHEER AHMED MASRI, *ANIMALS IN ISLAM* 20 & 29 (1989) (explaining that Islamic Law provides details about the tools that should be used to slaughter animals) (For example, Muslims are required to use sharp knives to make the death of the animals less painful.).

and look after it so that it would always be a reminder of his power and wondrous creations.

*"There are, in the land, neighboring plots, gardens of vineyards, cornfields, palm trees in clusters or otherwise, all watered with the same water, yet We make some of them taste better than others, there are Signs in that for people who use their intellect."* *Quran* [13:4]

God takes pride in His creation of the environment, not only the earth but also the sky, the water,<sup>49</sup> the wetlands, the mountains, and all his creatures. He uses these creations throughout the Quran to challenge human power and show human weakness in comparison to His power. God instructs humans to look after His creation as his vicegerents or deputies.<sup>50</sup> Therefore, any acts that destroy, directly or indirectly, the creations of God—such as dumping toxic wastes into rivers and oceans, manufacturing products that destroy the ozone layer, careless oil spills, hunting endangered species for pleasure, interfering in unnecessary or irresponsible ways with the ecosystem, and similar actions—are all considered illegal under Islamic law.

## V. COMMERCIALY PROHIBITED ACTIVITIES UNDER ISLAMIC LAW

### A. *Al Riba* (Usury)

Riba literally means "interest,"<sup>51</sup> and its prohibition is often misunderstood as preventing any charges above the principal of a loan. However, it is important to understand that Riba is only the *exorbitant* increase of the principal for no reason other than the passing of time. In pre-Islamic times, money lenders used to exploit the neediness of borrowers. The customer was obligated to pay interest in return for borrowing a sum of money. The interest accumulated over time and, if by the end of the term of the loan the borrower was not able to pay back the loan with the interest, in return for extending the term of the loan the accumulated interest became part of the principal and interest would now be charged on the higher sum. If the interest rate was exorbitant, this easily became a vicious circle, a black hole from which the borrower was never able to escape. And, since it was considered a crime, punishable by

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49. Water in Islam is regarded as the "secret of life," and it is essential for washing off physical and spiritual impurities. Therefore, it is a sin to waste or pollute it because of its importance to the maintenance of the lives of all of God's creatures. See MAWIL IZZI DIEN, *THE ENVIRONMENTAL DIMENSIONS OF ISLAM* (2000) (detailing the treatment of the environment in Islam).

50. *Quran* 2:31("And when thy Lord said to the angels: 'I am about to place a vicegerent in the earth,' they said: 'Wilt Thou place therein such as will cause disorder in it, and shed blood?—and we glorify Thee with Thy praise and extol Thy holiness.' He answered: 'I know what you know not.'").

51. JAQUIR IQBAL, *ISLAMIC FINANCE MANAGEMENT* 100 (2009).

imprisonment, if someone did not pay his or her debts, it often led not only to the financial ruin but also to the personal ruin of the customer. This is where the Quran introduced a clear prohibition.<sup>52</sup> Riba must not give the lenders the power to exploit borrowers with no end.

*“O you who believe, you shall observe GOD and refrain from all kinds of usury, if you are believers.” Quran [2:278]*

*“If you do not, then expect a war from GOD and His messenger. But if you repent, you may keep your capitals, without inflicting injustice, or incurring injustice.” Quran [2:279]*

*“O you who believe, Devour not usury, doubling and quadrupling (the sum lent). Observe your duty to Allah, that you may be successful.” Quran [3:130]*

Islamic jurists generally agree that borrowers and lenders should share the profits and losses that result from investing the loans. They argue that fixed interest obligations assumed by the borrower regardless of whether the result of the investment is a profit or a loss is what makes Riba a manifestation of evil. The problem is that most Muslim jurists talk about profit and loss sharing even though loans are needed for purposes other than business investments. Most people need loans to buy houses or to obtain medical treatment for costly illnesses. In such cases, there is no profit to be expected that could be shared between the borrower and the lender. At the same time, it is not possible and was not intended by Islam that people should depend on the philanthropy or goodwill of others to buy their houses or obtain medical treatment. They need a solution that is both practical and in line with Islamic law.

Muslim jurists also generally agree that it is acceptable for there to be a price for the deferment of the payment of debt. One of these jurists is the very well-known and respected Ibn Rushd.<sup>53</sup> The justification for the distinction between price increases caused by deferment and Riba is that in Riba the principal grows with no end, while increasing the price in return for deferment does not affect the principal. The price of the loan increases only until the borrower starts paying back the loan. As soon as payments are made, it starts shrinking immediately. In other words, Riba is an exorbitant interest rate payable at the end of the loan term. If it cannot be paid, the rate is added to the principle and the vicious circle continues.

By contrast, a more modest payment obligation toward principal and interest that is payable regularly during the loan period and reduces the amount payable at the end of the loan period is acceptable. This is a good way of finding financial help in times of need. There is no problem if the lender charges a fee for providing the service and covering his expenses.

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52. ALY KHORSHID, *ISLAMIC INSURANCE: A MODERN APPROACH TO ISLAMIC BANKING* 31 (2004).

53. IQBAL, *supra* note 51, at 29.

The problem lies in the exploitation of weaker parties by exorbitantly high interest that puts the borrower in a worse situation after having gotten the loan.

*"The usury that is practiced to increase some people's wealth, does not gain anything at GOD. But if you give to charity, seeking GOD's pleasure, these are the ones who receive their reward manifold." Quran [30:39]*

It would be beyond the scope of this Article to apply these principles to the financial meltdown in the aftermath of the collapse of the American mortgage market. Suffice it to say that Islamic law does not oppose fair lending toward the purchase of a home as long as the borrower has to and is able to make regular payments that cover the cost of the loan (interest) and reduce the principal. However, Islamic law certainly stands in the way of predatory lenders that know full well that their clients will not be able to make their house payments once their adjustable rate mortgages (ARMs) move out of the initial phase during which an attractive—and often below market—rate was offered to attract the borrowers. Similarly, Islamic law does not allow interest-only mortgages. This author believes, arguably, society would not be experiencing the worst recession since World War II if Western capital markets had followed at least these basic principles of Islamic law.

#### *B. Al Gharar (Speculative Activities)*

Professor Mustafa Al Zarqa's definition of Gharar is "the sale of probable items whose existence or characteristics are not certain, due to the risky nature which makes the trade similar to gambling."<sup>54</sup> Most sales of futures options, forwards, and derivatives, as well as hedging operations, would fall under this definition. Gharar is not clearly prohibited in the Quran,<sup>55</sup> but it is widely held that Gharar is prohibited by the Sunnah. The Prophet Muhammad (P) warned against ambiguous sales. The essence of the prohibition is the prevention of unfair surprises, that is, unexpected rights and obligations that distort the balance of a business agreement and result in hatred and disputes between the parties to such agreements. Therefore, the main aspects of all contracts must be clear and precise in order for the contract to be valid. Thus, the sale of fish yet to be caught or the sale of unborn animals is rendered invalid in Islamic law.<sup>56</sup> The reason is, obviously, that the fish may never be obtained or the animal may never be born or may be born with defects.

The Prophet Muhammad (P) prohibited Gharar in order to prevent

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54. *Id.* at 104.

55. KHORSHID, *supra* note 52, at 39.

56. IQBAL, *supra* note 51, at 104.

disputes and to protect the weaker parties to an agreement. The Western concept of *clausula rebus sic stantibus* is a related idea. Because of the very wide interpretation many Islamic scholars give to Gharar, namely that it prohibits any contracts about future uncertain events, even everyday insurance contracts, not just financial derivatives, are problematic in Islamic law. However, this is not entirely logical. It cannot be the intention of the prohibition of speculative contracts to prevent such useful instruments as automobile or health insurance. This point will be discussed more fully below.

### C. *Al Maisir (Gambling)*

The word Maisir is derived from the Arabic root [yusr],<sup>57</sup> which means “ease” or “convenience.” Islam rejects any profits that are mainly the outcome of games of chance or luck.<sup>58</sup> Thus, casinos, gambling, and lotteries are prohibited under Islamic Law.<sup>59</sup>

*“They ask you about intoxicants and gambling: say, ‘In them there is a gross sin, and some benefits for the people. But their sinfulness far outweighs their benefit.’ They also ask you what to give to charity: say, ‘The excess.’ GOD thus clarifies the revelations for you, that you may reflect.” Quran [2:219]*

Maisir has only gradually come to be prohibited by Islam since it was an activity that was very strongly incorporated in the lives of many Arabs in pre-Islamic times.<sup>60</sup> Thus, the above verse was sent down to the people as a first step in the prohibition process. The next verses are stricter and clearer about the prohibition of Maisir. It says that Maisir is an act of Satan that no Muslim should be involved in.

*“O you who believe, intoxicants, and gambling, and the altars of idols, and the games of chance are abominations of the devil; you shall avoid them, that you may succeed.” Quran [5:90]*

*“The devil wants to provoke animosity and hatred among you through intoxicants and gambling, and to distract you from remembering GOD, and from observing the Contact Prayers (Salat). Will you then refrain?” Quran [5:91]*

Maisir is known to distract humans from remembering God is in times of financial need. Instead of working hard and having faith in God to help them through the crisis, humans tend to spend the little money they have on gambling, trusting in the games of chance rather than in God’s power.

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57. BRIAN KETTELL, FREQUENTLY ASKED QUESTIONS IN ISLAMIC FINANCE 114 (2010).

58. MUHAMMAD AYUB, UNDERSTANDING ISLAMIC FINANCE 112 (2007).

59. *Id.*

60. KETTELL, *supra* note 57.

*D. Other Activities*

There are other activities that are discouraged under Islamic law. Monopolizing food in order to raise prices and maximize profits, while limiting the access of the poor to the food, is one of the most harshly punished activities under Islamic law. 'Umar Ibn Al Khattab (may Allah be pleased with him) reported that the Prophet Muhammad (P) said, "He who brings goods for sale is blessed with good fortune, but he who keeps them till the price rises is accursed" (Ibn Majah and Darimi).

Consumption of some products, like alcohol and drugs, is prohibited because they are unhealthy for the human body and mind. It follows that the sale and circulation of such products is also prohibited. Selling products that lead to the deterioration or destruction of the human mind or body is considered a sin. Therefore, all transactions related to these kinds of products are considered invalid. A corporation selling products considered unhealthy by Islam is considered to be spreading illness in society and is required to refrain from this activity. The Quran, in many verses, warns against unjust enrichment resulting from exploitation of the ignorance and inexperience of others.

*"And do not eat up your property among yourselves for vanities, nor use it as bait for the judges, with intent that you may eat up wrongfully and knowingly a little of (other) people's property." Quran [2:188]*

*"O you who believe, do not consume each others' properties illicitly—only mutually acceptable transactions are permitted. You shall not kill yourselves. GOD is Merciful towards you." Quran [4:29]*

The Sunnah is filled with Hadiths and stories about the exploitation of the inexperience or ignorance of others. One of the Hadiths was transmitted by Tawus Ibn 'Abbas (may Allah be pleased with him), who said that the Prophet Muhammad (P) said, "A town dweller should not sell the goods of a desert dweller on behalf of the latter" (Bukhari). This Hadith aims at protecting the inexperienced desert dweller from the manipulation of the town dweller who is more familiar with the market prices and may take advantage of the desert dweller's ignorance and inexperience in the market. Interestingly, a similar prohibition of the exploitation of inexperienced or ignorant parties can be found in several Western legal systems, including §138 (2) of the German Civil Code.<sup>61</sup>

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61. BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Jan. 2, 2002, BUNDESGESETZBLATT [BGBL. I], as amended, §138, ¶ 1-2 (Ger.), available at [http://www.gesetze-im-internet.de/englisch\\_bgb/englisch\\_bgb.html#BGBengl\\_000P138](http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#BGBengl_000P138) (last visited Mar. 25, 2011) (Section 138 provides, "(1) A legal transaction which is contrary to public policy is void. (2) In particular, a legal transaction is void by which a person, by exploiting the predicament, inexperience, lack of sound judgment or considerable weakness of will of another, causes himself or a third party, in exchange for an act of performance, to

## VI. ISLAMIC ALTERNATIVES TO THE PROHIBITED ACTIVITIES AND THE ESTABLISHMENT OF ISLAMIC FINANCIAL INSTITUTIONS

With all the prohibitions against various kinds of commercial dealings, in particular when broadly interpreted, Muslims became victims of the dichotomy between doing business with the West and following the commandments of Islam. This is why Islamic Financial Institutions (IFIs) came into existence. In Islamic countries, IFIs found fertile ground to grow. They offered alternatives to the commercial activities that are prohibited under Islamic law. Below is a brief summary of some of the business services offered by IFIs as alternatives to the previously mentioned prohibited activities.

### *A. Al Murabaha (Cost-Plus Financing)*

Murabaha is an agreement between a bank and a client to purchase a certain product on behalf of the client with the intention to sell it to the latter for the same purchase price but on better terms. For example, if a client wants to buy a car but cannot pay the full purchase price immediately, the bank buys the car and sells it to the client in exchange for monthly or yearly installments or credit. In addition to the price, the client also pays the bank's expenses and an agreed upon profit, either a percentage or a fixed amount.<sup>62</sup>

In a Murabaha agreement, the customer is able to buy a product that he or she needs but cannot afford for a deferred price. Although the deferred price to be paid by the client is higher than the original purchase price, Murabaha is still consistent with Sharia. In a Murabaha agreement, the IFI is entitled to the original purchase price, the costs of the provision of its services, plus a reasonable fixed profit that is agreed upon between the parties. In this agreement, there is no exploitation of the weaker party and no risk of unfair surprise. It is merely a trade untainted by the risk that Riba pushes the borrower into a black hole of exorbitant interest obligations.

### *B. Al Mudaraba (Trust Financing)*

In a Mudaraba contract, one of the parties provides the capital (the investor), and the other provides his or her work, expertise, and skills (Mudarib).<sup>63</sup> The Prophet Muhammad and some of his companions were also Mudaribs. They traded with wealth that belonged to other investors and

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be promised or granted pecuniary advantages which are clearly disproportionate to the performance.”).

62. AHMED AL-SUWAIDI, *FINANCE OF INTERNATIONAL TRADE IN THE GULF* 91 (1994).

63. See *id.* at 73 for more information about Al Mudarba.

shared the profits with them if profits materialized.<sup>64</sup> Mudaraba is a way of doing business that does not excessively burden any of the parties. Profits and losses are shared equally. It is also possible that in a Mudaraba contract only profits are shared and any financial losses are completely borne by the investor.<sup>65</sup> This is still an equitable deal and permitted by Islamic law because the burden sharing remains in effect with one side investing capital and the other investing labor and expertise.

*C. Al Musharaka (Profit Sharing)*

Literally, Musharaka means "to share." In the context of Islamic finance, however, Musharaka is a jointly-owned business, where the lender bears the risk together with the borrower. If the deal proves to be profitable, the lender and the borrower share the profits, but if it turns out to be a disappointment, they also share the loss. Musharaka obviously affords more protection to the borrower than interest-based loans that fix an interest rate regardless of whether the deal proves profitable or not.<sup>66</sup> The risk is divided between the borrower and the lender and so are the loss and the profit.

*D. Al Ijara (Leasing), Al Muqarada (Revenue Bonds), and Baiu Salam (Agricultural Financing)*

Under an Ijara agreement, a bank acquires a commodity that a client needs but cannot afford, with the intention to lease it to the client for use in his or her business at an agreed-upon rate. Usually the objects of such agreements are machines and vehicles.<sup>67</sup> Muqarada bonds are issued by a bank and sold to investors to be invested in a project whose profits and losses are distributed among the shareholders.<sup>68</sup>

Baiu Salam is a contract of sale whereby the buyer pays the price of a certain commodity with specified qualities in advance. This kind of financing is most commonly used in the context of agricultural production. It is important to mention that such a sale comprises Gharar, since the object of the contract does not exist at the time the contract is concluded. The only reason why this contract would not be considered invalid is because there is no other way of financing the desired agricultural

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64. ABDULLA SAEED, *ISLAMIC BANKING AND INTEREST: A STUDY OF THE PROHIBITION OF RIBA AND ITS CONTEMPORARY INTERPRETATION* 51 (1996).

65. *Id.*

66. *Id.* at 61.

67. CHRISTINE ENNEW & NIGEL WAITE, *FINANCIAL SERVICES MARKETING: AN INTERNATIONAL GUIDE TO PRINCIPLES AND PRACTICE* 195 (2007).

68. ANGELO M. VENARDOS, *ISLAMIC BANKING & FINANCE IN SOUTH-EAST ASIA: ITS DEVELOPMENT & FUTURE* 85 (2005).

production. In other words, if the buyer did not provide the price in advance, the products would not come into existence.

*E. Takaful (Islamic Insurance)*

Each human being is subject to potential disasters, like a destructive storm, flood, or earthquake that leaves a person or corporation bankrupt, a sudden death that leaves a family without a provider, or an accident that causes a disability or other loss of income. The only protection against losses resulting from such disasters lies in insurance that mitigates, if not entirely eliminates, the loss and damages endured. But many Shariah scholars believe the way conventional insurance systems operate is inconsistent with Sharia since their business involves Riba, Maisir, and Gharar.<sup>69</sup> Does this mean that Muslims have to bear all the risks and confront these disasters all by themselves in order to comply with the commandments of their religion? Obviously not.

In response, IFIs came up with an alternative to conventional insurance that, in their view, is more consistent with Islamic law. The idea of Takaful originated from what was known at the time of the Prophet Muhammad (P) as the “Aaqilah.” The Aaqilah was a pooled fund to which all the members of a certain tribe made contributions to indemnify any member of their tribe who was struck by one of these disasters.<sup>70</sup>

Today, IFIs provide the same kind of service but call it “Takaful.” Takaful literally means “solidarity.” The way Takaful works is that a group of participants agree to pay monthly premiums in order to be insured in case of any misfortune and to help out their fellow Muslims in case any of them is the misfortunate one.<sup>71</sup> The participants in a Takaful agreement enter the contract as both insured and insurer. Premiums are divided into two parts: one part goes to the indemnification of the participants and the other to be invested in any activity that is consistent with Sharia.<sup>72</sup> The profits or losses resulting from such investment are shared among the Takaful participants and the IFI.<sup>73</sup> The part of the premium that has been dedicated to the indemnification of the participants is also invested. However, these funds are distributed only to participants who have faced a calamity.<sup>74</sup>

The problem that many Muslim scholars have with conventional

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69. MUHAMMAD AYUB, AN INTRODUCTION TO TAKAFUL—AN ALTERNATIVE TO INSURANCE 1, available at <http://www.sbp.org.pk/departments/ibd/Takaful.pdf> (last visited Mar. 24, 2011).

70. *Id.*

71. *Id.*

72. *Id.* at 1–2.

73. *Id.* at 2.

74. See AYUB, *supra* note 58, at 417–32 for more information about Takaful, how it works, and how IFIs benefit from it.

insurance companies seems to be the total shift of the risk to the insurance company. Since the clients are not shareholders or risk bearers of the insurance company, they have certainty over the cost of the transaction, while the insurance company has uncertainty about the claims it will need to satisfy. In other words, the Maisir or gambling part of such transactions is the possibility that an insured party may pay only one or two monthly installments before disaster strikes and then receive the entire value of the insurance policy. Alternatively, another insured party may pay monthly installments all her life, never have an accident, and, therefore, never get back any of the money she has invested.<sup>75</sup>

However, that is the same as what happens in the Aaqila, which has been operational since the time of the Holy Prophet and has never been seriously criticized. A system where all the members of a tribe make contributions but only those who were affected by disaster received payments has all the characteristics of Western insurance companies. Is there not the same amount of Gharar or uncertainty about who will face the disaster and thus need the funds? Is there not Gharar about the amount of funds needed to cover the damage that will occur? Is there not Maisir or gambling in the fact that a member may pay for many years and never get anything in return and another may pay only for a month and be indemnified in full from the money that other Muslims have invested in the Aaqila?

In this author's opinion, and with all due respect to the creators of this system, if what makes conventional insurance incompatible with Sharia is the Maisir and the Gharar, these factors are also present in Takaful and Aaqila. Additionally, since an activity would only be considered allowed under Islamic law if the insured and the insurer share the losses as well as the profits resulting from the investment of the premiums, then Takaful is not insurance. If the insured may lose their funds that they have invested in an IFI, sharing the losses as well as the profits, then how are they insured? Is it consistent with Islamic law that Muslims pay premiums to protect their businesses and families against disasters and the IFI loses its contributions and, hence, its protection in bad business transactions?

Moreover, in a Takaful agreement, there is a "donation clause" to the effect that the accumulated premiums of a participant will be donated to another in case the other is the one who faces the hazard first.<sup>76</sup> But again, this is not insurance if the insured is required to donate his or her investment and may subsequently be confronted with the fact that all previously paid premiums have been expended because he or she was not among the first to face the calamity. And if Takaful "embodies the elements of shared responsibility, common benefit and mutual

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75. IQBAL, *supra* note 51, at 105.

76. AYUB, *supra* note 58, at 421.

solidarity[.]”<sup>77</sup> does conventional Western insurance not offer the same advantages? Unsurprisingly, there was never a consensus of opinions among Muslim scholars that conventional insurance is prohibited under Islamic law. In fact, many Muslim scholars regard conventional insurance as a necessity in today’s business world.<sup>78</sup>

#### *F. Al Quard Al Hassan*

Al Quard Al Hassan is an interest-free loan. The sole obligation of the borrowers of a Quard Hassan is to repay the amount of the loan. Most IFIs limit such interest-free loans to the needy.<sup>79</sup> The capital for such loans usually originates from the Zakah and Sadaqah deposited previously at the IFIs by other wealthy Muslims. The Quran emphasizes the idea of the Quard Hassan several times. It encourages Muslims to give loans with lenient repayment terms and not claim back the money at all if possible.

*“If the debtor is unable to pay, wait for a better time. If you give up the loan as a charity, it would be better for you, if you only knew.” Quran [2:280]*

The Prophet Muhammad (P) in many of his Hadiths also encouraged giving interest-free loans to the needy. The Prophet Muhammad (P) specifically told lenders not to claim their money back if they can afford such generosity and they feel that claiming back the loan would excessively burden the borrower. Jabir bin ‘Abdullah (may Allah be pleased with him) narrated that the Prophet Muhammad (P) said, “May Allah’s mercy be on him who is lenient in his buying, selling and in demanding back his money” (Bukhari).

### VII. IMPLICATIONS FOR DOING BUSINESS IN AND WITH ISLAMIC COUNTRIES

The Islamic values discussed above are translated into prohibited and permitted commercial activities, which implicate the world of business. It must be remembered that Islam to Muslims is not just a faith; it is also the law that governs their lives and the way they choose to live their lives. Therefore, to find a Muslim who will conduct his or her business in a manner that contradicts Islamic law is rare. Important Muslim businessmen and women, small investors, and huge corporations alike are constantly worried that their businesses may comprise Riba or Gharar. Even average individuals, who cannot afford to buy themselves a car or a house and have to borrow the money from a bank, may have sleepless nights over the loan they had to take and the sin of Riba that they were forced to commit. A

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77. *Id.*

78. *Id.* at 430–31.

79. ENNEW & WAITE, *supra* note 67, at 195.

direct response to these prohibitions, as previously mentioned, is the appearance of IFIs, Islamic banks, and Islamic insurance companies.

However, some open-minded Muslim scholars have defended conventional banking and insurance systems, albeit with reservations against the abuse of inexperienced clients and excessive profits, as a necessity for the prosperity of the economies of Islamic countries, under the notion of *Masaleh Mursala*. This means that there has been no consensus opinion among Muslim scholars on the prohibition of conventional banking and insurance systems. Without consensus, however, the prohibition of dealing with Western banks and insurance companies does not become binding upon Muslims. This means that each Muslim can decide for herself whether to engage in these kinds of business practices. Some Muslims will enter into conventional banking and insurance contracts, which explains why Western banks and insurance companies are still operating profitably in most Islamic countries. From a business point of view, for example, Egyptian businessmen have found that rejecting conventional banks and insurance companies will only alienate business partners from non-Islamic countries and will lock them out of international markets. The same is true, of course, for other Islamic countries. Therefore, Western companies and individuals can usually find business partners in Islamic countries who understand that there is no prohibition of conventional banking and insurance, properly understood, in Islamic law.

As for businesses that deal in prohibited products, the matter is stricter. These prohibitions are clearly stated in the Quran and Sunnah, which are the primary and divine sources of Islamic law binding upon all Muslims. Thus, a wine business will not flourish in Islamic countries, nor will a business that sells and markets pork products. All members of Islamic society frown upon the sale of prohibited products. An investor is well advised to become aware of Islamic law on prohibited products before investing in ventures in Islamic countries. As previously stated, prohibited products are limited to pork, wine, and blood. Therefore, it is not difficult for an investor to avoid going wrong after brief research about the Islamic country in which he or she intends to do business.

## VIII. CONCLUSION

The first and most important conclusion is that CSR, and all that it represents, is not only consistent with the Sharia, but actually lies at the very heart of it. Sharia is filled with trade rules that stress the concept of CSR. Because Islam is a faith in addition to a law, Muslims find these concepts stated in the Quran and Sunnah binding and impossible to circumvent once they correctly understand them. Thus, after taking a close look at the primary sources of the law, one finds that commercial ethics are

much more highly regarded in Islamic commerce than in the Western world of business, where making profits is the ultimate goal.<sup>80</sup>

The unsupervised activities of the banks and allowing them to take over the financial markets in ways beyond the regulatory means of the state is the main reason in the current recession why gains were privatized while losses were socialized.<sup>81</sup> One notices that if the commercial rules in Islamic law were more regarded in the West, at least some of the complications of the current financial crisis would not have taken place. However, although there are some prohibited commercial activities in Islamic law, like exploiting weaker parties in a contractual relationship, there are also many other activities that have been incorrectly dragged under the column of “prohibited activities.” Loans, for instance, can be a good way of financing urgent expenses.

Everyone understands that banks have to make profits and cover their expenses and, therefore, cannot offer loans as a benevolent activity. Since Muslim scholars have agreed that the increase of the price is allowed in return for the deferment of payment, this author fails to see why Sharia would prohibit these loans. If they help the borrowers without exacerbating their financial troubles, is this not in the interest of Muslim society? A loan that helps the borrower afford a home (without getting into a vicious circle of interest and debt) is actually encouraged by Islamic law, the main objective of which is the welfare of humans. There is no reason for a socially responsible bank to be frowned upon by Islamic society. This is true as long as the bank gives loans to its clients for a reasonable price for deferring the payment and offers feasible payment terms without fixing an exorbitant interest rate.

Likewise, IFIs may not be Islamic if they do not regard CSR rules and if they only aim to invent business opportunities by calling their businesses “Islamic.” In other words, some IFIs try to circumvent Sharia by giving the prohibited activities different names. There are many Quranic verses and Prophetic Hadiths that encourage Muslims to understand the law correctly without prohibiting what God has made lawful to them.

*“O, you who believe, Do not forbid the good things that God has made lawful for you and do not transgress, For God does not love the transgressors.” Quran [5:87]*

Thus, when learning the Quran and Sunnah, a Muslim should consider the overall spirit of Sharia. This means that the outcome can never be against the public interest of Islamic society in the long term. To make the lives of Muslims easier, God has included in the Quran certain verses

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80. Sallyanne Decker & Christopher Sale, *An Analysis of Corporate Social Responsibility, Trust and Reputation in the Banking Profession*, in PROFESSIONALS' PERSPECTIVES OF CORPORATE SOCIAL RESPONSIBILITY 152 (Samuel O. Idowu & Walter Leal Filho eds., 2009).

81. *See id.*

that give an overview of the spirit of Sharia in order to help the faithful decide about issues that come up after the legislation process is over.

*"Say: The things that my lord has indeed forbidden are the shameful deeds, whether (committed) publicly or in secret; sins and trespasses against truth or reason." Quran [7:33]*

This verse states that any trespasses against truth or reason, like attempts at exploitation or deception and any acts of injustice, are prohibited in Islamic law. Finally, the essence of most of the prohibitions of the Islamic law, which came down to attain the welfare of its followers, is this:

*"We have not sent you (Muhammad), except out of mercy from us towards the whole world." Quran [21:107]*

# CHINESE CORPORATE LAWYERS FACE CHALLENGES IN MAINTAINING CORPORATE SOCIAL RESPONSIBILITY IN THE AGE OF GLOBALIZATION

Ding Xiangshun\*

## A. INTRODUCTION

In China, the term “lawyer” is defined as “a practitioner who has acquired a lawyer’s practice certificate pursuant to law and provides legal services to the public.”<sup>1</sup> Since the reforms to the regulation of lawyers in the early 1980s, the Chinese legal services industry has developed dramatically, and the swift expansion of the legal profession is evident in both quantity and quality.<sup>2</sup> By the end of 2009 there were over 166,000 practicing lawyers, compared with just several hundreds in the early 1980s.<sup>3</sup> Chinese lawyers have become better able to pursue the interests of their clients, and their income from legal practice has increased substantially.<sup>4</sup> The process of professionalization has contributed to a trend towards specialization, and more lawyers have begun to specialize in commercial

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1. Zhonghua Renmin Gongheguo Lüshi Fa (中华人民共和国律师法) [Law of the People’s Republic of China on Lawyers] (promulgated by the Standing Comm. Nat’l People’s Cong., May 15, 1996, effective Jan. 1, 1997, amended June 1, 2008), art. 2 (China) [hereinafter Lawyer’s Law].

2. The “Interim Regulations of the People’s Republic of China on Lawyers” was adopted in 1980 and provided the legal foundation for the rehabilitation of the lawyer system. This state-centered legislation was revised as the “Law of the People’s Republic of China on Lawyers” in 1997. This revision aimed to frame the legal profession in the context of a socialist market economy. The latter version was more profession centered, as it made the profession more independent of the state and granted it a higher degree of autonomy from the Ministry of Justice.

3. See Deng Zhihui (邓志慧), Sifabu Zhongguo Zhiye Lishi Renshui yi Da 16.6 Wan (司法部: 中国执业律师人数已达16.6万) [*Ministry of Justice: Number of Lawyers Working in the Legal Profession Reaches 166,000*], PEOPLE’S DAILY ONLINE (Feb. 16, 2010), <http://politics.people.com.cn/GB/1027/10979482.html>.

4. See *id.* For general information regarding Chinese news, see the official press agency of the government of the People’s Republic of China, Xinhua News Agency. XINHUA NEWS AGENCY, <http://www.xinhuanet.com/english2010/>.

transactions rather than practicing litigation (especially criminal litigation) for non-commercial clients.<sup>5</sup>

Simultaneous with this trend has been increasing demand, in terms of both hiring or recruiting, for specialized lawyers or exclusive legal employees from enterprises because of the development of the rule of law, a mixed market system, and a general opening to the outside world. More and more enterprises now seek advice from legal professionals, and some have even established internal legal affairs departments where legal employees play an important role in corporate governance and conducting domestic and international transactions.<sup>6</sup>

In this Article, the term “corporate lawyer” refers to those legal professionals enrolled either as attorneys-at-law dealing with transactions for corporate clients or internal legal employees with special legal qualifications. The policy of opening to the outside world began in the late 1970s, and globalization has significantly affected the nature and characteristics of Chinese legal professionals, including corporate lawyers. In particular, accession to the WTO in 2001 made China a full member of the world economy. At that time, China also began opening its market to the world more fully. Chinese companies now have more opportunities to enter the world market, which means that Chinese enterprises have to compete with international enterprises in multinational market environments. Throughout this process, Chinese corporate lawyers have faced new challenges emerging from the needs of their clients in a newly globalized China and from society for maintaining social responsibility. The goals of this paper are to explore the challenges that Chinese corporate lawyers face regarding competence and professional ethics and to suggest possible solutions that the Chinese legal community should consider.

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5. The rate of representation of criminal cases is very low. Some professors estimate that the representation rate in criminal cases is lower than twenty percent. See Yufan (羽帆), Quanguo 210 Gexian Meiyou Lüshi Xingshi Anjian Daililü Budao 20% (全国210个县没有律师 刑事案件代理率不到20%) [*Two-Hundred and Ten Counties Are Without Any Lawyers and the Representation Rate in Criminal Cases is Lower than 20% of Agents*], QIANLONG.COM (Aug. 27, 2010), <http://news.qianlong.com/28874/2010/08/27/118@6040734.htm> [hereinafter *Two-Hundred and Ten Counties*].

6. See generally Yin Nianzhang & Wen Yungang (尹年长 & 闻运钢), Qianyi Woguo Qiye Falü Guwen Zhidu Cunzai de Wenti ji qi Wanshan (浅议我国企业法律顾问制度存在的问题及其完善) [*A Brief Discussion on the Problem of the Enterprise Legal Consultant System and Its Improvement in China*], 27 J. GUANGDONG OCEAN UNIV. No. 2 (2007) (China) (discussing the need to develop the role and function of the enterprise legal consultant). For instance, China Orient Asset Management Corporation (COAMC), a wholly state-owned financial enterprise, established its department of legal affairs at its founding. The main job of its legal department is to be in charge of management of the enterprise’s legal affairs. See generally CHINA ORIENT ASSET MANAGEMENT CORPORATION, <http://www.coamc.com.cn/en/> (last visited Apr. 8, 2011).

## B. THE SPLIT BAR QUALIFICATION OF CORPORATE LAWYERS

Generally, corporate lawyers are those legal professionals who work for or represent corporate clients in transactional law. The role of the corporate lawyer is to ensure the legality of commercial transactions and give advice regarding legal rights and duties, including the duties and responsibilities of corporate officers. However, in China, legal professionals who work for corporations include not only practicing lawyers employed in law firms but also in-house legal employees. These legal professionals providing legal advice to corporations are divided into two categories: internal and external.

External legal counselors are those who are authorized by corporate clients to deal with clients' business affairs. Internal legal counselors are those in-house lawyers with legal qualifications that allow them to work for and within corporate entities. After being recruited by an enterprise, those lawyers who have worked at law firms can adjust their statuses from practicing lawyer to internal lawyer. Additionally, internal counsel who have not practiced externally are divided into two categories: enterprise legal advisor (*Qiye Falü Guwen*) and corporate lawyer (*Gongsi Lüshi*).

1. *The Qualification of "Enterprise Legal Advisor"*

The enterprise legal advisor system emerged from the Operational Regulation for the Head of State-Owned Enterprises, issued by the State Council in 1986,<sup>7</sup> which provided that state-owned enterprises could create the position of legal advisor as internal legal employees. However, the qualifications to be an enterprise legal advisor were not fully established until 1997 when the following three important central administrative bodies became involved: the Ministry of Personnel, the Commission of Economy and Trade, and the Ministry of Justice.<sup>8</sup> Unlike other legal professionals, an enterprise legal advisor is regarded as the internal legal employee of the enterprise that employs him or her and is not allowed to practice for general clients. As of 2005 there were over 90,000 legal advisors, more than 30,000 of whom had passed the qualification exam to be a legal advisor.<sup>9</sup>

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7. Quanmin Suoyouzhi Gongyeqiye Changzhang Gongzuo Tiaoli (全民所有制工业企业厂长工作条例) [Operational Regulations for the Head of State-owned Enterprises] (promulgated by the State Econ. & Trade Comm'n., Sept. 15, 1986, effective Oct. 1, 1986) (China).

8. See Qiye Falü Guwen Zhiye Zige Zhidu Zanzing Guiding (企业法律顾问执业资格制度暂行规定) [Provisional Regulations on the Qualification of Enterprise Legal Advisors] (promulgated by the Ministry of Justice, Mar. 12, 1997, effective Aug. 14, 2004) (China) [hereinafter Qualification for Enterprise Legal Advisors].

9. Wu Shaoying (吴少鹰), Qianlun Woguo Qiye Falü Zhiye Zhidu de Wanshan yu Chonggou (浅论我国企业法律职业制度的完善与重构) [Simple Discussion on the Perfection and Restructure of the Legal Profession System in China's Enterprises],

Legal advisors are concentrated in large or medium-sized enterprises, particularly in state-owned enterprises affiliated with the central government. As of 2007, 121 of the 159 central-level state-owned enterprises had independent legal affairs departments.<sup>10</sup>

An enterprise legal advisor's duties include but are not limited to the following: legal consultation for the enterprise's business operations, including internal management and business with third parties; reviewing and verifying the legality of labor contracts, labor management rules, and salary structures; drafting contracts; and reviewing various legal documents.<sup>11</sup> To obtain qualification as an enterprise legal advisor, applicants are required to pass an examination that includes four parts: comprehensive legal knowledge; economy and civil and commercial legal knowledge; knowledge of enterprise management; and knowledge of the practice of enterprise legal advisors.<sup>12</sup>

## 2. *The Qualification of "Corporate Lawyers"*

In 2002, the Ministry of Justice established the qualifications to be a corporate lawyer. To become a corporate lawyer, one must pass the unified bar examination, also established in 2002, or obtain practical licenses to be a lawyer.<sup>13</sup> Corporate lawyers are also employees of the enterprise for which they work. Once they are hired by the enterprise, they serve as in-house counsel and are not permitted to practice in a law firm or represent other clients.<sup>14</sup>

According to the documents issued by the Ministry of Justice that created the category of corporate lawyer, the main purpose for creating this special category was the need to better meet the demand for legal services among large enterprises, especially large state-owned enterprises, particularly after China acceded to the WTO.<sup>15</sup> Since then, a small number of corporate lawyers have been located in enterprises and banks that operate nationwide, such as China CITIC Bank and HuaXia Bank Lenovo Group Limited. Different than enterprise legal counsel, corporation lawyers have

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Zhongguo Sifa (中国司法) [Justice of China] Vol. 11 (2007).

10. See generally Fazhi Ribao (法制日报), LEGAL DAILY, www.legaldaily.com.cn (last visited Apr. 8, 2011).

11. See Guoyou Qiye Falü Guwen Guanli Banfa (国有企业法律顾问管理办法) [Measures for the Administration of In-house Legal Counsels of State-owned Enterprises], (promulgated by the State Asset Supervision & Admin. Comm., May 11, 2004, effective June 1, 2004), art. 24 (China).

12. See Qualification for Enterprise Legal Advisors, *supra* note 8.

13. See Sifabu Guanyu Kaizhan Gongsì Lüshi Shidian Gongzuo de Yijian (司法部关于开展公司律师试点工作的意见) [Advice of the Ministry of Justice on Carrying out the Pilot Work on In-house Lawyers] (promulgated by the Ministry of Justice, Oct. 12, 2002) (China).

14. See *id.*

15. See *id.*

additional legal qualifications and are governed by the lawyers' law and regulations of lawyers' ethics.<sup>16</sup> All corporate lawyers are members of local lawyers' associations. Since corporate lawyers hold unified bar qualifications, they may practice at a law firm. As of 2009, over 250 central and local large enterprises employed corporate lawyers, and the number of corporate lawyers was 1,217.<sup>17</sup>

There is little demand for in-house legal departments among domestic-oriented enterprises. For medium and small-sized enterprises, it is not necessary or possible to recruit a legal professional. They usually hire external counsel to handle legal affairs as needed. But, for some national or international enterprises, departments of legal affairs composed of legal advisors or corporate lawyers play a very important role in dealing with regular operations and legal affairs.<sup>18</sup> The creation of the category of corporate lawyer exemplifies this trend.

Although their routes to obtaining qualification and supervision differ, often there are no substantial differences in the scope or type of work corporate lawyers and legal advisors actually do. They may work together in the same department for large enterprises. For example, the in-house legal department at China Eastern Airlines Corporation Limited, one of the country's top-three carriers listed on the Shanghai, Hong Kong, and New York Stock Exchanges, was chosen as the "Chinese Company In-house Team of the Year" in 2010. According to Guo Lijun, general manager of the department,

[i]n-house departments are now seen as an indispensable, cost-effective and expert resource . . . . They have expertise in law and the legal industry, combined with [an] intimate understanding of their companies' businesses and strategic goals . . . . [T]he in-house legal function is

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16. Lūshi he Lūshi Shiwusuo Zhiye Zhengshu Guanli Banfa (律师和律师事务所执业证书管理办法) [Measures for the Administration of the Practicing Licenses of Lawyers and Law Firms] (promulgated by the Ministry of Justice, Sept. 21, 2009) (China).

17. Chen Jumei (陈菊梅), Woguo Saqian Yuming Lūshi Dangxuan Geji Renda Daibiao he Zhengxie Weiyuan (我国三千余名律师当选各级人大代表和政协委员) [*Three Thousand Lawyers Elected to All Levels of NPC Deputies and CPPCC Members*], MINISTRY OF JUSTICE, [http://www.moj.gov.cn/moj/2008-04/15/content\\_833721.htm](http://www.moj.gov.cn/moj/2008-04/15/content_833721.htm) (last visited Apr. 8, 2011).

18. See *Two-Hundred and Ten Counties*, *supra* note 5. The state-owned Assets Supervision and Administration Commission (SASAC) even issued legal documents to demand the central state-owned enterprises to set up such internal departments. See Lian Yingting (廉颖婷), Yangqi Zong Falü Guwen Zhidu Daxiang Gongjianzhan (央企总法律顾问制度打响攻坚战) [State-owned Enterprises Are in a Critical Stage for Establishing the System of General Legal Advisors], LEGAL DAILY, (May 13, 2007), [http://www.legaldaily.com.cn/index\\_article/content/2007-05/13/content\\_615312.htm](http://www.legaldaily.com.cn/index_article/content/2007-05/13/content_615312.htm)(China).

regarded as important as finance and audit departments. Its influence is on the rise in every stage and aspect of the company's operations.<sup>19</sup>

Even those enterprises with internal legal staff must sometimes depend on external lawyers on some important issues or projects such as initial public offerings (IPOs) or major litigation. The area of enterprise affairs has become one of the most rapidly developing areas for Chinese lawyers. Thus, when discussing corporate lawyers in China, we must consider commercial lawyers in law firms who provide legal services for enterprises.

### C. WHAT DOES GLOBALIZATION MEAN FOR CHINESE CORPORATE LAWYERS?

Globalization means that businesses of all types operate abroad and regularly partner with foreign firms. As with the development of many service-oriented industries, "the international movement of American law firms has been largely motivated by a desire to follow and retain existing clients, as well as to expand the client base to include lucrative foreign interests."<sup>20</sup> "Because the law is fundamental to doing business in the modern world and additional complexities are created by doing business across national borders, attorneys hold a unique position in global commerce."<sup>21</sup> "By educating themselves about their clients, the transactions, and the places the transactions affect, lawyers ideally help ensure a productive and smooth-operating global market."<sup>22</sup> This is also true for Chinese lawyers, particularly Chinese corporate lawyers.

The policy of openness to the outside world and accession to the WTO has enticed more foreign enterprises to enter China, and Chinese enterprises are entering foreign markets.<sup>23</sup> Both Chinese and foreign enterprises compete and collaborate in Chinese and international markets, thereby extending the scope and space of legal practice for Chinese corporate lawyers. Their main role is to ensure the legality of commercial

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19. Yun Zhang, *ALB China In-House Survey: In Search of Best Practices*, ALB Legal News (May 31, 2010), <http://china.legalbusinessonline.com/surveys-and-ranking/alb-china-in-house-survey-2010-in-search-of-best-practice/46314>.

20. Justin W. Evans, *The Magic Confluence: American Attorneys, China's Rise, and the Global Value Chain*, 18 *IND. INT'L & COMP. L. REV.* 277, 278 (2008).

21. *Id.*

22. *Id.* (quoting Cynthia Losure Baraban, Note, *Inspiring Global Professionalism: Challenges and Opportunities for American Lawyers in China*, 73 *IND. L.J.* 1247, 1271 (1998)).

23. Li Renzhen (李仁真), *WTO yu Zhongguo Falü Fuwu Shichang de Duiwai Kaifang* (WTO 与中国法律服务市场的对外开放) [*WTO and Opening up of China's Legal Service Market*], *Zhongguo Sifa* (中国司法) [Justice of China] Vol. 11 (2004).

transactions and advise corporations of their legal rights and duties, including the duties and responsibilities of corporate officers. In order to do so, they must have knowledge of contract law, tax law, accounting, securities law, bankruptcy, intellectual property rights, licensing, zoning laws, and other laws specific to the business of the corporation in different countries. Multinational business brings new opportunities for Chinese corporate lawyers, but such opportunities also bring elevated requirements in terms of competence. They need to know not only Chinese law but also foreign and international law; they need to collaborate not only with their Chinese colleagues in Chinese but also with their multinational colleagues in foreign languages, particularly in English.<sup>24</sup>

Globalization affects the practice of Chinese corporate lawyers in many ways. First of all, foreign enterprises become Chinese lawyers' clients. With more openness in the Chinese market, international enterprises and some small enterprises and non-profit organizations set up entities or representative offices in China. Because of the limitations on the practice of foreign lawyers in China and the demand for local personnel with expertise in Chinese law, foreign entities have to work with Chinese lawyers either directly or through their foreign lawyers.<sup>25</sup> Serving foreign clients and collaborating with foreign lawyers has become a new challenge for many Chinese lawyers, especially for corporate lawyers.

Second, Chinese corporate lawyers have to collaborate and compete with foreign lawyers in China. China started to approve the entry of foreign lawyers in 1992 when the Ministry of Justice issued the interim Regulation on the Establishment of Foreign Law Office in China, providing that foreign law firms are allowed to establish representative offices.<sup>26</sup> As of 2010, there were 224 representative offices in mainland China representing 21 countries and 65 representative offices in Hong Kong.<sup>27</sup> Thus, with the openness of the economy, the globalization of the Chinese corporate law market is also emerging and is the source of most of the opportunities

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24. Evans, *supra* note 20, at 287–88.

25. According to the Measures for the Implementation of the National Judicial Examination, only nationals of the People's Republic of China may become members of the Chinese bar, and foreign lawyers lack authority to represent clients in Chinese courts. See Guojia Sifa Kaoshi Shishi Banfa (国家司法考试实施办法) [Measures for the Implementation of the National Judicial Examination], (promulgated by the Ministry of Justice, Aug. 14, 2004, effective Aug. 14, 2004), art. 13 (China).

26. The Interim Regulation on the Establishment of Foreign Law Office in China was jointly promulgated by the Ministry of Justice and State General Administration of Commerce and Industry and replaced by Regulations for Administration of Representative Offices of Foreign Law Firms in China in 2001.

27. See *China's Law Profession Advances as Nation Builds Rule-of-Law System*, EMBASSY OF THE PEOPLE'S REPUBLIC OF CHINA IN AUSTRALIA (Feb. 17, 2010), <http://au.china-embassy.org/eng/xw/t658820.htm>.

awaiting foreign lawyers in China.<sup>28</sup> However, legal practice is an exception to this openness since foreign lawyers lack authority to represent clients in Chinese courts and may not interpret the applicability of Chinese laws.<sup>29</sup> Chinese lawyers have advantages and privileges over foreign lawyers in interpreting Chinese law and representing clients in court. Partially due to the ambiguousness of the regulations, while foreign lawyers are only allowed to interpret foreign laws and their practice is limited, many foreign lawyers do provide legal services through their local representative offices or headquarters overseas.<sup>30</sup>

For example, a foreign company interested in entering China usually will want to employ the insight and network of a local Chinese law firm. "At the same time, however, the business may also want to retain their own lawyers, to give objective advice already known to be trustworthy and competent, and to manage the legal relationship between the company and its Chinese attorneys."<sup>31</sup> Therefore, with the formation of a platform for Chinese lawyers and foreign lawyers to work together, Chinese lawyers have to compete and work with their international colleagues. International corporate legal services is the most important area for foreign law firms in China. The total income for foreign lawyers in China in this area reached US\$4 billion in 2009.

Third, Chinese lawyers have to work and compete with foreign lawyers in overseas markets for their Chinese clients. With the development of the Chinese economy, more Chinese enterprises have started to enter foreign markets. In this situation, Chinese corporate lawyers have to work on issues relating to foreign laws in foreign legal environments and must collaborate with foreign lawyers in foreign countries.

In contrast to the adversarial nature of trial law, corporate law is team oriented. When Chinese corporations enter international business, the corporate counsels for both sides of a transaction are not strict competitors; they seek a common ground for their clients.<sup>32</sup> In some important projects, such as IPOs, the collaboration between Chinese lawyers and foreign lawyers is critical because foreign corporate lawyers have expertise in

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28. See Sida Liu, *Globalization as Boundary-Blurring: International and Local Law Firms in China's Corporate Law Market*, 42 L. AND SOC'Y REV. 771, 779 (2008).

29. Evans, *supra* note 20, at 306.

30. For example, the Shanghai Bar Association tried to crack down on foreign law firms for conducting unauthorized activity in 2007. See *China May Crack Down on Foreign Law Firms*, CHINA DAILY (May 16, 2006), [http://www.chinadaily.com.cn/china/2006-05/16/content\\_590787.htm](http://www.chinadaily.com.cn/china/2006-05/16/content_590787.htm).

31. Evans, *supra* note 20, at 290.

32. See Liu, *supra* note 28, at 780-83 (explaining the competitive nature of Chinese and foreign law firms for local work and noting the difference in working with corporate clients rather than Chinese firms).

providing services concerning Hong Kong law or U.S. law, while Chinese lawyers have expertise in the reorganization part of the deal.

#### D. CHALLENGES IN TERMS OF THE COMPETENCE AND LEGAL ETHICS OF CHINESE CORPORATE LAWYERS

In contrast with “Western democratic countries, the landscapes of legal professionalism in non-democratic countries [such as China] have exhibited a completely different picture.”<sup>33</sup> But, one result of globalization and the opening to the outside world has been to force Chinese legal professionals to compete with their Western counterparts that have developed their legal ethics over several hundred years in a relatively static environment. It is obvious that these new challenges “place Chinese lawyers in a less competitive position vis-à-vis their Western [rivals], who tend to have higher professional and academic standards.”<sup>34</sup>

One American remarked that “[w]hile some local lawyers [in China] are often cheaper [than international ones], if they have not spent extensive time in the West, they may not have the professional insight into or understanding of the foreign side to really act as an effective ‘bridge.’”<sup>35</sup> Facilitating a business requires insight into the client’s needs, expertise, flexibility, and most of all, a service mentality. With the rapid development of the Chinese economy and globalization, the new complexity of legal issues deeply affects the legal practice of Chinese corporate lawyers. Chinese corporate lawyers are often not competent to meet these new challenges for several reasons, including the language barrier, an inadequate understanding of foreign laws and foreign legal cultures, and the difficulty of governing corporate lawyers’ behavior and ethics.

##### 1. *The Language Barrier*

The first and most obvious challenge is the language barrier. Because so many international transactions are conducted and completed primarily in English, it is crucial for Chinese corporate lawyers to have excellent communication skills in both Chinese and English. Throughout the negotiation process, lawyers constantly write and revise the legal documents which will bind the parties. In international legal practice, English is used widely. Most Chinese law students and lawyers study English in college, but few can competently combine their English skills

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33. Carlos Wing-Hung Lo & Ed Snape, *Lawyers in the People’s Republic of China: A Study of Commitment and Professionalization*, 53 AM. J. COMP. L. 433, 437 (2005).

34. *Id.* at 451.

35. Evans, *supra* note 20, at 289–90 (quoting JOHN L. CHAN, CHINA STREETSMART: WHAT YOU MUST KNOW TO BE EFFECTIVE AND PROFITABLE IN CHINA 95 (2003)) (alterations in original).

with their legal practice. Although some translated laws are provided by the Standing Committee of the National People's Congress, with the Working Institute of the Chinese Legislature and the Legal Affairs Office under the State Council as a reference, neither the legislature nor any other government authority provides official translations of all Chinese laws. Translation has become a regular job for most Chinese corporate lawyers. When the applicable laws in an international transaction are Chinese, Chinese lawyers frequently have to translate them, which is costly and time-consuming.

## *2. Inadequate Understanding of Foreign Laws and Foreign Legal Cultures*

A second barrier for Chinese corporate lawyers is an inadequate understanding of foreign laws and foreign legal cultures. Chinese law schools usually provide some basic courses on foreign legal systems, but students have few opportunities to access more detailed and practical content relating to foreign and international legal practice. When trying to understand foreign laws, Chinese lawyers, especially those trained in mainland China, often cannot avoid falling back on their knowledge of Chinese law. This makes it more difficult for Chinese businesses and corporate lawyers to enter foreign countries and can even cause a disaster when Chinese corporations enter an overseas market.

For example, the first attempt at purchasing a foreign enterprise by a Chinese company failed partially because of poor understanding of foreign law. In 2004, Shanghai Automotive Industry Corporation (SAIC), one of China's largest auto manufacturers and the main joint venture partner of General Motors and Volkswagen, spent some US\$500 million to acquire a controlling 48.9 percent stake in the debt-laden Ssangyong Motor of South Korea.<sup>36</sup> The deal made SAIC the first Chinese automaker to have a controlling interest in a foreign car maker. However, in November 2009, after being accused of stealing technology from the company and being charged by the South Korean prosecutor's office with violating South Korean law when it ordered and carried out the transfer of Ssangyong's proprietary technology developed with South Korean government funding, SAIC had to withdraw from the South Korean market at a loss of about US\$3 billion.<sup>37</sup> This failure had many causes, but one of them was that SAIC suffered a labor strike in South Korea which would have been illegal in China. An inadequate understanding of South Korean law, especially the law of labor unions, may have contributed to the failure of the acquisition.<sup>38</sup>

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36. See Xia Jun, *Chinese Cars Make Inroads Abroad*, CHINA DAILY (Sept. 2, 2004), [http://www.chinadaily.com.cn/english/doc/2004-09/02/content\\_371086.htm](http://www.chinadaily.com.cn/english/doc/2004-09/02/content_371086.htm).

37. See Kim Hyun-cheol, *Ssangyong Motor to Test Korea-China Ties*, KOREA TIMES, Jan. 9, 2009, [http://www.koreatimes.co.kr/www/news/biz/2009/05/123\\_37591.html](http://www.koreatimes.co.kr/www/news/biz/2009/05/123_37591.html).

38. See *id.*

### 3. *The Difficulty of Governing Corporate Lawyers' Behavior and Ethics*

Compared to litigation lawyers' ethics, which are supervised and governed by judges and courts, corporate lawyers usually only interact with their clients in an outsider-client relationship. In China, every practicing lawyer is registered with and supervised by a local lawyers' association and local justice administrative authority. Chinese law creates a dual management structure in which both the local judicial administration department and the local mandatory bar association have regulatory power over annual registration, practical performance, and legal ethics.<sup>39</sup> In this dual management structure, compared to the strong control of lawyers by administrative authorities, lawyers' associations (which are mandatory)<sup>40</sup> have limited ability to regulate legal ethics.<sup>41</sup> As an American scholar observed, "[w]ith the Chinese legal system still maintaining strong central control, and the role of lawyers so highly uncertain, particularly outside private contract disputes, the lawyer's role is still evolving."<sup>42</sup> Although the All-China Lawyers Association has developed codes of ethics, "it is difficult to find any indication . . . that the codes of ethics have had much influence."<sup>43</sup> Lawyers have to "strive to identify themes of ethics and professional responsibility in the midst of a rapidly changing and often contradictory system."<sup>44</sup> Instances of corporate lawyers being convicted of malfeasance support this conclusion.

Guo Jingyi was an official with the Ministry of Commerce. He was charged with taking money equivalent to US\$1.3 million from several lawyers and admitted all charges before the trial court.<sup>45</sup> The chain between officials and lawyers runs as follows: the officials and lawyers are classmates or long time friends; a foreign company, through its lawyer, locates officials who are in charge of approving its investment; the officials, together with the lawyer, formulate the corresponding regulation and put the company's needs into the law or leave loopholes in it; the company submits its application to the relevant department; officials suggest the company "hire" the designated lawyer; the company pays a bribe through the lawyer; and finally, with the help of the lawyer and officials, the company's investment application is approved.<sup>46</sup>

39. Lawyer's Law, *supra* note 1, arts. 4, 45.

40. The lawyers' association is "a public organization with the status of a legal person and shall be the lawyers' self-disciplinary organization." *Id.* art. 45.

41. Judith A. McMorrow, *Professional Responsibility in an Uncertain Profession: Legal Ethics in China*, 43 AKRON L. REV. 1081, 1100 (2010).

42. *Id.* at 1098.

43. *Id.* at 1101.

44. *Id.* at 1098–99.

45. Jia Xu, *Former Commerce Inspector Gets Suspended Death*, CHINA DAILY (May 20, 2010), [http://www.chinadaily.com.cn/china/2010-05/20/content\\_9874446.htm](http://www.chinadaily.com.cn/china/2010-05/20/content_9874446.htm).

46. *Beijing Court Rejects Death-Row Commerce Official's Appeal*, XINHUA NEWS

Justice authorities are remote from actual legal practice, and lawyers' associations are often very passive regarding ethics. In Guo's case, two famous law firms were investigated and punished with temporary suspensions of business activities, and partners at the two law firms were arrested and charged with bribery.<sup>47</sup> The bribery lasted several years, and justice authorities and lawyers' associations found it very difficult to uncover.<sup>48</sup>

#### E. NEW EFFORTS TO CULTIVATE INTERNATIONAL LEGAL TALENT

Globalization raises significant challenges for Chinese corporate lawyers but also provides opportunities to serve international investors and collaborate with international lawyers. Even though the legal profession is still in its formative stages, a small number of corporate law firms have developed rapidly and already control much of the most profitable and prestigious legal work. For example, the law firm of King and Wood, established in 1993, has been a top Chinese comprehensive law firm for the past seventeen years.<sup>49</sup> With the development of the Chinese commercial legal market in a period of globalization, most elite commercial lawyers have been trained in the United Kingdom, the United States, Germany, and Japan; many with experience in world-renowned firms play more and more important roles representing international clients in international transactions.<sup>50</sup>

Despite the rapid pace of globalization, China still suffers from a shortage of high-level, international corporate lawyers in the domestic and international legal markets. In recent years, the Chinese government has started several projects to cultivate international corporate lawyers. An ambitious instance is the 2008 approval of the Peking University School of Transnational Law ("STL"), an American-style law school in Shenzhen. STL is operated completely by a team of prominent American law professors.<sup>51</sup> Its goal is to educate talented lawyers proficient in Chinese

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AGENCY (Aug. 13, 2010), [http://news.xinhuanet.com/english2010/china/2010-08/13/c\\_13444236.htm](http://news.xinhuanet.com/english2010/china/2010-08/13/c_13444236.htm).

47. Zhu Yan (朱燕), "Guo Jingyi An" Zhuizong: Xinghui Guo Jingyi 10 Wan Lushi Huoxing 5 Nian ("郭京毅案"追踪: 行贿郭京毅10万 律师获刑5年) ["Guo Jingyi Case" Update: *Bribing Guo Jingyi 100,000 Gets Lawyer Sentenced to 5 Years*], BEIJING NEWS, Sept. 25, 2010, at A07 (China).

48. *Ministry of Commerce and Other Former Officials Named by Deng Zhan Guo Jingyi Corruption Alliance Was Formed*, CHINA DAILY (Dec. 14, 2010), <http://www.china-daily.org/China-News/Ministry-of-Commerce-and-other-former-officials-named-by-Deng-Zhan-Guo-Jingyi-corruption-alliance-was-formed/>.

49. *See The Firm*, KINGANDWOOD.COM, [http://www.kingandwood.com/the\\_firm.aspx?language=en](http://www.kingandwood.com/the_firm.aspx?language=en) (last visited Apr. 8, 2011).

50. Sida Liu, *Client Influence and the Contingency of Professionalism: The Work of Elite Corporate Lawyers in China*, 40 L. & SOC'Y REV. 751, 752 (2006).

51. Jeffrey Lehman, the former president of Cornell University and former president of

and English, sophisticated about Chinese and foreign cultures, and fully qualified for membership in the Chinese and transnational legal professions.<sup>52</sup> STL students enroll in a four-year program that leads to both a Juris Doctor (“J.D.”) degree—the basic degree at American law schools—and a Juris Master (“J.M.”) degree—the basic graduate degree at Chinese law schools. The students learn substantive legal rules, critical thinking, and legal reasoning. STL also places a focus on teaching its students that lawyers around the world are considered members of a public profession with special duties to ensure that law is a force for good in society and to help promote the cause of social justice.<sup>53</sup>

Although the STL experiment is unfinished, more and more Chinese law schools, such as Renmin University Law School, have initiated international legal talent education programs.<sup>54</sup> The Ministry of Education even has plans to launch a new national education project to educate legal talent with international views and abilities. Under the plan, approximately ten of the top law schools among the 620 law schools in China will be selected on a trial basis. The government will invest money in those schools to invite foreign law professors to teach using critical teaching methods. Students will have more opportunities to study abroad and intern under the supervision of international lawyers.<sup>55</sup>

Nevertheless, such determination in meeting the needs of corporate lawyers by the Chinese legal community is not institutional. The Chinese legal system still maintains strong central control; the role of lawyers is highly uncertain; and legal ethics education is still a fringe subject in Chinese law schools. Without institutional evolution, Chinese corporate lawyers may struggle to survive in the highly competitive international legal market.

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the American Law Deans’ Association, serves as the dean. Stephen Yandle, who served as the associate dean of the Yale Law School for seventeen years, serves as associate dean. See *An Overview of The Peking University of Transnational Law*, PEKING UNIVERSITY SCHOOL OF TRANSNATIONAL LAW, <http://stl.szpku.edu.cn/en/about/index.aspx?MenuID=02010102> (last visited Apr. 8, 2011).

52. *Id.*

53. *Id.*

54. Renmin University Law School selects about thirty students annually who have strong English abilities. In addition to Chinese law courses, the law school provides a curriculum of foreign and international laws taught by foreign instructors.

55. The China Scholarship Council, a national institute affiliated with the Ministry of Education initiated more programs in support of Chinese students to study in foreign countries. See *Location – About Us*, CHINA SCHOLARSHIP COUNCIL, <http://en.csc.edu.cn/About/c309df7fb3fa40b3a179a7ad93f11988.shtml> (last visited Apr. 8, 2011).

