Pitfalls of Over-Legalization: When the Law Crowds Out and Spills Over

MARK T. KAWAKAMI*

ABSTRACT

While some academics argue that enforcing voluntary corporate codes of conduct with private law backed sanctions can improve the working conditions of marginalized workers in the global supply chain, there are various risks associated with this "legalization" process. Relying on evidence from the fields of sociology, psychology, and evolutionary anthropology, this contribution will discuss how external incentives like threats of legal sanctions can actually be detrimental to the intrinsic motivations of companies that want to be socially responsible. This paper will also analyze how the crowding out effect and the spillover effect that come with legalizing otherwise voluntary norms could lead to a series of unintended and harmful consequences. In light of these realizations, this paper will caution against taking codes of conduct "too seriously" and propose that rather than focusing on legal sanctions to threaten companies into compliance, a more facilitative approach based on collaboration, mutual respect, and social norms could better serve to improve the working conditions of laborers in the bottom echelons of our supply chain.

INTRODUCTION

Our general reliance on private law to either complement or substitute public law in order to reduce labor exploitations in the global supply chain comes from a certain lack of faith in public law to fully address the problem.[1] Skeptics and realists alike are alarmed by the fact

* PhD Researcher at the Maastricht European Private Law Institute, Maastricht University. Special thanks to Jan Smits, Anna Beckers, Anna Berlee, Daniel On, and Caroline Calomme for their comments during the drafting of this contribution.

1. RICHARD M. LOCKE, THE PROMISE AND LIMITS OF PRIVATE POWER: PROMOTING LABOR STANDARDS IN A GLOBAL ECONOMY 169 (2013) (observing that "labor laws and regulations are often violated, and the labor inspectorates/ministries charged with

Indiana Journal of Global Legal Studies Vol. 24 #1 (Winter 2017)

that traditional public law enforcement measures in our perpetually globalizing world are not particularly well suited to deal with a collective action problem that has metastasized across borders.[2] Some even believe that there is an inherent "mismatch between the 'highly legalistic' and rigid enforcement practices of government regulatory agencies and the dynamic and evolving reality of supply chain factories."[3] This mismatch is exacerbated in the global context by the fact that there is a noticeable "void"[4] in international governance as no governing body is currently capable of dealing with the problem of companies operating seamlessly across borders and circumventing national laws, "[t]he emergence of global supply chains . . . has rendered these national and international strategies inadequate because authority is dispersed not only across national regimes but also among global buyers and their myriad suppliers."[5]

While private actors and private laws cannot completely substitute for governments and public laws, private actors have the potential to assist the governments in ultimately reducing the problem of labor exploitation in the global supply chain. Fortunately, many global brands have already "acknowledged a degree of responsibility for workplace conditions in supplier factories" and are spending capital and resources "developing ever more comprehensive monitoring tools, hiring growing numbers of internal compliance specialists, conducting hundreds of factory audits, and working with external consultants and [nongovernmental organizations (NGOs)]"[6] in order to improve the working conditions of marginalized workers around the globe. While a galvanized private sector has the potential to make meaningful changes possible, there are reasons for us to curb our collective enthusiasm as well. For example, MIT's Richard Locke and his research team conducted extensive research by studying the supply chain of companies like Nike and concluded that the results of their corporate social responsibility (CSR) measures were—at best—mixed.[7] Based on his

---

inspecting workplaces and enforcing labor laws are weak, underfunded, and at times, prone to politicization or even corruption").

2. *See* JAN M. SMITS, PRIVATE LAW 2.0: ON THE ROLE OF PRIVATE ACTORS IN A POST-NATIONAL SOCIETY 5 (2011) (suggesting in his inaugural lecture that private law, in an of itself, may also be "no longer fit for purpose and therefore needs to change").

3. LOCKE, *supra* note 1, at 169.

4. *Id.* at 9 (noting that "[i]t is in this context that private initiatives have emerged to fill this regulatory void").

5. *Id.*

6. *Id.* at 1, 20.

7. *Id.* at 18 (noting that while the team observed some mixed improvements in workplace safety and hours after the implementation of codes of conduct, enabling rights

team's comprehensive analysis, Locke speculates that CSR measures and their improvements have not only "hit a ceiling," but that the improvements that the CSR measures have been able to achieve "appear to be unstable in the sense that many factories cycle in and out of compliance over time."[8]

This brings us to the present situation and the main focus of this contribution, which is the question of how private actors should proceed when implementing and enforcing CSR measures in light of these observations. Anna Beckers recently answered this question by focusing particularly on the private legal enforcement of otherwise voluntary corporate codes.[9] Beckers, among others, advocates not only for companies to contractually impose corporate codes on their downstream suppliers, but also argues that consumers, NGOs, and even downstream suppliers ought to rely on private law instruments to hold brands such as Nike and Apple accountable, even if their corporate codes were never intended to be legally binding promises to the public.[10]

While Beckers focuses predominantly on the external relationship between the buyer—the Nikes of the world—and the consumers, NGOs, and so forth, this contribution will pay attention to the relationship between the buyer and its downstream suppliers for two reasons: First, most egregious labor exploitations often take place at the supplier/manufacturer level, such as at the factories of Yue Yuen, Foxconn, and Li & Fung, and not necessarily at companies like Nike, Wal-Mart, and Apple. One could assume that if we focus our attention on the major brands, they will eventually stop doing business with these

---

such as the right to free association and to collectively bargain were still "outside the pale").

8. *Id*. at 174.

9. *See generally* ANNA BECKERS, ENFORCING CORPORATE SOCIAL RESPONSIBILITY CODES: ON GLOBAL SELF-REGULATION AND NATIONAL PRIVATE LAW (2015) (focusing on the characteristics of corporate social responsibility codes, their effects on society, and their legal consequences in order to provide a comprehensive analysis of corporate codes and the law).

10. *See id.* at 217–363 (detailing the various private law instruments that can be utilized to enforce these codes, including, but not limited to, negligence, contract with protective effect vis-à-vis third parties, and unfair commercial practices). *See also* Fabrizio Cafaggi, *Enforcing Transnational Private Regulation: Models and Patterns*, *in* ENFORCEMENT OF TRANSNATIONAL REGULATION: ENSURING COMPLIANCE IN A GLOBAL WORLD 75 (Fabrizio Cafaggi ed., 2012); Doreen McBarnet, *Corporate Social Responsibility Beyond Law, Through Law, for Law: The New Corporate Accountability*, *in* THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW 9 (Doreen McBarnet et al. eds., 2007) (observing the various pros and cons of enhanced corporate social responsibility measures); ANDREAS RÜHMKORF, CORPORATE SOCIAL RESPONSIBILITY, PRIVATE LAW AND GLOBAL SUPPLY CHAINS (2015) (noting the role of private law in corporate social responsibility and how it can be improved).

dubious suppliers and manufacturers or, more optimistically, that the brands will work to increase their due diligence by conducting more audits and shifting their liabilities downstream. However, focusing on the brands often does not create the necessary impact CSR advocates often claim that it will, especially when relying only on extrinsic motivators.

Second, even if the brands decide to be more socially responsible, there is no guarantee that the decision to do so will actually impact the working conditions of the marginalized workers. For example, De Beers, a diamond company that once controlled about 80 percent of the world's diamond sales, decided in the 1990s to get out of the "blood diamond" business and to "market only those it dug up itself" after receiving bad publicity for its mining practices.[11] Not only did De Beers's position in the market drop significantly as a result of this "socially responsible" decision, but De Beers's withdrawal unfortunately did not affect the working conditions of the miners as the void left by De Beers's exit was quickly filled by its competitors who did not mind dealing with "blood diamonds." So even if we were to concede that the threat of legal sanctions based on private law might compel the brands to change their behavior, this change alone does not automatically produce the level of impact that is necessary to actually improve the working conditions of marginalized workers.

While there are minor points to nitpick from Beckers's core arguments—essentially highlighting the benefits of private law enforcement of otherwise voluntary CSR codes against the brands—it must be said that her arguments are not entirely unconvincing as they clearly highlight various benefits of "taking corporate codes seriously" and targeting the Nikes of the world to be more accountable. The focus of this article, however, is not to dwell on these apparent benefits or their viability, but to note that enforcing otherwise voluntary corporate codes, or to "legalize" corporate codes, could actually be detrimental in some ways to the process of reducing labor exploitations in the global supply chain. This is to suggest that while holding companies liable and keeping them to their promises is, in and of itself, an admirable goal, doing so does not necessarily improve the working conditions of the marginalized workers.[12]

In regard to structure, this Article will first differentiate extrinsic incentives from intrinsic incentives, legal norms from social norms, as well as show how differently they each influence our commitment to

11. *Betting on De Beers*, THE ECONOMIST (Nov. 12, 2011) http://www.economist.com/node/21538145.

12. Admittedly, this is a rather instrumental understanding of the law, which, for the time being, overlooks its more normative functions.

social responsibility. Second, this contribution will highlight the potential drawbacks—such as the spillover effect and the crowding out effect—that can emerge from focusing too much on legal or extrinsic incentives by borrowing examples from a wide variety of fields, including sociology, behavioral psychology, and evolutionary anthropology. Lastly, this contribution will propose that not legally enforcing the otherwise voluntary codes of conduct can create an opportunity for collaboration and the chance for all of the parties involved to reaffirm their commitment to making meaningful and sustainable changes. The ultimate objective of this contribution is not necessarily to prevent consumers from suing the Nikes of the world or to stop Nike from contractually enforcing their corporate codes against their suppliers. The objective here is merely to increase awareness of some latent repercussions that can arise from such lawsuits and to present a possible alternative that, in some circumstances, could minimize such risks.

I. EXTRINSIC & INTRINSIC INCENTIVES

Before tackling the issue of whether legal enforcement of corporate codes renders positive outcomes that outweigh the possible repercussions, it is worth taking a preliminary look at why companies create codes of conduct in the first place. Against this backdrop, let us consider the possibility that there are good reasons and bad reasons for why we do the things that we do. While doing something good is indeed good, the reason why we do it ought to matter as well because lasting, meaningful change requires having the right motivation. To illustrate this point, Michael Sandel uses the example of paying children to read books. While we can agree that incentivizing children to read is a good initiative, we also recognize that children wanting to read for the sake of reading might be preferable to children reading only for the sake of getting paid. Sandel suggests that this is because "we corrupt a good, an activity, or a social practice whenever we treat it according to a lower norm than is appropriate to it."[13]

Sandel observed that there are high (or good) motives and low (or bad) motives in value jurisprudence and those high motives can be corrupted if we treat them as if they were low motives. High motives, for

13. MICHAEL J. SANDEL, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS 59 (2012); *see also* Edward L. Deci, *The Effects of Externally Mediated Rewards on Intrinsic Motivation*, 18 J. PERSONALITY & SOC. PYSCHOL. 114 (1971) (noting that "when money is used as an external reward for some activity, the subjects lose intrinsic interest for the activity"); Harry F. Harlow et al., *Learning Motivated by a Manipulation Drive*, 40 J. EXPERIMENTAL PSYCHOL. 228, 231–34 (1950).

example, are notions of public service, civic duty, fighting for fairness and equality, and helping our fellow human beings in their times of need. In sociology, these high motives (or motives that are intrinsically derived) are associated with "inherent goodness."[14] In the CSR context, the argument that follows from this observation is that inherent goodness—wanting to improve the working conditions and the treatment of marginalized workers—can be eroded by our tendency to enforce compliance to codes of conduct with threats of legal sanctions or monetary incentives (e.g., continued business). While creatively using contractual third party rights or negligence to enforce compliance to otherwise voluntary codes of conduct might indeed be plausible, we should pause, at least for a moment to ask the question, is doing so desirable in the first place?

Tabling the erosion of goodness concern for the moment, let us apply Sandel's framework of extrinsic versus intrinsic incentives in the context of enforcing corporate codes. Surely, there are companies that are intrinsically motivated by their Pollyannaish desire to "do good" and behave accordingly in a socially responsible manner even in the absence of some voluntary code. Just as there are intrinsically motivated companies, there are companies—possibly an overwhelming majority of them—that are extrinsically motivated and must be compelled into behaving in a socially responsible manner. These extrinsically motivated companies may appear to feign interest in being socially responsible, but the real reason for doing so is because of "pressures from consumers, investors, the media, and non-governmental organizations" and the "fear of the effects of such pressure on profitability."[15] In the words of Emad Atiq, these external pressures and incentives "compensate for the inadequacy of individuals' natural motivations to behave in socially desirable ways,"[16] but what impact does this actually have on compliance in the long run or on the working conditions of the marginalized workers? To refer back to Sandel's earlier scenario, what happens when the kids stop getting paid to read? Will they continue to read even without the external prompt or will they be less likely to read than before? We will come back to this question a bit later.

---

14. *See* Emad H. Atiq, *Why Motives Matter: Reframing the Crowding Out Effect of Legal Incentives*, 123 YALE L.J. 1070, 1077–78 (2014).

15. Robert J. Liubicic, *Corporate Codes of Conduct and Product Labeling Schemes: The Limits and Possibilities of Promoting International Labor Rights Through Private Initiatives*, 30 L. & POL'Y INT'L BUS. 111, 114–16 (1998) (noting that "good public relations are vital to the bottom-line interests of companies with images to protect").

16. Atiq, *supra* note 14, at 1072.

A. Legal Sanctions & Extrinsic Incentives

The most basic way to distinguish intrinsic from extrinsic motivations comes down to whether an individual wants to do something for its own sake (intrinsic), or because there is a contingent, "if-then" reward associated with doing something (extrinsic). The previous section already hinted to the fact that many companies implement codes of conduct due to external pressures.[17] Besides the purely market incentives, external pressure for companies to be socially responsible can also come from a variety of other sources, including compliance with labor laws and shareholder pressures, both of which are examples of extrinsic motivators. The upstream buyers—what this contribution has also been referring to as "the brands" or the "Nikes of the world"—prodded by these external pressures often transfer that demand to their downstream suppliers by attaching codes of conduct in their contracts, which the buyer can enforce with threats of legal sanctions. This is to suggest that by increasing the external pressures put on companies by consumers and NGOs, the likelihood that companies will put more pressure on their suppliers will increase, or in the alternative, as illustrated by the De Beers example, companies will simply stop doing businesses with "bad" suppliers or manufacturers to avoid the public scrutiny.

Focusing for the moment on the relationship between the buyer and the supplier, the process of the upstream buyer establishing codes of conduct, monitoring, auditing, detecting violations, and then sanctioning their suppliers is "the principal way both global corporations and labor rights NGOs address poor working conditions in global supply chain factories."[18] Colloquially referred to as "the carrot or the stick" approach, these types of extrinsic motivators certainly serve a normative function,[19] but the question here is whether they are effective at really modifying corporate behavior. In the relationship between the buyers and the suppliers, there is already an abundance of extrinsic prompts (i.e., contract law, promise of continued business relationship and profits, etc.) such that to legalize the otherwise voluntary code

17. *See* Hugh Collins, *Conformity of Goods, the Network Society, and the Ethical Consumer*, 5 EUR. REV. PRIV. L. 619, 626 (2014) (noting that "[t]he dominant motivation behind [codes of conduct] is presumably the concern that, if consumers believe that the processes by which the product was produced violate ethical standards, they may boycott a corporation's products in sufficient numbers to affect sales and profits").

18. Richard M. Locke et al., *Does Monitoring Improve Labor Standards? Lessons from Nike*, 61 INDUS. & LAB. REL. REV. 3, 3 (2007).

19. It could also be argued that the law, as a normative instrument, could render intrinsic motivation, but this argument will be addressed later in this contribution. *See infra* Part I.C.

would simply be to add an extra layer of extrinsic incentives. Even at the upstream level, there are a number of laws and extrinsic motivators (i.e., labor law, consumer law, etc.) already in place that aim to modify corporate behavior. So how much difference would a galvanized private sector actually make by adding more extrinsic incentives?

1. When Extrinsic Incentives Work

To answer the question posed above, Hugh Collins admonished that "we must remain skeptical about the effectiveness of much hyped corporate codes of conduct and similar measures in upholding minimum labor standards, for even well-intentioned Western corporations cannot properly supervise the daily conduct of management in foreign business in the context of the 'organized irresponsibility' of business networks."[20] The point Collins makes is quite clear: extrinsic motivators work well enough if there is constant monitoring and effective enforcement. Absent such external pressures, corporate codes might be ineffective, even in the presence of a well-intentioned, galvanized private sector.

In addition to Collins's point, a series of studies have shown that "external rewards and punishments—both carrots and sticks—can work nicely for algorithmic tasks . . ." but "they can be devastating for heuristic ones."[21] So extrinsic incentives, given the right circumstances may improve the performance of menial tasks but perhaps not tasks that require a lot of thought or creativity. Various aspects involved in the management of the global supply chain and ensuring compliance to corporate codes, however, cannot be described as menial tasks, which raises the question of whether external pressures like legal norms are really the best tool for corporate behavior modification. If anything, it is worth observing that these are the exact same obstacles (i.e., inefficient oversight, lack of oversight, etc.) that government regulations often face, and to expect private actors to do any better would be speculative at best.

While Beckers argues that it is viable for private law to "recognize these corporate codes as evolving serious unilateral forms of

20. Collins, *supra* note 17, at 626.

21. DANIEL H. PINK, DRIVE: THE SURPRISING TRUTH ABOUT WHAT MOTIVATES US 30 (2009) (summarizing arguments made in TERESA M. AMABILE, CREATIVITY IN CONTEXT (1996)); *see also* CAROL S. DWECK, SELF-THEORIES: THEIR ROLE IN MOTIVATION, PERSONALITY, AND DEVELOPMENT 16–17 (1999) (discussing study conducted by Elaine Elliot and Carol S. Dweck in 1988 finding that children who focus on "measuring ability" will condemn their own abilities when facing adversity, whereas children who focus on "learning" will treat adversity as a challenge and overcome them without condemning their ability).

regulations" that ultimately make enforcement possible,[22] the question worth revisiting is whether this is desirable in the first place. There are persuasive arguments to doubt that threats of lawsuits or creative use of private law instruments provide an adequate incentive for companies to comply with corporate codes. This leads us to the next section on when and why extrinsic incentives fail.

2. When Extrinsic Incentives Fail

Borrowing from the fields of psychology and sociology, various studies have substantiated the claim that in order to modify behavior, we must not rely solely on external-control systems.[23] A series of empirical research on the effectiveness of these compliance mechanisms validate this point:

> As for using incentives to promote compliance, the threat of sanctions in the form of reduced orders for noncompliant suppliers is rarely enforced, and factories that systematically improve their working conditions are not always rewarded (again, in the form of increased orders). Even if this threat were enforced, it could create perverse outcomes by punishing workers along with management and removing any continued incentives for factories to improve working conditions.[24]

This is to say that especially at the buyer/supplier level, extrinsic incentives are terribly inefficient and ineffective. It has been shown time and time again that even if properly monitored, codes of conduct are "not producing the large and sustained improvements in workplace conditions that many had hoped it would."[25] The reality of the fast-paced global supply chain is that "orders are often in the pipeline well before audits have been scheduled and that these global companies continue to place orders in many factories that have serious compliance

22. BECKERS, *supra* note 9, at 30.

23. *See* Edward L. Deci, *Intrinsic Motivation, Extrinsic Reinforcement, and Inequity*, 22 J. PERSONALITY & SOC. PSYCHOL. 113, 119–20 (1972) (suggesting that "one who is interested in developing and enhancing intrinsic motivation in children, employees, students, etc., should not concentrate on external-control systems such as monetary rewards"); *see also* PINK, *supra* note 21, at 134–35 (concurring that "profit motive, potent though it is, can be an insufficient impetus for both individuals and organizations").

24. LOCKE, *supra* note 1, at 38–39.

25. Locke et al., *supra* note 18, at 21.

issues."[26] To this point, in-depth research led, again, by Richard Locke and his team, showed that "[t]his reality does little to create the 'right' incentives needed to shift the 'calculus of compliance' by raising the cost of code violation above the cost of compliance and motivating steady improvements in factory conditions."[27] So we now have evidence to show that an extrinsic incentive, in and of itself, is not only ineffective, but that "as an emotional catalyst . . . [it] lacks the power to fully mobilize human energies."[28]

B. Legal Norms v. Social Norms in the CSR Context: A Necessary Detour

If additional extrinsic incentives are not the preferred solution, especially at the buyer/supplier level, it reasons to suggest that perhaps intrinsic incentives are the necessary catalyst to bring about truly meaningful changes.[29] So where does intrinsic motivation actually come from? Earlier, I stated that when an individual wants to do something for its own sake, and not because of a contingent reward associated with it that is said to be an example of intrinsic motivation. While philosophers could debate endlessly about whether purely intrinsic motivations actually exist (similar to the controversy surrounding whether altruism really exists),[30] for the sake of this contribution, we will assume that intrinsic motivations do actually exist and that they can be differentiated from extrinsic incentives. The more interesting argument that will be advanced in this contribution is to suggest that social norms are more conducive to creating and fostering intrinsic norms vis-à-vis legal norms. This opens up a Pandora's Box of sorts and the need for us to differentiate legal norms from social norms. The following paragraphs will be a detour to address this pesky, but necessary point.

26. LOCKE, *supra* note 1, at 38.

27. *Id* (reporting based on an analysis of over 800 Nike suppliers in 51 countries).

28. Gary Hamel, *Moon Shots for Management*, HARV. BUS. REV., Feb. 2009, at 92.

29. BRUNO S. FREY, NOT JUST FOR THE MONEY: AN ECONOMIC THEORY OF PERSONAL MOTIVATION 118–19 (1997) (noting that "[i]ntrinsic motivation presents an important determinant of human behaviour").

30. The controversy about altruism revolves around the claim that there can never be a truly selfless act. Even when helping others and sacrificing oneself, if one were to obtain pleasure from that act, then that act is said to be "selfish." Similarly, if our morals and values are shaped, at least initially, by our society or some other external stimuli, then nothing can be considered as purely intrinsic.

The likes of Austin,[31] Kelsen,[32] Hart,[33] Weber,[34] Dworkin,[35] Posner,[36] and many other prominent scholars have offered extensive explanations in their own attempts to distinguish laws from social norms and morals. This contribution, however, aspires to do no such thing nor will it replicate their discussions here, as that is not the intended aim of this contribution. Only to the extent that this contribution considers the reliance on legal norms to produce different outcomes from relying on social norms, the lessons from their debates will be bastardized and aggressively simplified to the following: Morals are internal or implicit standards of behavior that individuals possess that, when collectively manifested, become the foundation of societal or social norms. When these social norms are explicitly codified by governments or enforced by governing bodies, these social norms become laws or legal norms. At the same time, we must recognize that the law, as a normative instrument, can serve to influence what the accepted norms of the society ought to be, which in turn can influence our individual morals. In other words, the relationships between the law, social norms, and individual morals are quite incestuous and circular.

The difficulty in distinguishing legal norms from social norms, especially in the CSR context, derives from the fact that by requiring private actors to hold companies liable for otherwise voluntary codes, we are essentially asking private individuals to function as quasi-governing bodies, thus further blurring the distinction between legal norms and social norms. While regulatory enforcement of labor law by governments and the enforcement of CSR codes by private parties (through reliance on private law) are admittedly different things, they both share a common goal in this context that is ultimately to hold companies accountable and to improve the working conditions of the marginalized workers. It follows that the enforcement of a "legal norm," at least in our

31. *See generally* JOHN AUSTIN, THE PROVINCE OF JURISPRUDENCE DETERMINED (London, Prometheus Books 2000) (1832) (recognizing law, or more specifically positive law, as something that has power over an individual).

32. *See generally* HANS KELSEN, PURE THEORY OF LAW 8 (Max Knight, trans. 1967) (coining the term *Grundnorm* or "basic norm").

33. *See generally* H. L. A. HART, THE CONCEPT OF LAW 193 (1961) (stating that there is an inherent aspect of authority with the law as "those who would voluntarily obey shall not be sacrificed to those who would not").

34. *See generally* MAX WEBER, ECONOMY AND SOCIETY: AN OUTLINE OF INTERPRETIVE SOCIOLOGY 2 (Guenther Roth & Claus Wittich eds., 1978) (providing a general summary of economy and law, comparing social structures and normative orders).

35. *See generally* RONALD DWORKIN, TAKING RIGHTS SERIOUSLY (1977) (arguing against the theory of rights proposed by Hart and introducing a new moral framework of rights).

36. *See generally* ERIC A. POSNER, LAW AND SOCIAL NORMS (2000) (offering a new model of the relationship between "legal and nonlegal mechanisms of cooperation").

CSR context, cannot be limited to the enforcement of codified norms by governments, but must also include instances when private actors emulate or serve the functions of a governing body through private law.

When compelling companies to be more socially responsible, we must further distinguish when private actors are relying on the law from when they are not. Private actors relying on private law instruments to hold companies accountable ought to be classified as enforcers of legal norms, whereas private actors compelling companies to behave in a socially responsible manner through nonlegal means (e.g., grassroots campaigns and staging boycotts) ought to be considered as instigators for change based on social norms. As a way of concluding this detour, for the duration of this contribution, legal norms are different from social norms in the sense that breaching legal norms brings about legally enforceable sanctions by governments or private actors fulfilling a role of a quasi-governing body (akin to them making a citizen's arrest), whereas breaching social norms does not bring about legally enforceable sanctions.

C. Social Norms & Intrinsic Incentives

The argument put forward before the necessary detour was that social norms can be more effective than legal norms for creating and fostering intrinsic motivations.[37] Related to this point, Eric Posner observed that "most people refrain most of the time from antisocial behavior even when the law is absent or has no force [because t]hey conform to social norms."[38] In addition, take into account the rather surprising amount of literature that lists the various benefits of social norms vis-à-vis legal norms. For example, a social norm is often seen as an effective tool in a variety of circumstances to achieve social welfare,[39] to prevent market failures,[40] and to solve collective action problems.[41]

---

37. To be clear, this is not to suggest that social norms are intrinsic prompts by nature. A valid argument could be made here that social norms can also function as extrinsic incentives as well. The ostracization that can come as a result of violating a social norm can just as well be considered as an extrinsic incentive.

38. POSNER, *supra* note 36, at 4.

39. *Cf.* George Akerlof, *The Economics of Caste and of the Rat Race and Other Woeful Tales*, 90 Q. J. ECON. 599, 617 (1976) (suggesting that those who adhere to social norms gain more societal benefits than those who break social norms); Kenneth J. Arrow, *A Utilitarian Approach to the Concept of Equality in Public Expenditure*, 85 Q. J. ECON. 409, 409 (1971) (reconsidering the concept of social welfare equality per se by proposing models to achieve output equality—maximization of the sum of individual utilities—of government expenditures).

40. *See* Jules L. Coleman, *Afterword: The Rational Choice Approach to Legal Rules*, 65 CHI.-KENT L. REV. 177, 187 (1989) (arguing that in close-knit markets, social norms can

Most important in our context, there is even evidence to show that individuals conform better to nonlegal norms than to legal norms.[42] It is this relatively informal or voluntary nature of social norms that is often said to be the reason why social norms are more conducive to trust building and collaboration when compared to legal norms. The subsection below will elaborate on this point further.

1. When Intrinsic Incentives Work

Having exhibited reasons for why social norms could be more conducive to fostering intrinsic motivation, we must now determine how social norms can lead to intrinsic incentives and in turn, how intrinsic incentives can work to reduce labor exploitations in the global supply chain. First, consider reciprocity as a social norm. Reciprocity has "power by virtue of a kind of social contract among peers founded on mutual respect. Thus, they are true norms."[43] In the supply chain context, this social norm could work as follows: If a buyer expects honesty and fair dealings from the suppliers, then the buyer must first do the same. In other words, they must demonstrate to the suppliers how to be socially responsible and show the suppliers how to do it right, not just demand compliance. The details of how this type of a collaborative relationship, one with a common shared goal, can improve the working conditions of the marginalized workers will be tabled until Section III of this Article. Suffice it to state here that reciprocity—a social norm—creates intrinsic motivation because if someone shows you kindness, it is in our nature to want to repay that kindness and it is this desire to reciprocate that creates a sense of purpose or what Sandel referred to as the high or good norm.[44] Needless to say, this type of an incentive is drastically different from the extrinsic motivations created by threats of legal sanctions. It is an internal sense of purpose and the

achieve desired efficiency without the need for legal oversight); *cf.* POSNER, *supra* note 36, at 8.

41. *See* EDNA ULLMANN-MARGALIT, THE EMERGENCE OF NORMS 22 (1977) (posing that collective action problems call for the emergence of social norms).

42. Steven Shavell, *Law Versus Morality as Regulators of Conduc*t, 4 AM. L. & ECON. REV. 227, 244 (2002) (arguing that "use of morality alone will be superior to use of law alone as long as the added expense of the law exceeds its modest marginal social value").

43. MICHAEL TOMASELLO, WHY WE COOPERATE 36 (2009) (summarizing arguments made by JEAN PIAGET, THE MORAL JUDGMENT OF THE CHILD (1932)).

44. *See* ROBERT B. CIALDINI, INFLUENCE: THE PSYCHOLOGY OF PERSUASION 17 (rev. ed. 2007) (laying out the rule of reciprocity); *cf.* EMILE DURKHEIM, THE DIVISION OF LABOR IN SOCIETY 97 (Steven Lukes ed., W.D. Halls trans., 2014) (noting that "reciprocity is possible only where cooperation exists and this in turn does not occur without the division of labor").

notion of working toward a shared common goal that incentivize us to better adhere to the standards cast by the society rather than when we are just told to do something.[45]

2. When Intrinsic Incentives Fail

The previous subsection argued that informal sanctioning based on social norms can be, at times, a better enforcement mechanism than a set of rigid legal sanctions,[46] but this is not always the case. To be clear, extrinsic incentives are very much necessary, just as labor laws and regulatory enforcements are necessary, because intrinsic motivations alone will not necessarily fix all of the problems in the global supply chain. There will be times even when intrinsic incentives fail and times where it is appropriate to fall back on legal sanctions and other external devices. What is important to bear in mind is that the purpose of this contribution is not necessarily to refute the desirability and the viability of enforcing corporate codes through private law or to prevent consumers or buyers from doing so entirely. The objective of this contribution is merely to raise some of the latent repercussions associated with doing so and to present a possible alternative that, in some circumstances, could be more beneficial than the legal enforcement of voluntary codes of conduct. This objective is of great importance given that in recent times "there has been a gradual displacement of nonlegal regulation by legal regulation."[47]

With this in mind, the first section can thus be summarized as follows: To advocate for voluntary corporate codes to be enforced legally through private law mechanisms, essentially would be to treat codes of conduct as binding legal norms, which would require brands to police their supply chain as enforcers and for consumers to essentially make "citizen's arrests" in order to hold companies accountable. Advocating for the desirability of such measures would be to implicitly stand by and endorse the effectiveness of extrinsic incentives as behavior modifiers, which has been proven to be a less effective strategy than previously believed. The next section will show that not only is it a less than effective strategy, but possibly a counterproductive one as well.

---

45. *See* TOMASELLO, *supra* note 43, at 38 (arguing that children, even as young as three, observe and enforce social norms because they recognize they are part of a larger collective society).

46. *Cf.* Christine Horne, Sociological Perspectives on the Emergence of Social Norms, in SOCIAL NORMS, 3, 19 (Michael Hechter & Karl-Dieter Opp eds., 2001) (arguing that social norms are an effective control mechanism when informal social sanctions are present).

47. POSNER, *supra* note 36, at 8.

II. RISKS OF LEGALLY ENFORCING VOLUNTARY CODES

This section, as promised above, will provide additional reasons why converting otherwise voluntary codes of conduct into legally enforceable promises could be a less than desirable process by taking into consideration the possibility of the crowding out effect and the spillover effect that could arise from the conversion process.

A. When the Law Spills Over

A spillover effect occurs when one action creates seemingly unrelated or unintended consequences. For example, the typical carrot-or-stick type of extrinsic incentive system tends to have substantial negative effects in that it incentivizes unethical behavior.[48] For example, "[t]he very presence of goals [the carrot] may lead employees to focus myopically on short-term gains and to lose sight of the potential devastating long-term effects on the organization."[49] Similarly, a study of fifty-one corporate "pay-for-performance" schemes found that extrinsic motivations such as monetary incentives "can result in a negative impact on overall performance."[50] This phenomenon is just one illustration of a spillover effect, where the extrinsic incentive that was implemented rendered unintended and detrimental consequences counterproductive to the original goal.[51] This section will elaborate in more detail below about the spillover effects that can arise from taking corporate codes too seriously.

1. Substantiating the Spillover Effect

---

48. *See* Edward L. Deci et al., *A Meta-Analytic Review of Experiments Examining the Effects of Extrinsic Rewards on Intrinsic Motivation*, 125 PSYCHOL. BULL. 627, 659 (1999) ("[R]eward contingencies undermine people's taking responsibility for motivating or regulating themselves."); PINK, *supra* note 21, at 50 ("[G]oals imposed by others—sales targets, quarterly returns, standardized test scores, and so on—can sometimes have dangerous side effects.").

49. Lisa D. Ordóñez et al., *Goals Gone Wild: The Systematic Side Effects of Over-Prescribing Goal Setting* 7 (Harvard Bus. Sch., Working Paper No. 09-083, 2009), http://www.hbs.edu/faculty/Publication%20Files/09-083.pdf.

50. *When Performance-Related Pay Backfires*, LONDON SCH. ECON. & POL. SCI. (June 24, 2009), http://www.lse.ac.uk/newsAndMedia/news/archives/2009/06/performancepay.aspx.

51. *See* Gunther Teubner, *Juridification: Concepts, Aspects, Limits, Solutions*, *in* JURIDIFICATION OF SOCIAL SPHERES: A COMPARATIVE ANALYSIS IN THE AREAS OF LABOR, CORPORATE, ANTITRUST AND SOCIAL WELFARE LAW 3 (Gunther Teubner ed., 1987) (arguing that legal intervention in highly complex situations could produce a "regulatory trilemma," where the legal intervention can be ineffective, counterproductive, and incoherent).

Section I of this contribution already alluded to the fact that enforcing code violations with legal sanctions could create perverse outcomes that end up punishing workers or removing continued incentives for factories to improve working conditions.[52] For example, seeking damages from the supplier or terminating contractual relationships with suppliers that failed to meet the code could lead to a reduction of the supplier's already slim profit margins. This could force the already budget-constrained supplier to fire its employees and further marginalize them.[53] Another typical example of a spillover is the emergence of temporary workers and independent contractors. In order to circumvent providing benefits and protections entitled to employees, many businesses hire contractors rather than employees. For example, "[m]any Mexican electronics suppliers hire agency workers on multiple sequential short-term contracts so that workers fail to accumulate employment benefits afforded to full-time workers as required by the national labor code."[54] While some jurisdictions have laws that explicitly prohibit this type of questionable corporate behavior, it is often difficult to enforce them. As a result, laws intended to empower and protect workers create a spillover effect of sorts, where the workers get hired through sequential short-term contracts or as mere contractors. These are classic examples of when attempting to improve the working conditions of marginalized workers could exacerbate the problem. This, in a nutshell, is the spillover effect, which also reaffirms the risks of extrinsic motivators. The following subsection will address other, more latent examples of the spillover effect and its risks in the CSR context.

a. Kasky v. Nike Example

In *Kasky v. Nike*, Nike was sued for making allegedly false statements about the working conditions of its supply chain to the public.[55] The thrust of Kasky's argument was that "[t]o the extent that MNCs [multinational corporations] are using their adherence to voluntary codes as a means of assuaging public concerns about their activities abroad, then MNCs should be prepared to have those claims

52. LOCKE, *supra* note 1, at 38–39.

53. Paul Krugman, *Reckonings; Hearts and Heads*, N.Y. TIMES (Apr. 22, 2001), http://www.nytimes.com/2001/04/22/opinion/reckonings-hearts-and-heads.html (citing Oxfam findings that displaced child sweatshop workers ended up with worse jobs, became unemployed, or were forced into prostitution).

54. LOCKE, *supra* note 1, at 160.

55. Kasky v. Nike, Inc., 27 Cal. 4th 939, 946–48 (Cal. 2002).

scrutinized as a matter of consumer protection laws."[56] The facts of the case are as follows: Since 1993, Nike had claimed that it "assumed responsibility for its subcontractors' compliance with applicable local laws and regulations concerning minimum wage, overtime, occupational health and safety, and environmental protection."[57] Between 1996 and 1997, however, serious labor exploitations were discovered in factories subcontracted by Nike in countries such as China, Vietnam, and Indonesia.[58] In response to these allegations and adverse publicity, Nike denied these claims wholeheartedly:

> Nike and the individual defendants said that workers who make Nike products are protected from physical and sexual abuse, that they are paid in accordance with applicable local laws and regulations governing wages and hours, that they are paid on average double the applicable local minimum wage, that they receive a 'living wage', that they receive free meals and health care, and that their working conditions are in compliance with applicable local laws and regulations governing occupational health and safety. [59]

This denial, which was published in a press release and circulated in newspapers nationwide, served as the basis of Kasky's claim. Kasky argued that Nike made these statements "for the purpose of maintaining and increasing [Nike's] sales and profits"[60] and that Nike's statements were made "with knowledge or reckless disregard of the laws of California prohibiting false and misleading statements."[61] Kasky initially brought the suit against Nike on behalf of the general public of the state of California, under California Business and Professions Code Sections 17204 (unfair and deceptive practices) and 17535 (false advertising).[62] As a side note, it is worth noting that this case is the manifestation of one of Beckers's ideas where a private actor used

56. Sean D. Murphy, *Taking Multinational Corporate Codes of Conduct to the Next Level*, 43 COLUM. J. TRANSNAT'L L. 389, 431 (2005).

57. *Kasky*, 27 Cal. 4th at 947.

58. *Id.* (citing news reports that "workers were paid less than the applicable local minimum wage; required to work overtime; allowed and encouraged to work more overtime hours than applicable local law allowed; subjected to physical, verbal, and sexual abuse; and exposed to toxic chemicals, noise, heat, and dust without adequate safety equipment, in violation of applicable local occupational health and safety regulations").

59. *Id.*

60. *Id.*

61. *Id.* at 948.

62. *Id.* at 946–47.

private law instruments in order to hold a company accountable.[63] Again, this contribution does not contest that doing so would indeed hold companies more accountable but asks a different question of what impact this would actually have at the supplier/manufacturer level, where most of the violations are taking place.

In response to Kasky's claims, Nike filed a demurrer arguing that his suit was barred on the grounds of Nike's freedom of speech. Before the actual issue of false advertising could be debated at the Superior Court level, the case went to the Court of Appeal and subsequently to the California Supreme Court, where the pivotal issue became whether Nike's public statements—its speech—was protected under the First Amendment. The California Supreme Court ultimately held that "when a corporation, to maintain and increase its sales and profits, makes public statements defending labor practices and working conditions at factories where its products are made, those public statements are commercial speech that may be regulated to prevent consumer deception."[64] On appeal, this case went up to the United States Supreme Court, which initially granted *certiorari*, but the Court subsequently dismissed the writ as "improvidently granted."[65] In other words, the U.S. Supreme Court did not adjudicate on the substantive basis of Nike's free speech claim. Once the U.S. Supreme Court kicked the case back down to the California courts, the parties eventually decided to settle the case, the details of which the public was not privy to.

While this was indeed a "win" for Kasky, the spillover effect from this victory was that companies like Nike learned from this "mistake" and since then have generally been more careful about making definitive public statements about their corporate social responsibility.[66] Rather than definitively stating that "we *are* socially responsible," many

63. *See* Fabrizio Cafaggi, *The Regulatory Functions of Transnational Commercial Contracts: New Architectures*, 36 FORDHAM INT'L L.J. 1557, 1562 (2013) (noting that "[w]hen suppliers commit to comply with social standards related to children, gender, or general labor conditions and these obligations have become part of the commercial contract, a breach may refer to the 'commercial' contract with the buyer, to the employment contract, and to the code of conduct imposing obligations and the certification regime that attests compliance with fair labor conditions").

64. *Kasky*, 27 Cal. 4th at 969.

65. Nike, Inc. v. Kasky, 539 U.S. 654, 657–58 (2003) (holding that "(1) the judgment entered by the California Supreme Court was not final within the meaning of 28 USC §1257; (2) neither party has standing to invoke the jurisdiction of a federal court; and (3) the reasons for avoiding the premature adjudication of novel constitutional questions apply with special force to this case").

66. McBarnet, *supra* note 10, at 42 (observing that "[a]s a result of *Kasky v. Nike*, and similar legal developments elsewhere, business organizations have been put on notice to be wary of their CSR PR, and perhaps to be conscious that their voluntary codes of conduct and CSR reports may prove less voluntary than they thought.").

codes of conduct and public statements uttered in the aftermath of cases like *Kasky* display a certain level of temerity. Nike's Code of Conduct, for example, employs the following phrases: "there is no finish line," "our work with contract factories is always evolving," and "[i]t is our *intention* to use these standards . . . ."[67] The "promises" laid out in Nike's Code of Conduct are intended to improve its reputation but have been carefully crafted so that Nike will not be held liable in the event that they fail. If companies are careful in this way, it makes it more difficult for consumers to make claims based on reasonable reliance or false advertisement. The lesson here is that when introducing legal sanctions or the threat thereof in regard to compliance to codes, the spillover effect could be that companies, in the long run, will simply stop making statements that could put them in hot water or forget about implementing a CSR code all together.

To illustrate this latter point, there is an interesting example arising out of Germany. In April of 2010, the Hamburg Customer Protection Agency accused a German retailer, Lidl, of unfair competition, based on the fact that Lidl advertised certain products to be socially responsible when, in fact, its suppliers in Bangladesh were exploiting laborers.[68] The legal basis of the claim was the European Union's Unfair Commercial Practices Directive,[69] which prevents companies from making misleading claims to consumers that could unfairly advantage the business making unsubstantiated claims. Lidl eventually settled out of court and was forced to retract its ads promoting its social responsibility. The spillover from all of this was that Lidl has yet to implement a new CSR code. This example not only shows that sometimes consumers going after a company to hold them accountable could lead to that company abandoning its corporate code in its entirety but, moreover, raises the interesting point on perverse incentives. If we were to take corporate codes too seriously by going after companies that implement codes, the public will essentially be targeting companies that are at least trying to be socially responsible while not targeting companies that do not even bother to be socially responsible. While cases like *Nike* and *Lidl* might be boasted as a

67. *Nike, Inc. Code of Conduct*, NIKE, INC., http://about.nike.com/pages/transform-manufacturing (follow "Code of Conduct" hyperlink) (last visited Sept. 22, 2016) (emphasis added).

68. *See* Ramon Mullerat, *International Principles and Rules—Current Legal and Soft Law Initiatives*, *in* GLOBAL BUSINESS AND HUMAN RIGHTS: JURISDICTIONAL COMPARISONS 15, 37 (James Featherby et al. eds., 2011).

69. *See* Council Directive 2005/29, Unfair Commercial Practices Directive, art. 6(2)(b), 2005 O.J. (L 149) 22, 28 (EU) (stating that a company is bound "where the commitment is not aspirational but is firm and is capable of being verified, and the trader indicates in a commercial practice that he is bound by the code").

"victory" for the consumers by some, a key question remains unanswered: What impact did these so-called victories actually have on improving the working conditions of the marginalized workers?

b. The Benefit Corporation Example

Another argument to substantiate the spillover effect of legally enforcing codes of conduct is the reality that "extrinsic prompts deprive the individual of that chance to exhibit her intrinsic motivations to others, which, in turn, undermines the value to the individual of having intrinsic motives."[70] In other words, CSR measures such as codes of conduct and self-regulations "can place more responsible firms at a competitive disadvantage in international competition."[71] Take, for example, companies that incorporate as benefit corporations in the United States.[72] Incorporating as a benefit corporation requires a company to be transparent in regard to their social and environmental performance standards as well as to meet a higher legal accountability standard.[73] This essentially means putting social objectives on par with financial objectives explicitly in its corporate charter, which must state a specific public purpose that the corporation will pursue. These requirements add a heighted sense of accountability for the directors whose fiduciary duty is no longer limited to maximizing profits but to do so in a socially responsible manner.

While one could argue that the emergence of the benefit corporation and the enforcement of codes of conduct through private law instruments can harmoniously coexist—possibly even be mutually beneficial—there is a lingering concern of a possible spillover. Incorporating as a benefit corporation, a voluntary choice that companies make, is more likely to be a decision based on intrinsic motivation rather than extrinsic motivation. It is unquestionably a more serious commitment to being socially responsible compared to non-benefit companies that simply implement a corporate code. While benefit corporations require both their shareholders and directors to treat social responsibility on par with their other fiduciary duties,

70. Atiq, *supra* note 14, at 1081; *see also* Bruno Frey, *Crowding out and Crowding in of Intrinsic Preferences*, *in* REFLEXIVE GOVERNANCE FOR GLOBAL PUBLIC GOODS 75, 78 (Eric Brousseau et al. eds., 2012).

71. DAVID VOGEL, THE MARKET FOR VIRTUE: THE POTENTIAL AND LIMITS OF CORPORATE SOCIAL RESPONSIBILITY xvii (paperback ed. 2006).

72. Currently, benefit corporation legislation is effective in over half the country and numerous states are working to pass legislation. *FAQ*, BENEFIT CORPORATION, http://benefitcorp.net/faq (last visited Sept. 22, 2016).

73. B LAB, B CORPORATION 2012 ANNUAL REPORT 6 (2012) https://www.bcorporation.net/sites/all/themes/adaptivetheme/bcorp/pdfs/BcorpAP2012_Web-Version.pdf.

companies not registered as a benefit corporation hold profit as their primary objective. The problem, as hinted earlier, is that legalizing corporate codes could place more responsible firms—the benefit corporations of the world—at a competitive disadvantage.[74]

For instance, when the public goes after some non-benefit companies that supposedly violated their corporate codes, this creates an appearance, at least, that the companies the consumer watchdogs did not go after are legitimate or that they are socially responsible. If these companies can be perceived as being socially responsible, without actually incorporating as a benefit corporation, benefit corporations might lose out on the recognition that they rightfully deserve. The spillover here is that by legitimizing a possible "imposter," companies that are intrinsically motivated (i.e., benefit corporations) could be put at a competitive disadvantage vis-à-vis companies that are only extrinsically motivated. This spillover is also an example of a crowding out effect, which will be addressed in the next subsection. To summarize the point on the spillover effect, "taking corporate codes seriously" could make it more difficult for the public to distinguish companies that are intrinsically motivated from those that are extrinsically motivated to the detriment of companies that are actually trying to make a meaningful change.

2. The Spillover Effect in the CSR Context

One of the reasons why voluntary codes proliferated in the first place was exactly because of their nonbinding nature. The spillover effect for enforcing them legally could be the reduction of CSR initiatives and their desirability. While some might consider the voluntary nature of many CSR measures to be its weakness, this perceived "weakness" is also its primary strength.[75] It is because of this voluntary nature that intrinsically motivated companies can signal to the public that they are being socially responsible. By making compliance to these codes essentially mandatory, spillovers are bound to happen. The next section will discuss a related phenomenon of the crowding out effect and how the proposal to take codes of conduct seriously could render even more detrimental side effects.

B. When the Law Crowds Out

74. VOGEL, *supra* note 71, at xvii.

75. *See, e.g.*, JAN EIJSBOUTS, CORPORATE RESPONSIBILITY, BEYOND VOLUNTARISM: REGULATORY OPTIONS TO REINFORCE THE LICENCE TO OPERATE 11–17 (2011).

The crowding out effect, in its most basic sense, is the phenomenon where an increase in one aspect of regulation leads to the decrease (thus, the crowding out) in other types of regulation. Sandel, for example, observed that "economists often assume that markets do not touch or taint the goods they regulate. But this is untrue. Markets leave their mark on social norms. Often, market incentives erode or crowd out nonmarket incentives."[76] In the CSR context, this can be seen in two different but related ways: first, an increase in the number of legal sanctions or the enforcement of codes of conduct by relying on private law can crowd out or reduce the impact of nonlegal or social norms; and second, the introduction of extrinsic incentives can similarly crowd out intrinsic incentives.

Here are some examples: The previous section on the spillover effect suggested that legalizing the enforcement of codes of conduct could crowd out or reduce the incentive for companies to incorporate as a benefit corporation. Another classic example of this is that CSR, as a self-regulatory mechanism, could prevent governments from taking necessary steps to create regulation and deflect regulatory scrutiny in the hopes that CSR measures can address the problem.[77] The converse of this is equally true: if there is an excess of legal sanctions, nonlegal norms could be crowded out. This section will illustrate more examples of the crowding out effect and attempt to substantiate how it can pose serious risks that could undermine the entire thought behind the legalization of voluntary codes.

1. Substantiating the Crowding Out Effect

There is plenty of evidence to support the claim that legal or extrinsic sanctions can be ineffective, if not down right detrimental, from a diverse field of studies ranging from sociology, behavioral psychology, and even evolutionary anthropology. In the words of evolutionary anthropologist Michael Tomasello, "[i]n the case of an intrinsically rewarding activity, external rewards undermine this intrinsic motivation . . . ."[78] Political philosopher Michael Sandel concurs that "[w]hen people are engaged in an activity they consider

76. SANDEL, *supra* note 13, at 64; *see also*, DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS 68–69 (describing how monetary incentives can corrupt intrinsic incentives and how market norms can crowd out or push out social norms).

77. *See* LOCKE, *supra* note 1, at 157; *see also* VOGEL, *supra* note 71, at 162–66.

78. TOMASELLO, *supra* note 43, at 9–10 (observing that children who are initially rewarded are less likely to help in a repeated situation than are children who are not rewarded initially due to what is known as the "overjustification effect").

intrinsically worthwhile, offering them money may weaken their motivation by depreciating or 'crowding out' their intrinsic interest or commitment." [79] Sociologist, Christine Horne, has similarly admonished that "the existence of a strong legal system inhibits informal sanctioning and weakens the social relations that facilitate the exercise of such control."[80] Legal philosopher Emad Atiq has noted that laws are by nature extrinsic prompts that "compete with or 'crowd out' the agent's intrinsic . . . motivation to engage in an activity."[81] Behavioral economist Dan Ariely observed that "introducing market norms into social exchanges . . . violates the social norms and hurts . . . relationships."[82] Daniel Pink, a former aide to Secretary of Labor Robert Reich (subsequently turned motivation guru), succinctly described the crowding out effect in the following manner:

> Say you take people who are motivated to behave nicely, then give them a fairly weak set of ethical standards to meet. Now, instead of asking them to 'do it because it's the right thing to do,' you've essentially given them an alternate set of standards—do this so you can check off all these boxes.[83]

The most impressive collection of research conducted on the subject of the crowding out effect was led by Edward Deci, one of the pioneers in this field, who found that the crowding out effect has been tested and the results replicated in a meta-analysis of 128 studies over three decades. Deci concluded that "the crowding out effect is a robust phenomenon, and many kinds of tangible rewards for socially desirable behavior undermine intrinsic motivation."[84] In addition, there is even more empirical research that substantiates the observation that individuals lose their intrinsic motivations for engaging in an activity when they are successfully induced to participate in it for extrinsic

79. SANDEL, *supra* note 13, at 122; *see also* Deci et al., *supra* note 48, at 628–29.

80. Horne, *supra* note 46, at 20; *see also* Christine Horne, *Community and the State: The Relationship Between Normative and Legal Controls*, 16 EUR. SOC. REV. 225, 236–37 (2000).

81. Atiq, *supra* note 14, at 1080.

82. ARIELY, *supra* note 76, at 76.

83. PINK, *supra* note 21, at 139–40 (citing *Evaluating Your Business Ethics*, GALLUP (June 12, 2008), http://www.gallup.com/businessjournal/107527/evaluating-your-business-ethics.aspx).

84. Atiq, *supra* note 14, at 1083 (citing Deci et al, *supra* note 48, at 627); *see also* PINK, *supra* note 21, at 37.

reasons.[85] The following subsection will replicate some of the more popular and most commonly cited examples.

a. Israeli Day Care Example

The Israeli daycare experiment,[86] a study conducted by Uri Gneezy and Aldo Rustichini, asked the question of "whether imposing a [monetary] fine on parents who arrived late to pick up their children was a useful deterrent."[87] The answer that the researchers found was "no, the fine [was] not a useful deterrent," but more alarmingly, the problem (of parents being late) got worse after the imposition of the fine. This phenomenon can be explained in the following way:

> Before the fine was introduced, the teachers and parents had a social contract, with social norms about being late. Thus, if parents were late . . . they felt guilty about it . . . and their guilt compelled them to be more prompt in picking up their kids in the future . . . . But once the fine was imposed, the day care center had inadvertently replaced the social norms with [legal] norms.[88]

---

85. *See* Atiq, *supra* note 14, at 1072; *see also* SANDEL, *supra* note 13, at 122–25 (2012) (citing a classic study of blood donation conducted by Richard Titmuss that illustrates markets crowding out non-market norms); RICHARD M. TITMUSS, THE GIFT RELATIONSHIP: FROM HUMAN BLOOD TO SOCIAL POLICY 314 (Ann Oakley & John Ashton eds. 1997) (noting that "commercialisation of blood and donor relationships represses the expression of altruism [and] erodes the sense of community . . ."); Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality*, 88 TEX. L. REV. 1151, 1151–52 (2010) (noting that in some cases offering monetary rewards to whistle-blowers led to less, rather than more, reporting of illegality); Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71, 72 (2003); Dan M. Kahan, *Trust, Collective Action, and Law*, 81 B.U.L. REV. 333, 338–39 (2001) (noting that "the advent of incentives will produce less, not more, of such [desirable] behavior"); Carl Mellström & Magnus Johannesson, *Crowding out in Blood Donation: Was Titmuss Right?*, 6 J. EUR. ECON. ASS'N 845, 857 (2008) (affirming the argument of Richard M. Titmuss that monetary compensation for blood donations crowds out the supply of blood and suggesting that the skepticism towards monetary compensation for blood donations seen in many countries is warranted).

86. *See generally* Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUD. 1 (2000) (presenting the results of an experiment in which parents were made to pay a fine if they were late to pick up their children from daycare and arguing that penalties may have the opposite effect on behavior than expected, which, if true, would cause the deterrence hypothesis to lose its predictive value).

87. ARIELY, *supra* note 76, at 76.

88. *Id.* at 76–77 (summarizing the research of Gneezy and Rustichini).

The daycare example substantiates the claim that social norms can, at times, be a more useful enforcement mechanism than stringent regulations or the imposition of legal or monetary sanctions. To come back to Sandel's earlier example about paying children to read books, it seems entirely possible, given this observation, that once the monetary incentives are gone, the children might be less inclined to read than before because their intrinsic incentives have been eroded.

b. Swiss Nuclear Waste Example

Another example demonstrating the crowding out effect is the Swiss Parliament's dilemma involving nuclear waste storage and its disposal. The Swiss Parliament needed to find a city where it could store and dispose nuclear waste. Social scientists, Bruno Frey and Felix Oberholzer-Gee, conducted a survey asking Swiss residents whether they would be willing to have the undesirable facility in their city.[89] A surprising 50 percent of the people said yes to this survey question in the absence of any extrinsic prompts, but when Frey and Oberholzer-Gee asked if they were willing to do so in return for a monetary compensation the yes response dropped to 25 percent.[90] This example, one of the most often cited examples by social scientists, demonstrates how extrinsic incentives can reduce the willingness of the populace to behave in a desirable manner. The researchers in explaining this result noted that "[e]mphasizing social norms and civic virtue [has] greater effect on encouraging" good behavior than "threatening individuals with legal sanctions."[91]

c. Honest Tax Reporting in Minnesota Example

The problem of increasing compliance with tax laws in the state of Minnesota also showed how cracking down on the people by increasing the enforcement of tax codes may not be the best behavior modifier as well. This study revealed that compliance to tax law increased, not when taxpayers were "threatened with information about the risks of punishment for noncompliance," but when they were "just told that more than 90 percent of Minnesotans already complied, in full, with

89. Bruno S. Frey et al., *The Old Lady Visits Your Backyard: A Tale of Morals and Markets*, 104 J. POL. ECON. 1297, 1302 (1996).

90. BARRY SCHWARTZ & KENNETH SHARPE, PRACTICAL WISDOM: THE RIGHT WAY TO DO THE RIGHT THING 192 (2010).

91. Atiq, *supra* note 14, at 1084 (citing to research of Richard D. Schwartz & Sonya Orleans, *On Legal Sanctions*, 34 U. CHI. L. REV. 274, 299 (1967)).

their obligations under the tax law."[92] The take away here is that threats of sanctions and reminders for their need to comply did not compel the taxpayers as much as the softer approach of simply letting people know that the majority of the others had already complied. Based on this finding, Sunstein and Thaler observed "either desirable or undesirable behavior can be increased, at least to some extent, by drawing public attention to what others are doing."[93] With this realization, can we honestly assume that legally enforcing otherwise voluntary corporate codes will be an effective solution to improve the working conditions of the marginalized workers?

2. The Crowding Out Effect in the CSR Context

In the words of the aforementioned Daniel Pink, "[t]he problem is that most business haven't caught up to this new understanding of what motivates us" and that "[t]oo many organizations . . . still operate from assumptions about human potential and individual performance that are outdated, unexamined, and rooted more in folklore than in science."[94] Unfortunately, many lawyers, legislatures, and academics seldom consider this fact either when advocating for new laws or encouraging the public to rely on laws to solve our collective problems. We must embrace the idea that there are other ways to resolve the labor exploitation problem in the supply chain because relying too much on the law will "reduce[] the likelihood that group members will impose social sanctions," which could bring about a better result.[95] If we take the observations mentioned in this subsection at face value, there ought to be serious hesitations about attempting to enforce otherwise voluntary codes of conduct through private law instruments. In sum, studies from eclectic and widespread disciplines confirm that not only do extrinsic motivators, such as monetary rewards or threats of legal sanctions, often fail to modify behavior (absent constant oversight and effective enforcement), but more alarmingly, they can even be detrimental to intrinsic motivations.

92. RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 67 (2009).

93. *Id.*

94. PINK, *supra* note 21, at 9.

95. Horne, *supra* note 46, at 20; *see also* Eric A. Posner, *The Regulation of Groups: The Influence of Legal and Nonlegal Sanctions on Collective Action*, 63 U. CHI. L. REV. 133, 136 (1996).

C. Obligatory Caveat

Obviously, companies and consumers are not all tardy mothers picking up their kids from daycare or taxpayers of dubious nature. However, the point about how we as human beings perceive social norms vis-à-vis legal norms or how we act based on intrinsic motivation versus extrinsic motivation is an applicable observation in this context. There are many situations when introducing legal norms to address a particular problem crowds out the social norms, which could reduce intrinsic motivations and ultimately exacerbate the problem.[96] Looking at the examples above, some might argue that companies do not fall victim to the crowding out effect, believing that a group of individuals is more reasonable and careful and thus will respond more logically to extrinsic incentives than individuals. There is evidence, however, to confront this particular view, as research shows that groups are just as susceptible to these effects, if not more.[97] "Groupthinking" and the discussions that take place in the boardrooms of companies by groups of individuals often produce unsatisfactory results. This is because "[f]ar too often, groups actually amplify . . . mistakes" made by individuals.[98]

In the interest of objectivity, however, it must be noted that not every action has a crowding out effect or a spillover effect. For example, it was stated earlier that external incentives work nicely for algorithmic or menial tasks and there is no crowding out effect observed in such cases.[99] This commentary acknowledges that extrinsic incentives can be a useful tool in various instances. However, as Simon Deakin acknowledges, "mandatory legal rules may not be well suited to some contexts,"[100] and, surely, the same can be said for the legal enforcement

96. *See* ARIELY, *supra* note 76, at 72–73.

97. *See* Geoffrey M. Hodgson, *Institutions and Individuals: Interaction and Evolution*, 28 ORG. STUD. 95, 111 (2007) (noting that "[i]ndividuals have habits; groups have routines . . . [which] are the organizational analogue of habits.").

98. CASS R. SUNSTEIN & REID HASTIE, WISER: GETTING BEYOND GROUPTHINK TO MAKE GROUPS SMARTER 2 (2015); *see also* IRVING L. JANIS, GROUPTHINK: PSYCHOLOGICAL STUDIES OF POLICY DECISIONS AND FIASCOES 7-9 (2d ed. 1982) (suggesting that groups are susceptible to biases and mistakes even more than individuals because of group-thinking).

99. *See* Edward L. Deci et al., *Extrinsic Rewards and Internal Motivation in Education: Reconsidered Once Again*, 71 REV. EDUC. RES. 1, 14 (2001) ("[R]ewards do not undermine people's intrinsic motivation for dull tasks because there is little or no intrinsic motivation to be undermined.").

100. Simon Deakin et al., *Do Labour Laws Increase Equality at the Expense of Higher Unemployment? The Experience of Six OECD Countries, 1970-2010* 4 (Univ. of Cambridge Faculty of Law Legal Studies, Working Paper No. 11, 2014); *see also* Simon Deakin, *Addressing Labour Market Segmentation: The Role of Labour Law* 1 (Int'l Labour Office Governance & Tripartism Dep't, Working Paper No. 52, 2013) ("The law largely reflects

of otherwise voluntary codes of conduct. In short, we must be careful about when to rely on extrinsic incentives and when not to, which brings us to the point of the next section.

III. STRATEGIC RELIANCE ON THE LAW

One of the two aims of this contribution was to shed light on some of the unintended externalities that can come about from legalizing voluntary corporate codes. Having presented some of these problems in the first two sections, this third section will now move on to the second goal of this contribution, which is to offer an alternative approach that could possibly minimize these risks.

A. The Goldilocks Problem

As noted above, extrinsic incentives are necessary at times, but not to the extent that they crowd out intrinsic incentives. Given this realization, we must be wary of any suggestions that advocate for more and more laws to compel compliance. Therefore, in a challenge akin to the one that confronted Goldilocks, we must choose or design an approach that does not rely excessively on extrinsic incentives or rely on intrinsic incentives alone. Instead, we must opt for the path that uses a more balanced approach. The introduction of the inverted-U curve in this context could be beneficial.

1. The Inverted-U Curve

Psychologists Barry Schwartz and Adam Grant observed that a great many things of consequence obey the inverted-U curve: "Across many domains of psychology, one finds that X increases Y to a point, and then it decreases Y . . . . There is no such thing as an unmitigated good. All positive traits, states, and experiences have costs that at high levels may begin to outweigh their benefits."[101] The concept of the inverted-U is closely related to the Kuznet's curve and the economic theory of diminishing marginal utility.[102] In the legal context, it can be

---

the economics forces and social norms which give rise to segmentation, but can amplify and perpetuate its effects.").

101. Adam M. Grant & Barry Schwartz, *Too Much of a Good Thing: The Challenge and Opportunity of the Inverted U*, 6 PERSP. ON PSYCHOL. SCI. 61, 62 (2011), *cited with approval in* MALCOLM GLADWELL, DAVID AND GOLIATH: UNDERDOGS, MISFITS, AND THE ART OF BATTING GIANTS 52 (2013).

102. JAMES A. GWARTNEY ET AL., MICROECONOMICS: PRIVATE AND PUBLIC CHOICE 132 (15th ed. 2015) (explaining the law of diminishing marginal utility as "[t]he basic economic

illustrated by the following example: If legal norms are introduced to a state of complete anarchy, some sense of order may be restored assuming that the legal norms can be enforced efficiently and fairly.[103] The addition of more legal norms (moving along the X-axis) may create additional benefits (moving up the Y-axis), but after passing the apex of the inverted-U curve, additional legal norms could become detrimental. Could it be possible then that legally enforcing otherwise voluntary corporate codes is the tipping point?

2. Enforcement of Code of Conduct & The Inverted-U Curve

Legally enforcing otherwise voluntary corporate codes as advocated by Beckers could indeed hold companies more accountable,[104] but this does not necessarily root out the worst forms of labor exploitation in the supply chain. Moreover, legally punishing suppliers or holding companies liable to a code that they never intended to be legally binding, as this contribution already noted, has dire consequences. Given these negative externalities, an argument could be made that Beckers's suggestion, if taken wholeheartedly or to the extreme, could push us past the metaphorical apex of the inverted-U curve; however, this question of where exactly the apex is located is outside the scope of this particular contribution. Ultimately, Beckers would likely concur that a more strategic use of both legal and social norms would be prudent in the long run. As John Ruggie also confirms, the best course of action for us would be to "motivate, activate, and benefit from all of the moral, social, and economic rationales that can affect the behavior of corporations…" and to "provid[e] incentives as well as punishments, identify[] opportunities as well as risks, and build[] social movements and political coalitions that involve representation from all relevant sectors of society . . . ."[105] Our approach, thus, needs to be a holistic one as a more "strategic use of the law" is necessary in order for us "to

principle that as the consumption of a product increases, the marginal utility derived from consuming more of it (per unit of time) will eventually decline").

103. The absence of law or government does not, however, mean that there will be no order. *See* POSNER, *supra* note 36, at 3 ("In a world with no law and rudimentary government, order of some sort would exist. So much is clear from anthropological studies. The order would appear as routine compliance with social norms and the collective infliction of sanctions on those who violate them, including stigmatization of the deviant and ostracism of the incorrigible.").

104. *See* BECKERS, *supra* note 9.

105. John Gerard Ruggie, *Business and Human Rights: The Evolving International Agenda*, 101 AM. J. INT'L L. 819, 839–40 (2007).

improve the way citizens conceptualize their obligations to each other."[106]

B. Capability Building Rather Than Monitoring & Punishing

When it comes to the relationship between the buyer and the supplier, suppliers, especially in developing economies, already "lack resources, technical expertise, and management systems necessary to address the root causes of compliance failures."[107] The reality of our supply chain is that buyers are not only demanding cheaper materials from their suppliers, but also requiring them to be produced in a socially responsible way, due to increasing external pressures from consumers and NGOs.[108] The consumers themselves also suffer from a similar type of dissonance where they want goods to be made in a socially responsible manner, but they are generally very cost-sensitive. As a result, buyers and suppliers are "often locked in a low-trust trap in which suppliers claim that brands are sending them mixed messages, insisting on faster cycle times, better quality, and lower prices while policing and admonishing them for poor working conditions."[109] What the buyers are expecting from their suppliers in many cases is the impossible, and adding threats of legal sanctions to comply with corporate codes does not make the impossible any more possible. What could benefit the suppliers is if the buyers focused on building relationships with the suppliers based on collaboration, mutual respect, and the aforementioned social norms (e.g., reciprocity), which is more conducive to creating and fostering intrinsic motivations.[110]

In what Thomas Nagel calls the "view from nowhere" mindset, in order to build a relationship based on mutual respect and collaboration, what is necessary is an empathetic process of "putting yourself in someone else's shoes," a step rarely taken by the buyers who only see

106. Atiq, *supra* note 14, at 1070.

107. LOCKE, *supra* note 1, at 78.

108. *See id.* at 38 (noting that "[w]hile sourcing departments continue to squeeze factories on price, compress lead times, and demand high-quality standards, compliance officers visit the factories and document the problems but do little to change the root causes underlying poor working conditions").

109. *Id.* at 124.

110. *See id.* at 18 (describing a collaborative buyer-supplier relationship to be one that is "based on a fundamental understanding that both the risks and the rewards of doing business together would be distributed more or less fairly between the parties; the gains would not be captured nor the losses borne by one or the party alone. It was this recognition and the positive spillovers it generated that created the real incentives for private firms to engage in the most effective private voluntary initiatives . . . ").

their suppliers as cogs in the manufacturing machine.[111] To put it differently, what we need more of are buyers that are willing to invest in building their suppliers' capabilities so that they can be socially responsible in the long run:

> Capability-building programs envision a mutually reinforcing cycle in which more efficient plants invest in their workers and that these more skilled and empowered employees, in turn, promote continuous improvement processes throughout the factory, rendering these facilities more and more efficient and therefore more capable of producing high-quality goods on time, at cost, in the quantities desired by ever-more demanding customers, while at the same time respecting corporate codes of conduct.[112]

It is this sense of a collective undertaking and working togetherness that this contribution posits as the prerequisites for modifying corporate behavior.[113] Rather than punishing suppliers even further for their failures or magically expecting them to offer unrealistically low prices while being in full compliance to their codes of conduct, the buyers must do more.

1. Auditors as Consultants Rather than Inspectors

Building this type of a relationship takes time and a significant amount of trust in an otherwise cutthroat business environment where buyers uproot and move entire operations from a supplier in one country to another, all to shed a few pennies. What is necessary in the end is a shift in management thinking and for the buyers to see their suppliers and their workers as assets, as something to be invested in in order to build trusting, collaborative relationships with shared goals and a common sense of purpose.[114] Labor exploitations of marginalized workers in the global supply chain can indeed be reduced, but only if the

111. *See generally* THOMAS NAGEL, THE VIEW FROM NOWHERE (1986) (discussing how human beings can consider the world from a "bird's-eye view" or an "agent-neutral role," that is, a different vantage point than their own experiences).

112. LOCKE, *supra* note 1, at 78.

113. *See* TOMASELLO, *supra* note 43, at 41, 57 (continuing to stress that there is "a uniquely human sense of 'we,'" which is a "sense of shared intentionality").

114. *See* Locke et al., *supra* note 18, at 13; *see also* Stephen J. Frenkel & Duncan Scott, *Compliance, Collaboration, and Codes of Labor Practice: The Adidas Connection*, 45 CAL. MGMT. REV. 29, 44–45 (2002).

"global buyers and their suppliers establish long-term, mutually beneficial relations and when various public (authoritative rule-making) institutions help to both support these mutually beneficial buyer-supplier relations and resolve a set of collective action problems that private actors cannot overcome on their own."[115] We need companies to not just say that they are being socially responsible or that they are trying by way of a corporate code, but to actually be more hands on with their suppliers.[116] In this sense, the buyers need to act more as consultants rather than inspectors.[117]

2. What the Consumers Can Do

In order to make the relationship between buyers and suppliers more collaborative, it becomes necessary for the consumers and other private actors to give these businesses some leeway as well. If consumers and NGOs were to enforce otherwise voluntary corporate codes by relying on various private law instruments in all instances, the risk is that the opportunity for the buyers and the suppliers to build mutually beneficial, collaborative relationships could be eroded. In addition, when consumers become watchdogs, which is not necessarily a bad thing in and of itself, there are possible spillovers as evidenced by cases such as Kasky and Lidl. For example, targeting companies that have corporate codes might create a perverse incentive problem of watchdogs going after companies that are actually attempting to be socially responsible, rather than targeting companies that do not care at all about being socially responsible. The point to be taken away here is that threats of legal sanction, while still an integral part of compliance, must be considered "more as a background condition or fallback mechanism, aimed at 'fostering' the joint problem-solving initiatives . . . ."[118] To simply add more and more legal norms in the hopes of compelling companies to follow their corporate codes would only push us past and down the apex of the inverted-U curve.

CONCLUSION

115. LOCKE, *supra* note 1, at 17.

116. *See* Frenkel & Scott, *supra* note 114, at 39.

117. *See* LOCKE, *supra* note 1, at 181 (suggesting that "[r]ather than act as 'inspectors' whose job focused primarily on uncovering Code of Conduct violations and punishing management for these infractions, these auditors acted more like consultants by engaging in joint problem solving, information sharing, and the diffusion of best practices that were in the mutual self-interest of the suppliers and aligned with the policies of global buyers").

118. *Id.* at 86.

This contribution started with the realization that public law cannot adequately deal with the problem of labor exploitation in the global supply chain, thus requiring the assistance from various private actors. The question presented in the introduction was to what extent private regulatory efforts ought to be backed by private law mechanisms and whether it would be desirable to convert otherwise voluntary codes of conduct into something legally binding. In an attempt to raise some concerns about "legalizing" codes of conduct in such a manner, Section I distinguished intrinsic incentives from extrinsic incentives and argued that intrinsic incentives were the prerequisites for making meaningful changes sustainable in the long run. To further validate the risk of taking corporate codes too seriously, Section II discussed how legalizing codes of conduct could lead to the crowding out of intrinsic motivations or how it could perversely incentivize companies to be reluctant about implementing a CSR framework for the fear of additional litigation. In light of these realizations, Section III suggested that rather than taking corporate codes too seriously and relying on threats of legal sanctions to make companies comply with their voluntary codes of conduct, the companies ought to try a more collaborative approach that focuses on social norms rather than legal norms. This was because in a number of situations actors often complied with social norms better than with legal norms and because social norms were more conducive to creating and fostering intrinsic incentives. Clearly, there is a dire need for public law to be better enforced, especially in the international context. While private actors are capable of using private law to emulate government regulators by auditing, monitoring, and sanctioning companies for breaching codes of conduct, the suggestion made in this contribution is that they should only do so strategically and after taking into consideration the possible repercussions. The consumers and the watchdogs should approach this issue by enabling the companies to take these extra steps, rather than by adding extra layers of extrinsic pressures, which could prove to be counterproductive in the long run.