



## Corporate Social Irresponsibility: A Challenging

A Rather Delicious Paradox: Social Responsibility and the Manufacture of Armaments

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# A RATHER DELICIOUS PARADOX: SOCIAL RESPONSIBILITY AND THE MANUFACTURE OF ARMAMENTS

N. A. J. Taylor

## ABSTRACT

*Purpose – To argue for the use of corporate social irresponsibility (CSI) proves far more useful in assessing arms makers' limits of responsibility in a different way altogether. By focusing on the negative 'externalities' – that is impact on society – we are able to examine the practice in the context of constitutive and regulatory norms (i.e. the accepted rules), as opposed to norms that are merely evaluative (i.e. moral) or practical (i.e. what's possible).*

*Methodology/approach – This chapter examines the investment policies, practices and procedures of a handful of Australian pension and sovereign wealth funds in relation to investment in the development and production of cluster munitions – a class of weapon banned under international law since August 2010.*

*Findings – The chapter finds that the negative externalities inherent in armaments manufacturing demand that institutional investors view such*

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*firms through a 'CSI lens', especially when tasked with identifying and developing strategies to account for emerging social norms such as the prohibition of cluster munitions.*

*Practical implications – The investor is advantaged by having at its disposal a roadmap for managing – though not necessarily predicting – emerging social norms. This is so for ethical, responsible and mainstream investment approaches, although is most readily compatible with investors who have pre-established exclusionary policies as well as effective implementation procedures.*

*Social implications – A CSI approach to investment in cluster munitions as outlined in this chapter benefits society by inducing economic actors, such as pension and sovereign wealth funds, to direct their capital in such a way as to minimize humanitarian and environmental harm.*

*Originality/value of chapter – Proponents of the social responsibility of business and investment have seldom assessed the makers of conventional armaments such as machine guns, attack helicopters and battle tanks. Fewer still have attempted to devise and implement such programs within firms. Simply put, the prevailing argument is that arms makers and their financiers are not capable of being socially responsible.*

**Keywords:** Arms makers; cluster munitions; conventional armaments; violent harm; international humanitarian law; corporate social irresponsibility

War, mechanization, mining and finance played into each other's hands. Mining was the key industry that furnished the sinews of war and increased the metallic contents of the original capital hoard, the war chest; on the other hand, it furthered the industrialization of arms, and enriched the financier by both processes. The uncertainty of both warfare and mining increased the possibilities for speculative gains: this provided a rich broth for the bacteria of finance to thrive on. (Lewis Mumford, *Technics and Civilization*, 1934)

Proponents of the social responsibility of business and investment have seldom assessed the makers of conventional armaments such as machine guns, attack helicopters and battle tanks. Fewer still have attempted to devise and implement such programs within firms, although a growing number of civil society groups have begun to identify those entities involved – both directly and indirectly – in the development, production and investment of 'controversial' weapons such as landmines and cluster

bombs (IKV Pax Christi and Handicap International and Netwerk Vlaanderen, 2010). Simply put, the prevailing argument is that arms makers<sup>1</sup> and their financiers are not capable of being socially responsible due to three unique characteristics. First, the producers of arms are commonly viewed as *agents of the state* due to its importance to maintaining national sovereignty, rather than independent actors with liability to manage the harm resulting from its products. Second, there is a belief that the manufacture of arms *necessitates a higher degree of opaqueness* than other industry groups due to national defence considerations. Third, the state plays a dual – and at times, conflicting – role as principal customer and regulator.

Whilst these three rocks in the road may be pushed aside,<sup>2</sup> I argue that the emerging concept of corporate social irresponsibility (CSI) proves far more useful in assessing arms makers' limits of responsibility in a different way altogether. By focusing on the negative 'externalities' – that is impact on society – we are able to examine the practice in the context of constitutive and regulatory norms (i.e. the accepted rules), as opposed to norms that are merely evaluative (i.e. moral) or practical (i.e. what's possible). Put another way, CSI effectively confines analysis to a relatively precise set of considerations, whilst a more traditional corporate social responsibility (CSR) approach necessitates choosing from a raft of potential implementation strategies and activities. Thus CSI provides a degree of specificity not offered by the more nebulous concept of CSR, as well as one that complements rather than competes with existing CSR programs and activities.

In arguing for the usefulness of CSI to institutional investors, I come to address a seemingly large paradox in the form of a small question: can arms makers be socially responsible? This chapter takes a small step toward answering that question by examining the investment policies, practices and procedures of a handful of Australian pension and sovereign wealth funds in relation to investment in the development and production of cluster munitions – a class of weapon banned under international law since August 2010. The case selection is especially significant since the international *Cluster Munitions Convention* is the most ambitious disarmament and humanitarian treaty of the last ten years, and the Australian investment industry – with A\$1.4 trillion in assets – is the fourth largest in the world. Whilst no Australian firm is in the top 100 manufacturers of conventional weapons globally (Jackson, 2010), Australian banking and financial institutions are among the largest investors in such companies overseas. By focusing on the Australian experience, this chapter explores the 'dilemma' institutional investors face when the positions of domestic governments do not explicitly prohibit direct and indirect investment as

has been done in other markets such as New Zealand, United Kingdom, Germany, France, Ireland, Holland, Luxembourg, Belgium, Switzerland, Lebanon, Mexico, Norway and Rwanda.

Drawing on theoretical discussions in international relations as well as critical studies of CSR, I find that the negative externalities inherent in armaments manufacturing demand that institutional investors view such firms through a ‘CSI lens’, especially when tasked with identifying and developing strategies to account for emerging social norms.

## CHARACTERISTICS OF THE ARMAMENTS INDUSTRY

The phrase ‘armaments industry’ is a misnomer: it is not a distinct industrial sector,<sup>3</sup> but rather a loose collection of firms operating in a number of disparate industry and sub-industry groups such as: aerospace and defence, electronics, semiconductors, information technology and ship-building. In addition, very few companies operate solely for military purposes, either deriving a significant proportion of their revenue from civilian goods, or producing ‘dual-use’ components that have both a military and civilian application. Despite widespread arguments to the contrary, the marriage of the military and industry was, in fact, an observed phenomena as early as 1897, when founder of the modern human rights movement Jean Henri Dunant, predicted that:

Everything that makes up the pride of our civilisation will be at the service of war. Your electric railroads, your dirigibles, your submarines... telephones... and so many other wonderful inventions, will perform splendid service for war. (Wallbank 1970, p. 343)

Today there are thousands of companies that may be classified as being in the ‘armaments industry’, albeit to varying degrees and in any number of ways. For example, Boeing is widely known as makers of commercial aircraft, however the firm also derive around half of its A\$60 billion revenue from military contracts. The structure of these businesses is such that any individual firm’s suppliers, operations and functions are likely to be located in different states. For this reason, it remains especially difficult for investors to precisely identify and implement policies that require the targeting – either through exclusion or engagement – of specific stocks or sectors as is common in responsible business and investment programs.

A number of national governments have begun disclosing high-level information on their domestic activity in this area, however significant gaps in publicly available information remain. For instance, there is no single document published by the US government on its development and production of conventional armaments, despite having the highest level of government expenditure, the greatest volume and value of exports, and the largest number of private companies of any state in the world. Instead, some basic information about the scale and scope of the arms production is made available along with other major sectors in the Annual Industrial Capabilities Report to Congress that has been published annually since 1996. Disclosure is slightly more forthcoming in parts of Europe, with the British and French publishing comprehensive stand-alone financial and employment data from 1992 to 1997 respectively. In the absence of regular reporting cycles, prior to a review of defence procurement in 2010, the Australian government last commissioned a bespoke survey of domestic activity in the mid-1990s as part of a broader strategic review.

In response, civil society groups and scholars have increasingly called for greater governmental and intergovernmental transparency through voluntary reporting instruments such as the Stockholm International Peace Research Institute's (SIPRI) Arms Industry Database or the UN Register of Conventional Arms. However, the information contained in these databases is incomplete and unverified. There is therefore a high degree of complexity and opaqueness that must be overcome when assessing the limits of responsibility of arms makers.

## **THE LIMITS OF RESPONSIBILITY FOR INSTITUTIONAL INVESTORS**

At \$1.4 trillion, Australia has the fourth-largest investment market in the world – thanks largely to the 9 per cent employee superannuation (pension) guarantee. Pension funds control about 75 per cent of Australia's investment capital and will do so while this compulsory system remains. And so despite employing a number of external service providers to advise, implement and assess the performance of the fund, pension funds are quite literally at the heart of the investment markets, and their actions are carefully and deliberately governed by a system of trust law.<sup>4</sup>

Historically, investment approaches that attempt to marry socially responsible principles – whether they have been ‘morally’, ‘religiously’ or ‘sustainability’ based – have been thought to contradict pension fund trustees’ fiduciary responsibility to act in the ‘best interests’ of its members (Kinder, 2005). The courts in Australia (as well as in the United Kingdom, which has the most similar legal system) by trustees have been adamantly opposed to the application of so-called ‘non-financial’ criteria to investment decisions.<sup>5</sup> This derives from the fundamental principle of trust law that states trustees must exercise their powers for a proper purpose (i.e. the purpose for which the power was granted).<sup>6</sup> In a trust whose purpose is to provide financial benefits to its beneficiaries, the purpose of the investment power can be none other than to augment, if possible, the value of the financial benefits to those members.<sup>7</sup>

The courts have been particularly intent on recognizing the moral plurality of Anglo-Australian society, counselling strongly against the incorporation of moral prejudice into fiduciary decision-making.<sup>8</sup> Collateral benefits, such as may satisfy some form of moral imperative, may accrue, but trustees must first and foremost pursue the purpose of the trust. Some links in this chain of logic are enshrined in statute in Australia. Section 52(2)(c) of *Superannuation Industry (Supervision) Act 1993* (SIS) provides that trustees must act in the ‘best interests’ of their members, which is interpreted to mean their best financial interests. Section 62 of SIS requires that the ‘sole purpose’ of a superannuation fund is to be the provision of benefits to members upon their retirement. Finally, section 52(2)(b) requires that a trustee exercise ‘the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide’.

There is however a broader range of factors that must affect the quality of the decision process and those that relate to the motives of the trustee. As regards to the motivation for the decision, there are five central considerations. First, the investment power must be exercised in the ‘best interests’ of the members, which is interpreted to mean their financial best interests.<sup>9</sup> Second, trustees cannot permit consequential, collateral benefits to prejudice their pursuit of the trust’s purpose. Third, the connection between the purpose and the benefit to the beneficiary must be material and direct. ‘Speculative and remote’ benefits, such as the impact of a single superannuation fund on the economy, will not suffice. Fourth, trustees are required to act impartially in balancing the interests of different members

of their fund. And fifth, the trustee may be required to rebut an assertion that the decision to pursue a socially responsible approach was motivated by some improper purpose, such as the furtherance of union policy (as in *Cowan v Scargill*) or some personal moral or ethical ground (as in *Harries v Church Commissioners*).

Commensurately, the quality of the decision process may be affected by a further three factors. First, Section 52(2)(b) of the SIS Act restates the general law principle that trustees must be able to demonstrate that they took due care and exercised appropriate levels of skill and diligence in coming to their decisions.<sup>10</sup> This means that any investment strategy chosen by a trustee must be founded on objective evidence, which has been rigorously analysed and carefully considered by the trustee. Second, trustees are required to give explicit consideration to whether their decisions are in the interests of their beneficiaries.<sup>11</sup> Third, the courts are highly unlikely, therefore, to participate in a determination of the relative merits of different investment strategies, so long they possess some basic level of plausibility and the procedural elements (independence, impartiality, loyalty, prudence, objectivity, care/skill/diligence etc.) are satisfied.

Hence Australian trust law is unlikely to impugn an investor which adopts a, broadly defined, 'socially responsible' investment approach, so long as the strategy is: carefully considered, designed and implemented; not expected by the trustees to prejudice the financial outcomes for members on retirement; and not polluted by outside motivations. Thus a strategy that is based on legal and financial theory norms will satisfy an Australian court. Examinations of the legal constraints on trustees in regards to socially responsible investment approaches are well developed and many, suffice to say, there are two predominant financial constraints on institutional investors. First, it is difficult to empirically prove the effect of CSR programs, and at best evidence suggests the impact on investment performance is statistically insignificant. Second, the ability to pursue a CSR policy may signal certain things about the company (stability, long term focus etc.) that may be the actual drivers of corporate performance. That is, CSR may be the result, not the cause of any above average corporate performance (Camejo, 2002). Less explored in the literature are those strategies based on irresponsible action, as defined by illegality. I now review the critical studies of CSR and traditional CSR literature that does address arms makers, followed by an examination of the 'cluster munitions dilemma' in Australia.

## APPROACHING THE TASK OF INVESTING THROUGH THE IRRESPONSIBILITY PARADIGM

An alternate strategy that the above analysis did not assess against the demands of the court is the inverse yet complementary concept of CSI. Based not on moral or practical norms, but rather constitutive and regulatory ones, strategies and practices based on CSI offer institutional investors specificity rather than an open-ended raft of environmental, social and governance concerns (Armstrong, 1977). This is because what is considered illegal is also likely socially irresponsible, or put another way: vice is finite, whilst the means and ends of virtue are infinite (Boatright, 2000). According to some research, the threshold of the law is likely to have significant impact on the concentration of business activity, especially in industries without retail customers where there is comparatively little 'reward for virtue' (Vogel, 2005). A number of meta-analysis into socially responsible and ethical investment approaches (Donald & Taylor, 2008), as well as traditional CSR strategies (Griffin & Mahon, 1997), demonstrates statistically insignificant returns. And yet a similar study of illegal and socially irresponsible corporate behaviour found a significant economic performance penalty (Frooman, 1997).

In one of the very few attempts to apply CSR criteria to arms makers, Byrne inadvertently comes close to advocating for a CSI approach when he suggests that there is a 'need to reconsider the justification for assigning limited liability to any corporation regardless of its products negative externalities' (Byrne, 2007, p. 213). Traditionally, CSR programs and frameworks have focused on aspirational and moral virtues of human rights and society. For instance, the UN Global Compact, formed in 1999, draws on a range of international conventions regarding environmental, social and governance issues such as the United Nations Declaration of Human Rights (1948) that is a set of aspirational goals rather than a defined set of laws. Similarly, both the Interfaith Centre for Corporate Responsibility (ICCR) formed in 1971 and the 1993 Interfaith Declaration on Business Ethics attempted to codify 'the shared moral, ethical and spiritual values' that must be imbued within business according to the three Abrahamic traditions: Judaism, Christianity and Islam. Yet arguably these initiatives have led to lasting and meaningful change in business behaviour.

Since the 2003 War in Iraq, there have been additional efforts to address the role of business in society, especially as it relates to human

rights. Taking a distinctly legalistic view, the Business & Human Rights Resource Centre was formed as a collaborative partnership between Amnesty International and various academic institutions and practitioners around the world, and which has come to house the work of the United Nations Special Representative of the Secretary-General on Business & Human Rights, Professor John Ruggie, who was appointed in 2005 following the failure of the 2003 *Norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights*, in part as a result of its normative ‘privatisation’ of corporate responsibilities under international law in which the classical view of legal personality – that being state-centric – was questioned. However the discussions that took place proceeding the failed norm were significant: it was the first time that States – which bear the primary obligation for the realization of human rights – recognized that business must also play its part.

The issue of state sovereignty and responsibility are the very basis of public international law; international law is primarily concerned with the rights and duties of states, not of market actors in their jurisdiction (Malanczuk, 1997). Although there exists public and private international law, the applicability of international laws to market actors such as corporations and investment capital providers is highly contested. In general, the responsibility falls with the state for the behaviour of all actors within its jurisdiction (i.e. state boundaries). However the application of that responsibility, between different issues and different nations varies widely as does the duty to ensure compliance in the instance of extraterritoriality. One of the central issues of international law as it relates to non-state actors is the fact that there exist 192 nation states and over 80,000 multinational corporations, which in turn have commercial relationships with millions of affiliates and suppliers all over the world.

However the ‘solution’ presented by CSI is incomplete: it explicitly relies upon the formation of domestic legislation (which, by its very nature varies between states) and the acceptance of international laws and principles. Therein lies another gap. At present no international law exists that places obligations on market actors directly – to do so would require the formation of a treaty. The UN Secretary-General Special Representative on Business and Human Rights John Ruggie reasons that there are four drivers why such a development is unlikely to materialise.<sup>12</sup> First, there exist a raft of cultural, religious and civilizational differences between states that have not been resolved in order to establish a truly universal set of human rights, and therefore it is unlikely this will occur based on the initiative of

market actors such as corporations and investors. Second, in order to reach agreement, the standards of such a treaty are likely to be lower than the standards set in the myriad of existing treaties concerning humanitarian or human rights standards. Third, enforcement would likely be left to nation states and result in variable standards between them. Forth, such significant treaties are complex matters to resolve, and the diversified and global structure of modern economic actors further exacerbates the prospect of formulating a binding instrument. Indeed, as United Nations Special Representative of the Secretary-General for Business & Human Rights, Professor John Ruggie stated previously:

... the root cause of the business and human rights predicament today lies in the governance gaps created by globalization – between the scope and impact of economic forces and actors, and the capacity of societies to manage their adverse consequences. (Ruggie, 2009, p. 3)

### **THE ‘CLUSTER MUNITIONS DILEMMA’ FOR AUSTRALIAN INSTITUTIONAL INVESTORS**

A cluster bomb is a weapon that has inside multiple – often hundreds – of small explosive sub-munitions or ‘bomblets’ that are dispersed over an area the size of several football fields from either the air or ground. As a result, the final location of each bomblet is impossible to control for those deploying them, and so whom they maim or kill is both unknown and indiscriminate. Some bomblets are even designed to look like soft drink cans, hockey pucks or tennis balls. As a result, the victim of a cluster munition could equally be a soldier, an innocent woman or a small child – later that day, in a week, or ten years. In Laos an estimated 50–70 million bomblets are still killing people over 35 years after they were dropped. In fact, research conducted by [Handicap International \(2006\)](#) found that as many as 98 per cent of the victims of unexploded cluster munitions are civilians, a third of which are children.

In December 2008 the Australian Government was among those norm entrepreneurs that signed the internationally agreed *Cluster Munitions Convention*. Repeated statements by the Australian Government since have conceded that the use of cluster munitions presents the risk of ‘unacceptable harm to civilians’ and must therefore be subject to an internationally binding ban. When the Convention came into effect in August 2010, there appeared a chorus of NGOs and governments that sought ‘an end for all time’ of the use of cluster munitions by prohibiting their production, use, stockpiling and transfer. It is widely believed that Article 1c of the

Convention further prohibits investment in companies that either develop or produce cluster munitions by also prohibiting signatories from any activity that may ‘assist and encourage’ any other countries to do so.

However for the Convention to be binding, the mere signing of a treaty by a government is not enough. In addition it must be ratified, which is achieved by introducing domestic legislation that makes it a criminal offence under Australia law to act in anyway contrary to the international Convention. In late March 2011, the Senate Committee on Foreign Affairs, Defence and Trade tabled its report to the Australian Senate on the proposed *Cluster Munitions Prohibition Bill*, some provisions of which violently differ from the commitments made by the Australian Government to the international community when it signed the Convention in 2008. In particular, there are two related loopholes in the bill that the Senate Committee responsible for reviewing the bill chose not to tighten.

First, the bill undermines that part of the Convention that requires Australia to ‘never under any circumstances’ act contrary to the Convention by adding phrases that explicitly allow those of our military allies that are not party to the Convention unfettered access to stockpile, retain and transit cluster munitions within Australia. No other signatory country in the world has expressly permitted such unfettered free access to its territories as this. It is unprecedented. The legislation further allows Australian military personnel to actively assist in cluster munitions-related activities during joint military operations with our non-signatory allies to the extent where, according to Human Rights Watch, Australian troops would be permitted to develop strategies, direct attacks, and assist in the deployment of cluster bombs – basically, to operate to the point where they can do anything bar pull the trigger.

Second, the legislation does not explicitly prohibit investment in companies that produce cluster munitions. Indeed the respective governments of New Zealand, Ireland, Holland, Luxembourg and Belgium have in their domestic legislation included statements specifically banning investment and provision of other financial services – such as banking, loans and equity – to companies that either develop or produce cluster munitions. Other governments, including those of United Kingdom, Germany, France, Switzerland, Lebanon, Mexico, Norway and Rwanda, have all publicly stated that they interpret the Convention as including a prohibition of direct and indirect investment. So the bill that is currently in front of the Australian parliament is clearly out of line with international standards and expectations.

Indications are that the investment community in Australia also wants this issue addressed with more adequate legislation. For instance, the Australian Council of Super Investors (ACSI) – a body that represents over A

\$300 billion of domestic retirement savings – has been especially vocal in its opposition to the proposed bill. In its latest submission to the *Senate Foreign Affairs, Defence and Trade Committee* dated 8 March 2011, ACSI states ‘the current drafting will have no practical effect on the financing of cluster bomb production’. In an earlier submission, ACSI called for amendment to ‘prohibit the direct and indirect financing of companies involved in the production of cluster munitions’ in order to ensure the Australian legislation does not ‘go against the spirit of the [Convention]’.

In its 2009 report recommending that the Australian Government ratify the Convention, the *Parliamentary Joint Standing Committee on Treaties* recommended that any bill prevent ‘investment by Australian entities in the development or production of cluster munitions, either directly, or through the provision of funds to companies that may develop or produce cluster munitions’. And yet, in research I began to publish in 2009 explained how two Australian pension funds and the Australia’s principal sovereign wealth fund are likely to have investments in companies that produce cluster munitions – in the absence of publicly available exclusion policies – despite the international Convention generally being read as seeking to prohibit such activity from August 2010. In addition, a significant number of the hired investment managers are also known to provide bank loans, investment banking, or other financial services to makers of cluster munitions which, whilst not as direct an issue for Australian institutional investors who employ the services of the investment manager, does demonstrate the complexity of some of the financial relationships involved. Nor is there any publicly available information suggesting that any of the three funds engage with the firms that are involved in cluster munitions production (See [Table 1](#)).

Advice from the Attorney-General’s department on the bill has pointed out that it presently ‘does not include an investment offence’ in its provisions adequate enough to prohibit investment in companies involved in the production of cluster munitions if that financing was not provided for the express purposes of developing or producing cluster munitions ([Australian Department of Foreign Affairs and Trade 2011](#), p. 11). The issue is that of the six companies known to be presently involved in such business, none do so exclusively – they make other civilian and/or military products.

Investment theory contends that the exclusion of the six companies would limit the investment returns available to members. This widely held logic applies to all sorts of companies, regardless of the reason for limiting the number of stocks available to invest in (i.e. whether it be

**Table 1.** Australian Exposure to Cluster Munitions Manufacturers Based Overseas.

	Australian Super	Health Super	Future Fund
Type	Pension Fund	Pension Fund	Sovereign Wealth Fund
Size	A\$32 billion (large fund)	A\$8 billion (small-mid fund)	A\$75 billion (primary government fund)
Publicly declared exclusion policy	No	No	No
Hired investment managers known to invest in cluster munitions manufacturers (relevant arms manufacturers)	Acadian Asset Management (US); <i>Poongsan Corp (South Korea)</i> . LSV Capital Management (US): <i>Textron (US)</i> . T. Rowe Price Group (US): <i>Alliant Techsystems (US), Lockheed-Martin (US)</i> . Vanguard (US): <i>Textron(US), Poongsan Corp (South Korea), Singapore Technologies Engineering (Singapore), Alliant Techsystems (US), Hanwha Corp (South Korea)</i> . Blackrock (US): <i>Singapore Technologies Engineering (Singapore), Textron(US), Hanwha Corp (South Korea), Alliant Techsystems (US), Lockheed-Martin (US)</i> .	Blackrock (US): <i>Singapore Technologies Engineering (Singapore), Textron(US), Hanwha Corp (South Korea), Alliant Techsystems (US), Lockheed-Martin (US)</i> . JP Morgan Chase (US): <i>Alliant Techsystems(US)</i> . Goldman Sachs (US): <i>Alliant Techsystems(US), Textron (US), Lockheed-Martin (US)</i> . Société Générale (France): <i>Alliant Techsystems(US)</i> . Credit Suisse (Switzerland): <i>Singapore Technologies Engineering (Singapore), Alliant Techsystems(US)</i> . General Electric (US): <i>Alliant Techsystems(US), Textron (US)</i> .	State Street (US): <i>Textron(US), Poongsan Corp (South Korea), Singapore Technologies Engineering (Singapore), Alliant Techsystems(US)</i> . Vanguard (US): <i>Textron(US), Poongsan Corp (South Korea), Singapore Technologies Engineering (Singapore), Alliant Techsystems(US), Hanwha Corp (South Korea)</i> . Goldman Sachs (US): <i>Alliant Techsystems(US)</i> . Blackrock (US): <i>Singapore Technologies Engineering (Singapore), Textron(US), Hanwha Corp (South Korea), Alliant Techsystems(US), Lockheed-Martin (US)</i> .

**Table 1. (Continued)**

	Australian Super	Health Super	Future Fund
	State Street (US): <i>Textron(US)</i> , <i>Poongsan Corp (South Korea)</i> , <i>Singapore Technologies Engineering (Singapore)</i> , <i>Alliant Techsystems(US)</i> .		
	Credit Suisse (Switzerland): <i>Singapore Technologies Engineering (Singapore)</i> , <i>Alliant Techsystems(US)</i> .		
Hired investment managers known to provide loans and investment banking services to cluster munitions manufacturers (relevant arms manufacturers)	State Street (US): <i>Lockheed-Martin (US)</i> . Morgan Stanley (US): <i>Textron (US)</i> , <i>Lockheed-Martin (US)</i> , <i>Singapore Technologies Engineering (Singapore)</i> . Credit Suisse (Switzerland): <i>Textron(US)</i> .	Morgan Stanley (US): <i>Textron (US)</i> , <i>Lockheed-Martin (US)</i> , <i>Singapore Technologies Engineering (Singapore)</i> . AXA (Switzerland): <i>Singapore Technologies Engineering (Singapore)</i> , <i>Lockheed-Martin (US)</i> , <i>Textron(US)</i> . Regions Financial Corp. (US): <i>Alliant Techsystems (US)</i> . Société Générale (France): <i>Textron(US)</i> . BNP Paribas (France): <i>Textron (US)</i> , <i>Lockheed-Martin (US)</i> .	State Street (US): <i>Lockheed-Martin (US)</i> . Goldman Sachs (US): <i>Alliant Techsystems(US)</i> , <i>Textron (US)</i> , <i>Lockheed-Martin (US)</i> . Canyon Capital Advisers (US): <i>Alliant Techsystems(US)</i> .

Goldman Sachs (US): *Alliant Techsystems(US)*.  
 General Electric (US): *Alliant Techsystems(US)*.  
 Barclays (UK): *Textron(US)*,  
*Lockheed-Martin (US)*.  
 Prudential Bank (UK):  
*Singapore Technologies Engineering (Singapore)*.  
 Mizuho Bank (Japan):  
*Lockheed-Martin (US)*,  
*Alliant Techsystems(US)*.  
 Sumitomo Mitsui Financial Group (Japan): *Lockheed-Martin (US)*.  
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 HSBC Holdings (UK): *Textron (US)*.  
 Credit Suisse (Switzerland):  
*Textron(US)*.

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*Note:* Due to the nature of modern investment management, the level of transparency in stock holdings and mandate contracts, as well as turnover of portfolios, it remains unclear whether the individual mandates between the aforementioned funds and their service providers (investment managers) either directs or results in the exclusion of cluster munitions manufacturers.

environmental grounds or climate change). However I am unaware of any investor specifically arguing for the bill to permit Australian entities to continue investing in companies involved in the production of cluster munitions overseas. The argument that is made is done so to strictly adhere to financial theory, not to oppose any emerging or established norm of behaviour. In the absence of legislation dictating for investors what they can and can't invest in, it will remain difficult for investors to identify and act on emerging norms such as the banning of cluster munitions. Given Australia has the fourth-largest investment market in the world arguably the extent to which the international Convention is successful rests on how institutional investors address such norms within their day-to-day operations and strategic policies.

## CONCLUSION

By focusing on the experience of institutional investors in Australia regarding the makers of cluster munitions, I have demonstrated how pension funds are faced with a 'dilemma': accept the Federal Government's restrictive application of the international Convention within its domestic legislation, or adopt a more expansive reading and cease investing directly and indirectly in cluster munitions over and above its stated obligations. An analysis of stock holdings of several Australian pension funds and the government's principal sovereign wealth fund indicates that, as yet, it is common for investors to wait for legislative direction before excluding particular stocks and sectors. This is so for investors who adopt either a mainstream or responsible investment approach, and is due, in part, to difficulties in implementation as well as compatibility with widely held investment principles such as the efficient market hypothesis.

The concept of CSI was offered as a practical and theoretically compelling solution for investors seeking to reconcile their fiduciary duties and investment objectives (i.e. mainstream or responsible investment approach) with the demands of both identifying and satisfying emerging social norms such as the prohibition of cluster munitions. In contrast to traditional CSR strategies and activities, CSI accepts as an intrinsic feature of armaments manufacturing the existence of certain 'negative externalities' that result from standard use of its products and services. This precise formulation limits the investor's responsibility considerations to constitutive and regulatory norms, as opposed to norms that are merely evaluative or practical.

In so doing, the institutional investor may better resolve what I have termed the ‘cluster munitions dilemma’ with suitable strategies and programs.

The mechanics of implementation options have been explored more fully elsewhere, but may broadly include both exclusion and engagement strategies. A pre-defined exclusionary policy ensures that identified stocks and sectors are ‘negatively screened-out’ (divested) from the investible universe as well as ‘blacklisted’ from any future investment. So-called ‘ethical investors’ such as [Christian Super \(2008\)](#) commonly exclude controversial weapons such as cluster munitions, which they view as being intrinsically ‘indiscriminate’ in design as well as ‘inhumane and cruel’. The vast proportion of mainstream and responsible investors, however, adopt an engagement approach, with no exclusionary mechanism on certain stocks and sectors. Signatory members of the UN Principles for Responsible Investment (UNPRI) – whose asset owners and service providers marshal over A\$22 trillion in assets – instead advocate for ‘responsible’ and ‘sustainable investment’ strategies which take environmental, social and corporate governance (ESG) factors into account, in so far as they are material (i.e. statistically significant) to investment performance. A small number of funds attempt to switch between being responsible (engagement) and ethical (exclusion) investment strategies, such that where engagement fails to achieve the desired change in company behaviour, investors have a pre-defined process for excluding the stocks from the portfolio. Alternatively, engagement and exclusionary approaches may be used more interchangeably depending on the issue that arises from the asset – such as in the case of an emerging international and domestic norm proscribing cluster munitions.

The benefits of the CSI approach are significant and many. The investor is advantaged by having at its disposal a roadmap for managing – though not necessarily predicting – emerging social norms. This is so for ethical, responsible and mainstream investment approaches, although is most readily compatible with investors who have pre-established exclusionary policies as well as effective implementation procedures. Society is benefited as a result of increasingly significant economic actors, such as pension and sovereign wealth funds, directing their capital in such a way as to minimize humanitarian and environmental harm. I have argued how the use of cluster munitions demonstrates in places like Laos demonstrate how corporate activity may impact broader social objectives. Given the severity of the problem in Laos, it recently added a ninth Millennium Development Goal on its road to economic development, which requires it clear its land of

unexploded ordnance. And both processes arguably better serve the beneficiaries' 'best interests', which is, after all, the sole purpose of the institutional investment industry.

## NOTES

1. For the purposes of this chapter, the terms "arms maker", "producer" and "manufacturer" will be used interchangeably to refer to all firms involved in the development and production of conventional armaments, including mere component suppliers.

2. For instance, E.F. [Byrne \(2007\)](#) challenges the Westphalian notion of state sovereignty and the importance of armaments production for national defence in order to assess arms makers against four corporate social responsibility criteria: environmental performance, social equity, profitability, and use of political power.

3. A widely accepted standard developed by the financial industry for classifying listed companies is the Global Industry Classification Standards (GICS) which include ten key sectors (each with their own industry groups and sub-industries): energy, materials, industrials, consumer discretionary, consumer staples, health care, financials, information technology, telecommunications services, and utilities.

4. For a more thorough legal analysis than the one that follows, see: [Donald and Taylor \(2008\)](#).

5. See most notably Megarry V-C in *Cowan v Scargill* (1985) Ch 270. The principles in that case were affirmed in Australia in *Buckland v AG for Victoria* (unreported judgment of the Supreme Court of Victoria, No.10536 of 1992), and more recently in *Asea Brown Boveri Superannuation Fund v Asea Brown Boveri* [1999] 1 VR 144, *Knudsen v Kara Kar* (2000) NSWSC 715, *Crowe v SERF* (2003) VSC 316 and *Invensys v Austrac Investments* (2006) 198 FLR 302.

6. *Balls v Strutt* (1841) 1 Hare 146 at 149; 66 ER 984 at 985.

7. This principle was clearly expressed in *Harries v Church Commissioners* [1992] 1 WLR 1241, a case involving a charity associated with the Church of England, a situation where one might have expected ethical considerations to have some influence. In that case Sir Donald Nicholls V-C held that: 'investments are held by trustees to aid the work of the charity in a particular way; by generating money. That is the purpose for which they are held. That is their *raison d'être*. Trustees cannot use assets held as an investment for other, viz, non-investment, purposes. To the extent that they do they are not properly exercising their powers of investment.'

8. See for instance see: *Harries v Church Commissioners, re Wyvern Developments* [1974] 1 WLR 1097; *Martin v City of Edinburgh District Council* [1989] 2 PBLR 8.

9. *Cowan v Scargill* [1985] 1 Ch 270. The principle was first endorsed in Australia in *Crowe v SERF* (2003) VSC 316. Earlier Australian cases cite *Cowan v Scargill* in support of other principles, or in obiter dicta.

10. Although not specifically stated in the legislation, the care, skill and diligence benchmarks are likely to be higher for professionals than for volunteers, and higher for experts than for lay-people; *ASC v AS Nominees* (1995) 133 ALR 1 at 14.

11. This is most clearly stated in *Martin v City of Edinburgh* (1988) SCT 329, which reviewed the adoption of an anti Apartheid investment policy in trusts

administered by a local council. Although a Scottish case, the principle is good law in Australia and the U.K. generally.

12. In 2003 the United Nations Social & Economic Council attempted an attempted normative re-conceptualisation of corporate responsibilities under international law such that “transnational corporations and other business enterprises have a responsibility to respect human rights” (Resolution 8/7) which was vehemently opposed by key industry lobby groups such as the IOE and ICC (2004).

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