

**Committee: Economic and Social Council**

**Issue: The effect of financial crisis on corporate social responsibility performance**

**Student Officer: Leonidas Ntoulos**

**Position: Deputy President**

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## **INTRODUCTION**

The financial crisis of 2008 is considered by most economists the second most severe financial crisis since the Great Depression. It began in the United States and led to a collapse of its banking system and then spread overseas. This crisis has clearly affected corporate social responsibility's initiatives because of the extraordinary pressure companies undergo, to survive. The most evident outcomes of the economic crisis were massive layoffs and excess cuts on community involvement programs. The impacts are distinguished in positive and negative. The crisis has affected and worsened issues like labor practices, especially work-life balance, and consumer issues, together with a harsher conflict of interests between the different stakeholder groups. However not all the impacts were adverse; many corporate social responsibility issues were pushed forward and were advanced after the crisis like, corporate governance related issues such as code of business conducts and anti-corruption policies. Corporate Social Responsibility aims in aiding society. It can help it on four main aspects. The first one is the environmental. In this, companies adopt environmental friendly equipment and policies, in order to protect the environment. The second one is poverty. Companies, through philanthropy, attempt to give to those who need some funds for survival. This does not only happen through donation but also through the initiation of training programs. The third aspect is ethical labor practices, which involve business ethics. Finally, volunteering, which involves the presence of some companies in specific events, showing that way their concern on an issue. Corporate Social Responsibility aims in tackling other social issues as well. The most important of them is child famine, poverty, women's right, human rights, cultural respect and disease prevention, among others. It is important to understand that crisis has affected the level of CSR initiatives. Companies now pursue CSR strategically, or due to lack of funds, do not pursue it at all, as it will be analyzed in the study guide.

## **DEFINITION OF KEY TERMS**

**Economic crisis**

Economic crisis<sup>1</sup> is a long-term economic state characterized by unemployment and low prices and low levels of trade and investment. Specifically talking about the 2008 economic crisis

### **Corporate social responsibility**

Corporate social responsibility<sup>2</sup> is a corporation's initiatives to assess and take responsibility for the company's effects on environmental and social wellbeing. The term generally applies to efforts that go beyond what may be required by regulators or environmental protection groups.

### **Gross Domestic Product**

Gross Domestic Product; is the total value of all final goods and services produced in the domestic economy by foreign or domestic owned resources, in a specific period of time.

## **BACKGROUND INFORMATION**

In 2007 the USA's consumption expenditures exceeded its GDP (Gross Domestic Product). Because of the foreign financing, along with the Federal Reserve who backed the falling interest rates, an era of low interest rates debt financed consumption began. Following an increase in the housing prices (around 40%), during 2000-2004, the demand for loans which would fund the house purchasing increased. The increase in the price led to an increase in supply of houses. Thus, bankers saw an opportunity coming out from this story and facilitated lending to consumers. They granted a large number of loans believing that even if the borrowers were unable to repay their loan, they would sell their house so as to pay it back. Moving towards 2008, interest rates would increase and housing prices would fall, leading house owners to foreclosure. Meanwhile, banks faced a negative equity, where liabilities were larger than their assets, leading them in a potential bankruptcy. The crisis in financial systems in transported into real economy, increasing rates thus reducing consumption and investment by consumers and firms bringing the country into a recession. This is how the crisis started in the US. However, the financial institutions harmed by the crisis were multinational corporations. This crisis was spread all over the world. Employees were fired overseas due to the fact that those banks faced negative gains and some of them had gone bankrupt. The consequences were disastrous all over the world. After the crisis'

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<sup>1</sup> The Free Dictionary, "economic crisis." WordNet 3.0, Farlex clipart collection. 2003-2008. Princeton University

<sup>2</sup> Staff, Investopedia. "Corporate Social Responsibility." Investopedia. N.p., 29 Aug. 2015. Web. 09 July 2017.

outbreak some countries fell into a recession (ex. Greece and Ireland). Before 2010, the effects of the crisis had spread all over the world.

### **Effects on Corporate Social Responsibility**

Corporate Social Responsibility is based on the idea that a company should attempt the maximum profit, within the ethical and societal laws. However, this is hardened by an economic crisis, which reduces a firm's profits. Seeing the firm as a purely profit maximizing organization, we can understand how it becomes more and more difficult to maintain the same levels of Corporate Social Responsibility actions as in a period with no economic crisis. Due to the recession existing in the economy firms are forced to lay off workers, drastically increasing unemployment, so as to cut production costs. According to International Labor organization, it is estimated that the economic crisis has left 210 million people unemployed<sup>3</sup>. It is also believed that due to the shortage of money firms will be less willing to pursue Corporate Social Responsibility policies. However, this view is contradicted by some economists or policy makers who believe that the firms, in crisis would prefer to pursue such policies. More specifically, it is believed that many companies would attempt to ameliorate their social image by engaging in such actions. Business strategists admit that such policies are a sustainable way to assure survival in the corporate world, even in periods of crisis. By that we can understand that firms are likely to pursue Corporate Social Responsibility.

As mentioned previously, the Corporate Social Responsibility can either deteriorate or ameliorate during a period of economic crisis.

Firstly, we have the scenario that Corporate Social Responsibility actually worsens. This again happens considering the firm a profit maximizing organization. In this scenario, firms will lay off workers, will stop funding public programs, stop caring about the working conditions of their employees, they might use cheaper materials which pollute the environment and in general disrespect society.

However, companies might engage or further pursue Corporate Social Responsibility in periods of crisis. The one reason might be the altruistic one, where companies want to help the society and ameliorate the living conditions of its citizens to the extent possible, during such a period. Another reason that they might engage in CSR is to improve their social status, and thus increase their popularity. Such actions might be environmental

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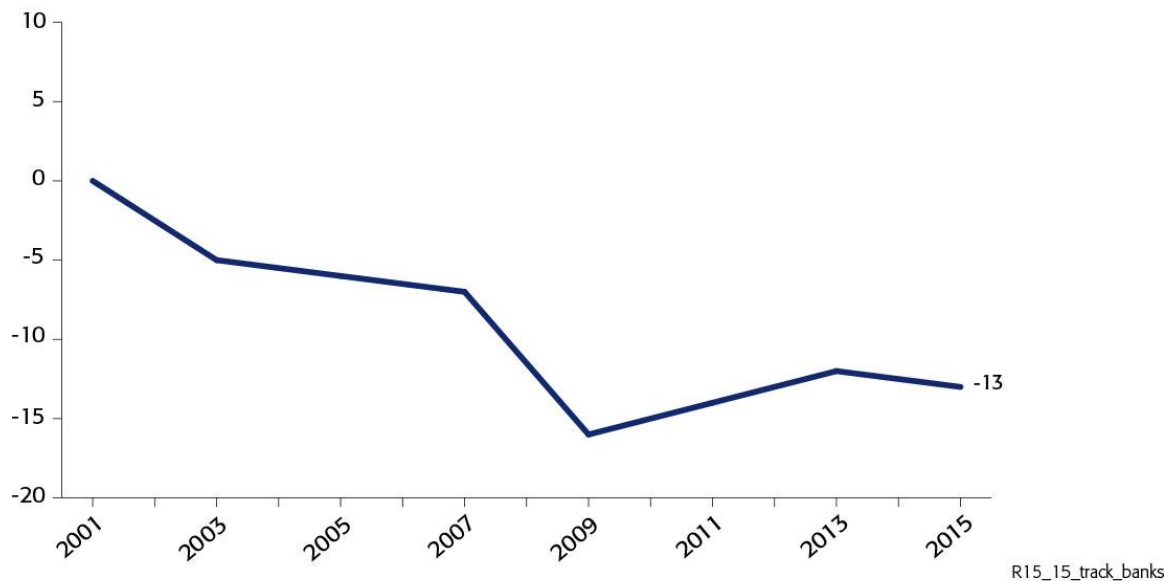
<sup>3</sup> Allen, Katie. "Global Unemployment to Rise to 212 Million, Says ILO." The Guardian. Guardian News and Media, 19 Jan. 2015. Web. 09 July 2017.

initiatives. For example, companies that want now to pursue environmental friendly policies and use clean energies will be able to profit in the future since this market is growing. In addition, companies which donate money to the public, create events with aim to improve society or help raise awareness on an issue (for example cancer) will improve their image to the public and will attempt promote their brand and increase their sales and popularity.

The conclusion reached however is that in the end, during a financial crisis, CSR is reduced. The main reason is said to be that companies have less assets to devote in such actions. Companies lose the sense of necessity that they should provide benefits to society. They consider their existence as a benefit to society thus they do not further pursue it. In addition to that, firms have to cut back their spending on CSR initiatives, due to the large internal pressures they face. Companies give importance to issues which are more severe on the time being.

### CSR Performance of Banks/Finance Industry

Net Performance,\* Average of 19 Countries,\*\* 2001–2015



\*"Among the best" and "Above average" minus "Below average" and "Among the worst"

\*\*Includes Argentina, Australia, Brazil, Canada, Chile, China, France, Germany, Greece, India, Indonesia, Italy, Mexico, Russia, South Korea, Spain, Turkey, UK, and USA. Not all countries were asked in all years.

On the above graph, the performance of the Corporate Social Responsibility is illustrated after 2000. We observe that the first years there is a continuous fall of CSR. Immediately after the crisis CSR keeps on falling, however after 2009, half a year after the beginning of the crisis, CSR becomes to increase. There is a positive relation between the economic crisis and CSR. During the crisis CSR actions increase.

## MAJOR COUNTRIES AND ORGANISATIONS INVOLVED

### Greece

Greece is one of the countries who struggle the most during the economic crisis. Greece remains under a recession (a period of negative GDP growth which lasts for more than six months) and faces high rates of unemployment, and until 2016 levels of deflation. The recession lasted for five years and a quarter and had significant effects on the Greek economy. The numbers in the beginning of 2015 were rather discouraging: youth unemployment exceeded 50%, at least 80% of the unemployed have been without jobs for more than six months, and gross government debt exceeded 160% of GDP. Greeks find themselves unable to conduct monetary policy, since they cannot print money as a part of the European Union economic alliance, dwindling that way Greece's economic potential. In addition to the already existing difficulties, the Greek government appears to be unwilling to cooperate, Greek people do not want to accept the bailout conditions, exacerbating that way the situation, making it more difficult for the country to exit the crisis. The economic crisis effects can be two. In the first case scenario, the firm is struggling financially for its survival and thus it is forced to cut back on its expenses. The first way to cut back is by reducing the money spend on actions of CSR. Thus, the CSR deteriorates in Greece. The second case scenario, is that the firm tries to exploit the situation, and thus invest on actions of Corporate Social Responsibility in order to show its good face in society, try to make its good more attractive to consumers and increase its profits.<sup>4</sup>

### Japan

Japan's economic problems go back to the 1990's, so they were not just created by the economic crisis in 2008. They were created by the aggressive economic policies (expansionary monetary and fiscal policies). Those policies initiated the Keynesian longest-running experiment. The result was almost zero interest rates, housing bubbles, chronic stocks and enormous government indebttness, 240% Japan's GDP. Between 2012 and the half of 2015, Japan had negative GDP growth in six out of 14 quarters, signifying higher unemployment. In the beginning of 2015, Japan had small wage increases, high taxation, increase in the prices of the essential good, and a significant demographic problem. Despite the efforts of the government and the central bank, Japan was unable to become the economic behemoth it was after the Second World War. Overall, Japan after 1990s had been

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<sup>4</sup> Ross, Sean. "4 Countries in Recession and Crisis Since 2008." Investopedia. N.p., 16 Nov. 2015. Web. 09 July 2017.

experiencing stagnation.<sup>5</sup> However, some accidents in the Japanese society, along with the highly-globalized firms led society to a quick understanding that government cannot assure the perfect function of society and that corporate help is needed. Despite the economic crisis, Japanese firms seem to be more than willing to engage in actions of CSR in an attempt to progress Japanese society. Such actions are observed in many areas necessary and firms try to incorporate in society the terms of equality, human rights, eradication of poverty and many other fundamental rights.

## **Russia**

From 1991 to 1999 the Russian Federation went through a period of remarkable economic growth. However, the increasing rates of GDP stopped with the global market crisis of 2008. Then a large decline of GDP and an extremely bad performance was observed in the Russian stock market. The benchmark share index and the RTS lost 75% of their value by the beginning of 2009. The industrial output declined by 12.5% in 2009 and many of the last year's gains were now lost. Positive GDP growth and amelioration of productivity was observed during 2012-3 and were considered the first signs of recovery. In October 2015, Forbes magazine ranked Russia as the single worst economy in the world. Crude oil prices, which was an important component of Russian exports fell.<sup>6</sup>

## **Italy**

Italy is another Balkan country, standing next to Greece, which has been facing enormous economic problems, especially in the period of 2008-2015. Italy was official out of recession in the third quarter of 2009. However, Italy, even after exiting recession, has been facing economic problems, especially with its labor productivity. Productivity per worker in Italy was higher in 2007 than in 2015. Since the peak in 2008, Italy has decreased its GDP around 10%, a number which reflects the problems in the economy. Consumption and investment remains low while unemployment reaches unprecedented levels- exceeding 44% in young people and 12% in the overall economy. Italy remains the slower gainer after the Great Depression.<sup>7</sup> However, especially during crisis, Italian entrepreneurs prioritized the need to support their society and invested great amounts of money in such actions.

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<sup>5</sup> Ross, Sean. "4 Countries in Recession and Crisis Since 2008." Investopedia. N.p., 16 Nov. 2015. Web. 09 July 2017.

<sup>6</sup> Ross, Sean. "4 Countries in Recession and Crisis Since 2008." Investopedia. N.p., 16 Nov. 2015. Web. 09 July 2017.

<sup>7</sup> Ross, Sean. "4 Countries in Recession and Crisis Since 2008." Investopedia. N.p., 16 Nov. 2015. Web. 09 July 2017.

### United States of America

Nine years after the beginning of the economic crisis, the country is still struggling to escape. By many economists, the situation in that period was compared with the Great Depression. However, the effects are obvious in the US economy. The housing industry has lost its prominent role on the US economy. Regarding the unemployment rates, they have now returned to normal, however the US have a large debt to pay off. In US the firms are distinguished into two categories. The one involves firms which due to the costs which are exacerbated by the crisis, drop every endeavor relevant to corporate social responsibility. On one side CSR attempts are reduced. Then, there are the firms that exploit crisis and want to promote in society the good face of their company, trying to attract more customers. On that aspect CSR increases

### International Labour Organization

The International Labor Organization is actively participating on the efforts of improvement of the CSR, especially in the periods of crisis. It considers it as an obligation for every company in an effort to achieve economic and social progress. In addition to the economic and social progress, ILO tries to promote the voluntary nature of the CSR and its benefits to the society. Finally, ILO offers advice to the policy makers and the governments on how to maintain CSR even in periods of crisis, when it becomes even more difficult.

### United Nations Global Compact

The UN Global Compact is an organization which tries to promote sustainable development in society. It is linked with companies and tries to promote CSR. UN Global Compact has to monitor how firms function based on specific principles of sustainability and report on their implementation. The initiative counts more than 13000 participants with stakeholders in more than 170 states. Overall, it is one of the largest organizations relevant to Corporate Social Responsibility, and through his 10 principles has controlled the way CSR is performed.

### TIMELINE OF EVENTS

Date	Description of Event
9 August 2007	BNP Paribas froze three of their funds, showing that they have no way of valuing the complex assets inside them (collateralized debt obligations (CDOs)), or packages of sub-prime loans. This was the first bank to admit the risk of exposure and bankruptcy.

14 September 2007	The British Northern Rock has borrowed a large amount of money in order to fund customer mortgages. Now, it can only pay off its debt by reselling those mortgages in the global markets. With low demand for securitized mortgages, Northern Rock faces a crisis and is in need of a loan from the British government. This generates fears that the bank will shortly go bankrupt leading consumers to withdraw their savings.
24 January 2008	Analysts report the largest fall in US home sales in the last 25 years.
17 February 2008	After two rejected private offers, Alistair Darling nationalizes Northern Rock claiming that it would be a temporary, necessary measure. The bank returns to private sector after four years.
14 March 2008	JP Morgan acquires the investment bank Bear Stearns. This action was noted as the biggest effect of the crisis up to that point.
7 September 2008	The US government bails out Fannie Mae and Freddie Mac- two enormous firms which had guaranteed thousands of sub-prime mortgages
15 September 2008	The American bank Lehman Brothers files bankruptcy, disseminating terror in the international markets. The main reason for bankruptcy was the high risk taken and the exposure to sub-prime mortgages.
17 September 2008	The UK's largest mortgage lenders, HBOS, is rescued by Lloyds TSB after a huge drop in its share price.
21 September 2008	Goldman Sachs and JP Morgan Chase change their status to banking holding companies, terminating the era of the dominant investment banking model. What triggered this change was the drop of the US banks in the stock market.
25-29 September 2008	Washington Mutual and Wachovia, two other American banks also collapse.
30 September 2008	Ireland is the first European country to enter a recession. The Irish government promises to secure the Irish banking system, a promise which the government was unable to keep.
October 2008	Henry Paulson, Former United States Secretary of the Treasury, passes in Congress the Troubled Asset Relief Program (TARP), which purchased or insured the sub-prime mortgage securities from large banks. This was one of the actions which affected the crisis.
7-8 October 2008	Iceland's three biggest commercial banks – Glitnir, Kaupthing, and Landsbanki – collapse. To protect the British customers, Gordon Brown used anti-terror legislation to freeze assets in UK subsidiaries.
8 October 2008	Eight central banks including the Bank of England, the European Central Bank, and the Federal Reserve cut their interest rates by 0.5% in an attempt to reduce the pressure on borrowers. This was considered one of the worst weeks in Dow Jones



13 October 2008	To avoid the collapse of the UK banking sector, the British government decides to bail out several banks, including the Royal Bank of Scotland, Lloyds TSB, and HBOS. However, the deal failed in the same week.
7 November 2008	It is reported that 240.000 Americans were left unemployed the previous month.
12 November 2008	After heavy criticism, Henry Paulson, alters the policy of TARP, stop purchasing toxic sub-prime mortgages and instead aids the banks via cash injections.
14 November 2008	The G20 holds a significant summit, the first one after Lehman Brothers collapse.
2 April 2009	The G20 agrees on an international stimulus package of 5\$ trillion.
27 August 2009	Adair Turner, the chairman of the Financial Services Authority, calls some banking activity "socially useless"
10 October 2009	Papandreou's administration in Greece, admits that the hole in Greek finances is twice as large as it was expected.
27 April 2010	The Greek debt is downgraded.
2 May 2010	Greece is bailed out for the first time, with a program of 110\$ billion worth. This action initiates the Eurozone crisis. Meanwhile the austerity program in Greece is intensified, resulting in many protests.
28 November 2010	European ministers agree to bail out Ireland, in a program of 85\$ billion worth
5 May 2011	The ECB bails out Portugal
21 July 2011	Unable to bring the economic situation in in order and under control, Greece is bailed out for the second time
5 August 2011	S&P downgrades US sovereign debt
12 February 2012	Greece passes its most important austerity package
12 March 2012	Unemployment in Europe reaches unprecedented levels
12 June 2012	The levels of borrowing in Spain reach extreme levels
26 July 2012	ECB president Mario Draghi, gives his strongest defense for the Euro, triggering markets to rally.

## UN INVOLVEMENT: RELEVANT RESOLUTIONS, TREATIES AND EVENTS

### Annual Sustainability Summit

Annual Sustainability Summit is a conference which takes place every year. On this summit topics, relevant to sustainability in modern corporations is discussed. Its main role is

to raise awareness among the executives of the corporations but also offer them ways for a more sustainable and social oriented corporate environment. The summit takes place under the UN Global Compact.

### **European Parliament resolution of 6 February 2013 (2012/2097(INI))**

Refers to the issue of Corporate Social Responsibility. It aims in promoting society's interests and a route to sustainable and inclusive recovery. The following clause mention what is the EU tries to promote:

“Recognises that the Commission communication is part of a series of policy statements serving to ensure that CSR is promoted more widely, is embedded in EU policies and will become an established principle for European action; calls on the Commission and the Member States to use the 2014-2020 CSR strategy as the basis for practical measures to encourage companies to become involved in CSR”<sup>8</sup>

### **European Parliament resolution of 13 March 2007 on corporate social responsibility: a new partnership (2006/2133(INI))**

On this resolution, the importance of initiation and strengthening of Corporate Social Responsibility in Europe is discussed. The Parliament tries to promote measures to encourage companies in engaging in such actions.

Clause 1; “Is convinced that increasing social and environmental responsibility by business, linked to the principle of corporate accountability, represents an essential element of the European social model, Europe's strategy for sustainable development, and for the purposes of meeting the social challenges of economic globalization”

Clause 10; “ Points out that CSR should tackle new areas such as lifelong learning, the organization of work, equal opportunities, social inclusion, sustainable development and ethics, so as to operate as an additional instrument for managing industrial change and restructuring”

## **PREVIOUS ATTEMPTS TO SOLVE THE ISSUE**

### **NGO'S Intervention**

In United Kingdom and many other countries there are Non-Governmental Organizations which are taking actions in order to promote CSR in their society, but also

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<sup>8</sup> EU resolution 2012/2097(INI)

monitor actions taken by the firms. A characteristic example of such organization is the Corporate Watch, which operates in the United Kingdom. Corporate watch remains active in most sectors of the economy; banking and financial, environment, arms trade and many others. They investigate corporations and provide an analysis of how their power is used in the society. Their motto is "information for action" and what they intend to do is give people as many information possible for the corporations for them to judge accordingly of how one works. Corporate Watch is an independent of state or corporations' organization which monitors the role of companies in society. Through this kind of initiatives Corporate Social Responsibility is further promoted and assured in a society.

## **POSSIBLE SOLUTIONS**

### **Providing an enabling environment for enterprises to adjust to crises**

It has been discussed and considered necessary, the creation of an environment which is going to allow firms to thrive on a sustainable way. The importance of a conducive environment is increasing, especially during periods of crisis. The government should participate in the formation of such an environment by enacting labor-relevant legislation, altering the institutional and legal framework and create a new way that firms cope with social issues. Is the government to implement such policies, the society can reach the maximum level of CSR, promoted and engaged by the firms. In addition, by the new legislation firms' productivity can increase, making themselves more profitable and efficient than before. Policy makers and government thus should consider which measures will lead society to the result wanted.

### **Providing wage subsidies to the firms**

Subsidizing firms during a period of crisis would lessen the burden of the production costs. Were the production costs lower firms would have more capital to devote in actions of Corporate Social Responsibility. In addition to that, wage subsidies will prevent firms from laying off workers, since now every worker costs less to the firm. This measure has been implemented in Germany, in companies which were not able to perform well because of the European economic slowdown. This measure proved effective since unemployment remained at low levels. Also, lower production costs would leave more capital for the companies free, capital which could be invested in actions of Corporate Social Responsibility. This measure, in that way could be more than effective.

### **Encouraging social dialogue at the enterprise, sectoral and national level**

Social dialogue and consultation are very important in periods of crisis in order to come up with tangible solutions concerning the societal issues. On this was Corporate Social Responsibility can be promoted in the corporate world. All levels of social dialogue are linked and can play a role in reforming. An example given by the ILO is that "a framework of reference can be set at national and/or at sectoral level, and the detailed implementation of measures can then be negotiated at company level".

### **Tax benefits offered to firms who perform CSR**

The initiative to lessen the taxes corporations pay in case they perform actions of Corporate Social Responsibility would be an exceptional way to incentivize firms participate in such attempts. The government thus should adjust the tax relief for each company according to the money invested on CSR and by accounting other factors such as its size and the nature of its product. It is important to assure that the firms will gain by this measure and definitely pursue it. Thus, the money they spend on CSR must be less than the tax they would pay. The measure would be effective since firms would both lessen their burdens but at the same time will advertise themselves in society.

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