



## **Sustainability in Global Supply Chains**

### **Arguments For and Against a Legal Obligation for Compliance with Human Rights and Environmental Standards**

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- › Against the backdrop of long-standing violations against human rights and environmental standards, a discussion is being held on how supply chains can be made more sustainable, which actors are responsible and at which points, and to what extent companies should be obliged to comply with human rights and environmental standards.
- › In addition to the Christian democratic system of values, factors making the case for a statutory regulation of corporate due diligence are also the creation of an equal legal framework for companies, the possibility to reduce litigation and reputational risks, and the access to sustainable financing.
- › Regarding purely national solutions, critics highlight competitive disadvantages for German companies, effects on human rights and environmental protection in manufacturing countries that are difficult to assess, as well as difficulties in implementation.
- › Whether or not a supply chain law is successful largely depends on the specific design of responsibilities and liability mechanisms laid down therein as well as its integration into the international context.

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## Introduction and Background

Global value chains are a fundamental pillar of globalisation, without which value creation would be inconceivable in most countries. They provide opportunities for increasing productivity and wealth, but also present a number of challenges when it comes to compliance with human rights and environmental standards.<sup>1</sup> Humane working conditions, child labour, accidents on manufacturing sites and long-term environmental damage have confronted us with these challenges for years. What is more, the current pandemic is making the issue of resilient supply chains more relevant than ever before.

How supply chains can be made more sustainable, and which actors are responsible for this, is increasingly the subject of debate – both at the European and international level as well as in Germany, too. The UN Guiding Principles for Business and Human Rights adopted by the United Nations Human Rights Council in 2011, which have been included in the OECD Guidelines on Multinational Enterprises, provide a global framework. They define clear responsibilities for states and companies based on three pillars:

- 1. Protection:** The duty of the state to protect human rights;
- 2. Caution:** The responsibility of companies to observe human rights; and
- 3. Redress:** The necessity of enabling victims of human rights violations caused by companies to access complaints mechanisms.

The EU Commission has called on all EU Member States to implement the UN Guiding Principles in national action plans. In December 2016, the German Federal Government adopted the National Action Plan for Business and Human Rights (NAP), which expects German companies to implement human rights due diligence on a voluntary basis. Monitoring is used to examine how many companies from 500 employees have introduced human rights due diligence processes.<sup>2</sup> Following an initial round of surveys in 2019, merely 17 to 19 per cent of companies had fulfilled the conditions. Nine to twelve per cent were “companies on the right track”, two to three per cent were “companies with an implementation plan”.<sup>3</sup> The second and decisive round of the survey has been running since March 2020. If it transpires that less than 50 per cent of responding companies comply with their due diligence obligations, the NAP and the coalition agreement provide for a legal obligation to be promoted in Germany and at EU level.

Some European states have already adopted statutory regulations, but these vary in terms of scope and design. The French *Loi de Vigilance* goes furthest by obligating companies to monitor human rights and environmental due diligence, as well as clear sanctions in case of non-compliance. The *UK Modern Slavery Act* and the Dutch law against child labour are limited to human rights due diligence. The *UK Modern Slavery Act* merely stipulates reporting requirements, whereas companies in France and in the Netherlands are obliged to compliance with due diligence obligations in their supply chains. Statutory regulations are being discussed in Switzerland, Austria and the Scandinavian countries. Due diligence regulations already exist at EU level, which refer to specific sectors and/or types of companies.<sup>4</sup>

## Statutory Regulation of Global Supply Chains – Pro and Contra

Against the background of the German and international debate, how is a statutory regulation of supply chains to be assessed in the potential trade-off between political responsibility, corporate due diligence and economic competitiveness?

### What Factors Speak in Favour of a Supply Chain Law?

#### Embedding in the Christian Democratic Foundation of Values and the Social Market Economy

The obligations associated with a supply chain law are based on the Christian concept of humans and its basic principles. The principle of personality, according to which every human is a creature and image of God, justifies human dignity, their rights and duties. Humans are empowered to be free and autonomous, but at the same time bear responsibility for themselves and the common good. They must not be degraded to an object of economic interests. Two obligations are derived in the context of global supply chains: The protection of human rights and compliance with ecological minimum standards to preserve creation as a natural basis of life for coming generations (intergenerational justice). The “Irenic Formula” of the social market economy, “of bringing the ideals of justice, freedom and economic growth into a reasonable harmony”<sup>5</sup>, provides the framework for action.

In a social market economy, a state regulatory framework ensures rule-governed competition and creates incentives for achieving goals in the common interest. Economic actors should freely operate within this framework. The internalisation of external effects, e. g. via pricing in social and ecological costs, forms part of the regulatory framework. It corrects competitive disadvantages that arise for sustainably operating companies owing to higher costs for compliance with human rights and environmental standards. In order to ensure compliance with regulatory principles (and the UN Guiding Principles) in global supply chains – in the absence of a “global state” – the national regulatory framework needs to be expanded and adapted to cross-border activities of market actors.<sup>6</sup> The work of international institutions (e. g. investment and trade agreements and multilateral organisations), which set and monitor the key framework conditions for international economic relations, should usefully supplement the above-mentioned measures.

#### Opportunities and Economic Benefits of a Supply Chain Law

An increasing number of companies also seem to advocate for a statutory regulation of corporate due diligence in global supply chains.<sup>7</sup> This is not only rooted in their value-based vision of themselves, they also expect economic benefits.

A law that clearly defines corporate responsibilities and creates legal certainty through a reliable framework, enables companies to adjust their processes in a more targeted way. Legally regulated proof of having fulfilled due diligence obligations may protect companies against criticism and the associated legal damage as well as that to their reputation. A law also provides companies with a “legal lever” for enforcing minimum standards in their supply chains and generates critical mass by expanding the circle of companies that requires its suppliers to comply with standards. This could make it possible particularly for small and medium-sized enterprises (SME), whose market power is often limited, to implement minimum standards.<sup>8</sup>

Origin and production methods of products are more and more important for the consumer, which is what they base their purchasing decisions on.<sup>9</sup> A legal obligation for consistent risk assessment, measures for preventing human rights violations or the breach of environmental standards, and last but not least transparent reporting, strengthen the consumer’s trust in companies. Reputational risks decrease, and the image of German

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Human dignity at the heart of the global economy

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Social and ecological incentives through the regulatory framework of social market economy

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Companies want legal certainty and a clear basis for implementing due diligence

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Reduction of litigation and reputational risks as a positive side effect

brands is protected. In the competition for qualified staff, too, a company's reputation gains importance since sustainability is an important criterion when choosing an employer, especially for younger target groups.<sup>10</sup>

A legal commitment to human rights and environmental due diligence may also strengthen the resilience of global supply chains by urging companies to carry out more in-depth risk management. It would increase the transparency of supply chains and enable a better assessment of risks pertaining to interruptions and failures. What is more, companies would be more motivated to determine different supply options so as to prevent supply failures owing to violations against the supply chain. This could also help to mitigate risks of failure in the wake of unforeseeable events such as extreme weather or pandemics. The COVID-19 pandemic clearly illustrates the necessity of this.

Compliance with human rights and environmental standards also opens up new financing opportunities. In addition to the classic risk-yield relationship, investment decisions are increasingly taken based on the so-called ESG criteria: *environmental, social, governance*. Regulatory efforts for sustainable finance indicate that ESG criteria will become increasingly important for access to finance in future. Even today, many investors are incorporating the sustainability factor into their decisions. For many investors, corporate due diligence is an important part of risk management, and an indicator for the robustness and profitability of an investment. A statutory regulation and the appropriate reporting could enable companies to prove ESG criteria, increase their attractiveness and expand their financing options.

Access  
to financing

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## What Factors Speak Against a Supply Chain Law?

### Disadvantages with Competition and in Development Cooperation

Opponents of a supply chain law consider the competitiveness of German companies to be under threat, unless such a law were introduced on the European level at the very least. In order to comply with prescribed due diligence when observing human rights and environmental standards, companies would have to take cost-intensive measures such as risk analysis, prevention measures and the fulfilment of documentation and reporting duties.

Is the competitive-  
ness of industry  
under threat?

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As a consequence, price increases are to be expected, which put German companies at a disadvantage in international price competition. We can expect evasive reactions from customers: Particularly for price-elastic products, whose demand reacts particularly strongly to price changes, consumers could switch to cheaper goods from non-compliant, foreign companies. The more extensive the statutory regulation, the higher the costs, prices and potential competitive disadvantages – unless it were introduced throughout the EU or internationally. However, a European or plurilateral regulation could also entail competitive disadvantages for German companies: The German economic structure is shaped by SMEs, who find it harder to bear the cost-intensive measures described above than is the case with large companies.

The dynamic described above could result in long-term damage to the human rights and environmental situation – as paradoxical as it may seem. Companies could avoid potential sanctions under the supply chain law by withdrawing from “risk areas” or shortening their supply chains. In developing countries, that would be accompanied with a loss of jobs, an increase in poverty and a decline in knowledge transfer.<sup>11</sup> Although foreign companies not subject to the supply chain law could fill the “gap” – this would not improve the human rights situation in developing countries, nor the competitiveness of German companies.

Conflicting goal  
in development  
cooperation?

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The reference to UN and OECD guidelines as international initiatives for a supply chain law presents weaknesses for two reasons: On the one hand, the UN Guiding Principles refer to human rights aspects, which the individual company can directly and immediately influence

International  
solution necessary

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or control.<sup>12</sup> The UN Guidelines do not therefore directly indicate whether they apply to the entire supply chain. On the other hand, the OECD guidelines are based on a voluntary approach.<sup>13</sup> The more a German supply chain law exceeds the UN and OECD guidelines, the greater the competitive disadvantage for local companies; unless an accordingly strictly regulated law is introduced in other countries. International coordination and joint legislative measures are thus required in order to compensate for possible competitive disadvantages. It is still too early to assess the national go-it alone initiatives, such as the French supply chain law, since there are still no court rulings from France to assess the repercussions on the competitiveness of French companies.<sup>14</sup>

### Difficulties with implementation and responsibility issues

Yet, even if there were a comparable supply chain law in many countries, there would be justified doubts about the feasibility of such a law: How can companies ensure compliance with human rights and environmental standards along the entire, to some extent strongly fragmented, supply chain?

A complete monitoring of supply chains – for example through constant on-site inspection or meticulous tracing of each individual component – hardly seems practical. That applies to SMEs in particular. Even the state “flagship seal” *Der Grüne Knopf (The Green Button)* does not yet cover all production steps.<sup>15</sup> In the pharmaceutical industry, which is already documenting supply chains, the composition of drugs is verified, but not necessarily the conformity with human rights and environmental standards that is eventually difficult to prove. Companies claiming to already comply with due diligence often only check their direct suppliers, which in turn have their own supply chains.<sup>16</sup> At present, it still seems very difficult to control all stages of the supply chain.

A complete traceability of supply chains seems difficult

Moreover, the responsibility for compliance with human rights and environmental standards does not lie with companies alone: Consumers, too, contribute towards improving production conditions with their purchasing decisions – by consciously buying products whose production demonstrably complies with human rights and environmental standards. Given that companies fear damage to their reputation, the purchasing decisions of consumers are an important lever. Against this background, a transparency and disclosure obligation would be useful and could already make an important contribution. States, above all, have a central responsibility since they are responsible for compliance with and enforcement of human rights and environmental standards in their countries. Consistent national legislation and enforcement is the only way to ensure that all employees benefit from better working conditions, and not only those who work for exports to Germany. Furthermore, states can increase transparency by introducing official seals, although the seal needs to be optimised, harmonised and controlled. Another instrument for establishing human rights and environmental standards are trade agreements. Hence in addition to companies, consumers and states also need to fulfil their role.

Consumers and states bear joint responsibility

## Outlook and Summary

From a Christian democratic perspective, a statutory regulation for compliance with human rights and environmental protection standards would definitely be a conceivable measure, which could have positive effects for companies. Criticism regarding the competitiveness and feasibility of such a law, as well as the reference to the responsibility of consumers and states are also justified, however.

Therefore, a statutory regulation would at least have to fulfil the following criteria:

- › **Determination of the due diligence and liability obligations to be fulfilled which are in line with and proportionate to corporate conditions.** SMEs in particular must not suffer any competitive disadvantages. Proportionate rules, differentiated between size, capacity and sector, would facilitate fair competition and better implementation.
- › **Incorporating the statutory regulation into a Smart Mix system** that comprises state and corporate due diligence obligations and combines voluntary and mandatory elements. A Smart Mix system ensures that the responsibilities for implementing human rights and environmental protection standards are divided appropriately between states and companies, and obligations are only applied where they are not implemented voluntarily in any case.
- › **Continuation of existing voluntary corporate alliances and multi-stakeholder initiatives** in order to build on experience and support companies in implementing due diligence obligations. This avoids unnecessary costs and bureaucracy. Where these measures fail to achieve their objectives or to comply with human rights and environmental protection standards, legal obligations must be reviewed.
- › **Support for capacity building of governments in developing countries** for monitoring and enforcing international human rights and environmental standards. The main focus is on empowering developing countries to fulfil their obligations when complying with human rights and environmental protection standards. This requires support from the International Labour Organisation (ILO) as well as bilateral and multilateral development policy instruments.
- › **Consistent advancement of international solutions** at EU and UN levels to prevent competitive disadvantages for German companies and to create a level playing field through uniform regulation. That is the basic prerequisite for sustainably and extensively improving human rights and environmental protection standards. The German EU Council Presidency this year affords the opportunity to play a central role in shaping these matters.
- › **Increase in transparency for consumers** through clearly designed reporting obligations and a consistent link with trustworthy seals. The influence of the consumer as an important lever for sustainable growth is strengthened as a result.
- › **Increased investments in and use of innovation**, making it easier to comprehensively track supply chains. In particular, blockchain technology appears to be promising.
- › **Coordination with measures for strengthening the resilience of supply chains due to the COVID-19 crisis.** The COVID-19 crisis has exposed the vulnerability of global supply chains. It is likely that companies will increasingly diversify or shorten their supply chains accordingly. If human rights and environmental protection criteria are taken into account in this process, it will be possible to strengthen the resilience of supply chains and “kill two birds with one stone”.

- 1 A detailed reflection on the opportunities and conflicting goals as regards implementing sustainability in supply chain can be found in Berger, A. (2019): Globale Wertschöpfung, globale Verantwortung? Nachhaltigkeit globalen Wertschöpfungsketten [Global Added Value, Global Responsibility? Sustainability of Global Value Chains] Konrad-Adenauer-Stiftung, Berlin. <https://www.kas.de/de/einzelartikel/-/content/globale-wertschoepfung-globale-verantwortung>.
- 2 The United Nations Economic and Social Council reprimanded Germany in 2018 on account of this voluntary approach in the National Action Plan on Business and Human Rights. Cf. UN ECOSOC (2018): Concluding observations on the sixth periodic report of Germany. E/C.12/DEU/CO/6, New York.
- 3 Ernst & Young (2020): Zwischenbericht Erhebungsphase 2019 [Interim Report Survey Phase]. <https://www.auswaertiges-amt.de/blob/2314274/3a52de7f2c6103831ba0c24697b7739c/20200304-nap-2-zwischenbericht-data.pdf> (last accessed on 14/04/2020).
- 4 In late April, EU Commissioner for Justice, Didier Reynders, announced his intention to advocate binding regulations at EU level, which oblige companies to comply with human rights due diligence in their global supply chains. Cf. Kashyap, A. & Kippenberg, J. (2020): European Commission Promises to Champion Corporate Accountability. <https://www.hrw.org/news/2020/05/04/european-commission-promises-champion-corporate-accountability> (last accessed on 15/05/2020).
- 5 Müller-Armack, A. (1969): Der Moralist und der Ökonom. Zur Frage der Humanisierung der Wirtschaft, [The Moralist and the Economist. On the Question of Humanising the Economy] in: Ders., Genealogie der Sozialen Marktwirtschaft. Frühschriften und weiterführende Konzepte, 2<sup>nd</sup> extended Ed., 1981, Bern, Stuttgart, pp. 123–140: 131.
- 6 Cf. Gönner, T. (2019): Soziale und ökologische Marktwirtschaft in einer globalen Wirtschaft [Social and Ecological Market Economy in a Global Economy] in: Fücks, R. & Köhler, T., Soziale Marktwirtschaft ökologisch erneuern. Ökologische Innovationen, wirtschaftliche Chancen und soziale Teilhabe in Zeiten des Klimawandels, [Ecologically Renewing Social Market Economy. Ecological Innovations, Economic Opportunities and Social Participation in Times of Climate Change] Berlin: 179–190.
- 7 At the start of December last year, some 55 entrepreneurs published a statement in which they speak in favour of a binding regulation. <https://www.business-humanrights.org/en/statement-f%C3%BCr-eine-gesetzliche-regelung-menschenrechtlicher-und-umweltbezogener-sorgfaltspflichten> (last accessed on 31/03/2020).
- 8 The effect would be further reinforced by a regulation at the EU level.
- 9 Cf. Dr Grieger & Cie. Marktforschung (2016): Slow Fashion Monitor 2016: Repräsentative Befragung von Verbrauchern rund um das Thema Mode und Nachhaltigkeit [Representative Survey of Consumers on the Subject of Fashion and Sustainability]. <https://docplayer.org/26180696-Dr-grieger-cie-marktforschung.html> (last accessed on 31/03/2020).
- 10 Cf. Institut der deutschen Wirtschaft (2014): Nachhaltigkeit macht Arbeitgeber attraktiv [Sustainability Makes Employers Attractive]. IW-Kurzbericht. <https://www.iwkoeln.de/studien/iw-kurzberichte/beitrag/corporate-social-responsibility-nachhaltigkeit-macht-arbeitgeber-attraktiv-186641.html> (last accessed on 31/03/2020).
- 11 Cf. vbw – Vereinigung der Bayerischen Wirtschaft e. V. (2019): Sozialstandards in der Lieferkette [Social Standards in the Supply Chain]. <https://www.vbw-bayern.de/Redaktion/Frei-zugaengliche-Medien/Abteilungen-GS/Sozialpolitik/2019/Downloads/20190430-Sozstand-in-der-Lieferkette-update-2019-final.pdf> (last accessed on 10/03/2020).
- 12 Cf. United Nations (2011): Guiding Principles on Business and Human Rights. [https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr\\_en.pdf](https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf) (last accessed on 10/03/2020): 14.
- 13 Vgl. vbw (2019): Sozialstandards in der Lieferkette [Social Standards in the Supply Chain]: 11–12.
- 14 Cf. European Commission (2020): Study on due diligence requirements through the supply chain. <https://data.europa.eu/doi/doi:10.2838/39830> (last accessed on 10/03/2020): 19.
- 15 Faserproduktion und Weben/ Spinnen [Fibre Production and Weaving/Spinning]; Cf. Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (2020): Der Grüne Knopf [The Green Button]. [https://www.bmz.de/de/themen/textilwirtschaft/gruener\\_knopf/index.html](https://www.bmz.de/de/themen/textilwirtschaft/gruener_knopf/index.html) (last accessed on 11/03/2020).
- 16 Cf. European Commission (2020): Study on due diligence requirements through the supply chain: 16.

## Imprint

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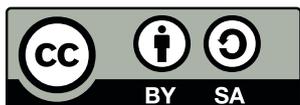
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