SUBMISSION BY SOMO TO THE TRADE COMMITTEE

The Need to Apply International CSR Standards to Trade

Seventh Informal Consultation between the OECD Trade Committee and Civil Society Organisations (CSOs)

This paper has been submitted by SOMO (Centre for Research on Multinational Corporations). The views expressed herein are those of the author and are not necessarily shared by members of the OECD.

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Discussion paper
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Globalisation and trade liberalization has led to a growth in power and influence of Multinational Enterprises (MNEs). As a result of trade agreements in the WTO, and regional or bilateral trade and investment treaties, the rights of MNEs to trade and invest worldwide are increasingly being secured at an international level. On the other hand the development of an international framework for the responsibilities of MNEs regarding human rights, workers’ rights and the environment is still weak. In particular, an international enforcement mechanism to ensure standards for Corporate Social Responsibility (CSR) for MNEs in worldwide trade is lacking.

There are many different definitions of CSR. NGOs often define CSR as a process in which corporations take responsibility for the social, environmental and economic consequences of their actions, throughout their product and service delivery chains, making themselves accountable and engaging in a dialogue with their stakeholders. When it comes to trade, CSR should also address business practices, such as pricing, delivery deadlines and other contractual conditions. These should not make compliance with international social and environmental standards impossible throughout the supply chain. The issue of fair pricing is therefore of particular importance when CSR is applied to trade. Resistance by developing countries against the development of international CSR standards applicable to trade is often caused by a lack of assurances for fair prices that include social and environmental costs into price setting.

The international forum where agreements on trade are being negotiated is the WTO, and one is inclined to look at this forum to discuss CSR standards to trade. However, it has long been acknowledged that agreeing on CSR standards in the WTO is a sensitive issue (for example, the inclusion of a ‘social clause’ in the WTO). More importantly, there is a need to address how WTO rules can undermine CSR efforts by governments:

- WTO regulates the behaviour of governments not corporations. As a result, whole countries can be punished for the misbehaviour of some corporations.
- WTO rules, such as GATS rules concerning standards and licences limit the ability of governments to regulate the behaviour of corporations. When governments use WTO...
exceptions (e.g. Art. XX of GATT 1994) to ban trade for protection of health and life, they can be challenged by other WTO members, which has a chilling effect on the introduction of regulatory measures.

- The WTO principles of non-discrimination conflicts with CSR mechanisms and initiatives that aim to distinguish between corporations that do comply with social and environmental standards and those companies that don’t. Social and environmental criteria can only be legally applied to all (domestic and foreign) companies.

- The WTO rules remain unclear in what way (1) voluntary and compulsory social and environmental labelling can be used (under the TBT agreement), especially when labels can restrict trade, (2) how far governments can use and extend WTO exceptions (e.g. Art. XX of GATT 1994) to ban trade e.g. for the protection of health and life, and (3) governments can use ILO conventions or environmental as criteria for their procurement practices.

- The WTO makes it difficult for governments to take measures against companies and countries that do not apply the precautionary principle. This was shown by the complaint raised by the US against the EU for not granting licences for the import of genetically modified organisms.

There is one clear example where the WTO has supported a CSR initiative and approved a waiver of trade obligations (non-discrimination) based on a human rights rationale. The Kimberley process, that aims to ban trade in diamonds originating from conflict areas, was linked to the WTO through a trade waiver. However, this seems to be a very exceptional decision, based on the serious commercial threat to the whole diamond trade. It is highly unlikely such trade waivers will be made concerning trade from non-conflict zones where there are social and environmental problems in production processes. It is problematic that effective CSR measures are dependent on approval of the WTO.

Another international forum that is active on CSR issues is the OECD. The set of OECD Guidelines for Multinational Enterprises is a framework outlining part of the concept of CSR that could be applied to international trade. The OECD Guidelines outline the expectations of OECD and adhering countries to their MNEs in a broad area of CSR aspects. However, in 2003 the OECD decided that the Guidelines apply only to investments and ‘investment-like’ relationships, and not to trade relations. With that decision recommendation Chapter 2, paragraph X dealing with relations among suppliers and other business partners was made meaningless.

The question of the scope of the OECD Guidelines - the definition of the activities to which the Guidelines are thought to apply has led to much debate. Elements such as the level of influence and the number of suppliers define whether or not the OECD Guidelines are applicable. From their experience with raising issues concerning alleged violations of the...
Guidelines in supply chains of OECD based MNEs, NGOs feel the interpretation by some governments has significantly narrowed the scope of the Guidelines in recent years. If trade-related cases are not generally deemed to be within the scope of the Guidelines, and the OECD Investment Committee is not able to deal with trade cases, OECD Watch calls for the development of a complementary instrument.

While the scope of the OECD Guidelines seems increasingly narrowed, the need for an internationally agreed CSR standard for international trade is becoming more and more apparent. International trade is growing and business structures and chains of productions and distribution are becoming more and more complex and intertwined. Most international trade is done by MNEs. The tendency to outsource production has been followed by a tendency of MNEs to outsource ICT, administration, research and other non core activities and processes to low-income countries. These growing outsourcing practices of MNEs link MNEs directly to trade. Sixty percent of FDI is in services. Investment in services is defined as "trade in services" by GATS/WTO. In other words, the differentiation between investors and traders becomes increasingly blurred. At the same time, improved information channels have increased knowledge about existing social and environmental problems, especially down supply chains of MNEs. This in turn has led to legitimate concerns from consumers and civil society organizations about the responsibilities of MNEs which they seem to disengage from while outsourcing.

Within the UN, The UN Norms for Business, developed within the Commission on Human Rights has potential to become the leading international framework for corporate accountability. The UN Norms include a strong paragraph on supply chain responsibility. The Commission has appointed a special rapporteur that will undertake research into a number of outstanding issues, one of which being “spheres of influence”.

At the voluntary level, a number of initiatives can be seen that address the social and environmental responsibilities of corporations vis-à-vis their suppliers and business partners. While some initiatives showed valuable progress, the impact in comparison to worldwide trade flows is very limited. A problem with these private initiatives is the issue of legitimacy and credibility of the monitoring schemes and the lack of guarantees to suppliers of a fair price, that allows being compliant. NGOs have questioned the top down approach that is often used in these schemes, where audit companies are hired to check social and environmental standards at suppliers. Furthermore, there is a lack of transparency of the auditing methods used, and a lack of external scrutiny. Ironically, while a lot of attention in WTO agreements is on ensuring that government laws and behaviour are transparent and predictable, no WTO rules compel governments to require business trading and investing in their countries to be more transparent.
One way to increase the credibility of voluntary initiatives is to include NGOs and trade unions in the governance structure of these initiatives. A good example of such so called multi-stakeholder initiatives is the UK based Ethical Trading Initiative (ETI). The ETI is an alliance of companies, NGOs and trade union organisations working to promote and improve the implementation of corporate codes of practice which cover supply chain working conditions. The ETI is increasingly recognising the limits of social auditing, and is exploring alternative or complementary models that emphasize education and training for suppliers, capacity building and worker education.

But the problem with even the most promising voluntary CSR initiatives addressing supply chain responsibilities is that they are concentrating on a number of sectors and corporations that have an interest in protecting their public image. Basically, these initiatives work for the well-intentioned. Generally, it can be seen that brand name companies are to a certain extent willing to take measures to improve social and environmental situations in their supply chains. When it comes to unbranded companies, like distributors and business-to-business companies, incentives are lacking to take CSR seriously. Thus, the inherent limitations of voluntary initiatives demonstrate the need for a complementary internationally agreed instrument to guarantee production and trade of all products takes place under socially and environmentally sound conditions.

NGOs are not the only ones concerned about the lack international CSR standards for trade. In a resolution of July 2005 the European Parliament (EP) outlines a number of recommendations to ensure that products imported in the EU are made under respectable labour conditions. Amongst others, the EP recommends that the European Commission propose to extend the scope of the OECD Guidelines from investment to trade. Furthermore, the EP recommends that the Commission investigate the creation of appropriate EU-level legal safeguards and mechanisms which identify and prosecute EU-based importers who import products which allow the violation of the core ILO conventions, including the use of child labour, in any part of the supply chain.

The Dutch government has also showed its concern about the lack of the applicability of CSR standards to trade relations. As a result of the 2003 clarification of the OECD on the scope of the OECD Guidelines, the Dutch government felt they had to turn down a number of cases raised by NGOs and trade unions that addressed serious problems in trade relations of Dutch companies. The Dutch government is now concerned that resistance from consumers against import of several overseas products may rise, thus weakening support for further trade liberalisation, and therefore is of the opinion that trade policy makers have a contribution to make in the search for new initiatives to cope with consumer concerns.
While it is welcomed that the Dutch government is raising these issues amongst its fellow trade policy makers within the OECD, the focus on delineating consumer concerns is too narrow. It suggests that as long as consumer concerns are taken away, the process of further trade liberalisation can be pursued. But consumer concerns will only rise when stakeholders or civil society groups are able to raise problems and when it comes to products directly bought by consumers, especially those products at the high end with a brand name. So the issue of how to deal with problems in production and distribution chains concerning non-consumer products and services remains unanswered.

There are limits to what can be expected from consumers in terms of making ethical choices. Fair trade products have only been able to capture small margins of the overall market. Even if they would be willing, consumers are often unable to make informed choices because they simply do not have the information, and supply chain are becoming more and more lengthy and complex. Computers, for example, consist of components from many different producers in many different countries. It will be very difficult to provide consumers with information about the production circumstances under which all these computer components are being made. Besides, it will be difficult to make a distinction between computer brands, as social and environmental problems can be seen in every supply chain of these brands. Also, difference in consumer prices does not necessarily reflect difference in payments to producers or workers but difference in marketing costs.

**Recommendations to trade policy makers:**

The increasing rights of MNEs to freely trade as a result of further trade liberalisation should somehow be balanced by a framework of cooperative, binding and enforceable international treaties that protect human rights (political, social, economic, cultural), consumer rights and the environment. Such a framework such provide incentives for all MNEs to take social and environmental responsibilities throughout their supply chains.

The ultimate goal should be that social and environmental standards are complied with worldwide. The international trade rules should support the transition to more sustainable production processes. Currently, trade rules undermine such efforts. Steps need to be taken in different international forums to curb this:

**At OECD level:**

- The OECD Members should broaden the scope of the OECD Guidelines to include supply chain responsibilities as stipulated in general principle 2.10 of the OECD Guidelines.
- As a minimum, OECD Governments should apply the OECD Guidelines to their own procurement policies, export credits and other government subsidies. Compliance to the
OECD Guidelines should be made a precondition to these policy instruments. As no company is forced to supply public authorities, or apply for insurances and subsidies, the OECD Guidelines remain voluntary.

- The OECD should undertake research into social and environmental problems and causes in different sectors. In addition to the proposal of the Dutch government research should be done into pricing mechanisms and price setting in product chains, best practices of pricing and contracts, and what constitutes a fair price that takes into account social and environmental costs.

At WTO level:
- The WTO rules should not prevent governments to adopt social and environmental regulation and ensure compliance by companies. The principles on non-discrimination (National Treatment and Most Favoured Nation) should not undermine CSR initiatives and regulation. The WTO members should adopt the necessary interpretations to allow governments:
  - To introduce, allow and monitor social and environmental labelling
  - To put in place social and environmental criteria in procurement practices
  - To introduce social and environmental regulations using article XX of GATT 1994 & GATS XIV on exceptions to WTO rules

At other international forums:
- Governments should take their commitments made in international forums (such as UNCTAD XI and the outcome of the WSSD in Johannesburg) in the field of corporate responsibility and accountability more seriously. As laid down in the action plan of the WSSD governments should develop intergovernmental frameworks for corporate accountability. Therefore, governments should support the further development of the UN Norms for Business within the UN Commission on Human Rights, with special focus on the current study on “spheres of influence”, which can contribute to a better understanding of responsibilities within trading relations.

- Private social and environmental auditing schemes should be better monitored and regulated to avoid misguided and ineffective auditing practices. Governments should support alternative and complementary multi-stakeholder models that emphasize education and training for suppliers, capacity building and worker education, to allow small producers to comply with the standards. The ILO should be strengthened to be able to build capacity of producers and producing countries and monitor social auditing schemes.
This paper has been drafted by SOMO as part of its CSR & Trade project, financially supported by NCDO, Novib and FDHT. This project seeks to identify the differences, similarities and gaps between the trade, investment and corporate social responsibility agendas. Where one the one hand, rights of Multinational Enterprises (MNEs) when investing and trading internationally are increasingly being regulated in different forums (such as the WTO), rules for the behaviour of MNEs are being developed on a voluntary basis (i.e. the OECD Guidelines). The project aims to come up with concrete policy proposals in the areas of CSR, investment and trade policies at the (inter) governmental level.

1 CSR Frame of Reference, CSR Platform of civil society organisations in the Netherlands, July 2003
2 Aaronson, S.A. ‘A Match made in the corporate and public interest: Marrying voluntary CSR initiatives and the WTO, date unknown
3 See also OECD Watch’ Discussion paper, “The OECD Guidelines for Multinational Enterprises and Supply Chain Responsibility, Cornelia Heydenreich, December 2004
4 OECD Watch, Five Years On, A Review of the OECD Guidelines and National Contact Points, Tricia Feeney, September 2005
5 European Parliament, Exploitation and child labour in developing countries, European Parliament resolution on the exploitation of children in developing countries, with a special focus on child labour (2005/2004(INI)
7 The Dutch Government has put the issue of CSR and trade policy on the agenda of the OECD Trade Committee
8 SOMO, ICT Sector Report, CSR issues in the ICT Hardware Manufacturing Sector, Irene Schipper & Esther de Haan, September 2005