

# Trade and the need to apply international Corporate Social Responsibility (CSR) standards

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Globalisation and trade liberalisation has led to a growth in the power and influence of Multinational Enterprises (MNEs). As a result of trade agreements in the World Trade Organisation (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.

## CSR in the WTO

The international forum where trade agreements are negotiated is the WTO. People could therefore be inclined to look to this forum to discuss CSR standards regarding trade. However, it has long been acknowledged that agreeing on CSR standards in the WTO is a sensitive issue, which was shown in the discussion about a possible 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 the GATS rules concerning standards and licences limit the ability of governments to regulate the behaviour of corporations. When governments use WTO exceptions, for example Article XX of GATT 1994, to ban trade for protection of health and life, they can be challenged by other WTO members. This 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, both domestic and foreign, companies.
- ❑ The WTO rules remain unclear. Firstly, in what way can voluntary and compulsory social and environmental labelling be used under the Technical Barriers to Trade (TBT) agreement, especially when labels can restrict trade? And secondly in how far governments can use and extend WTO exceptions, such as Art. XX of GATT 1994, to ban trade, for example for the protection of

health and life. Thirdly can governments use ILO conventions or environmental standards as criteria for their procurement practices?

- The WTO makes it difficult for governments to take measures against companies and countries that do not

## Defining Corporate Social Responsibility (CSR)

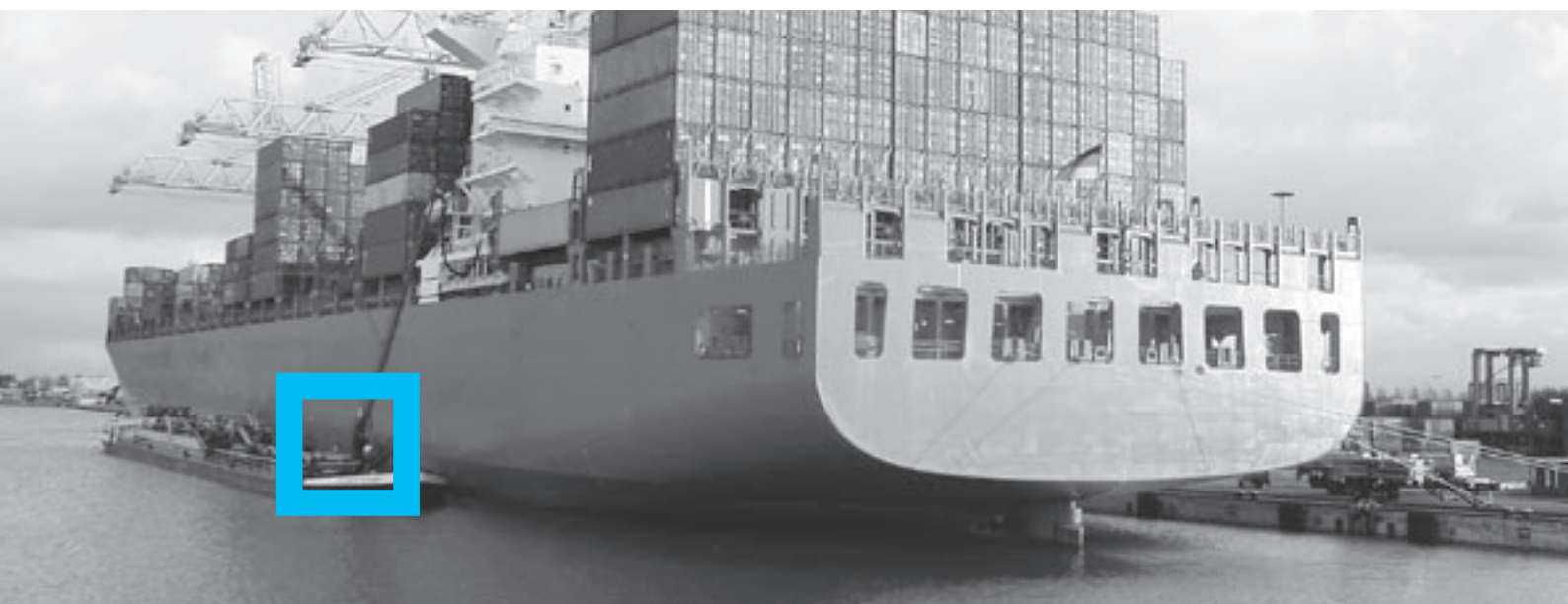
There are many different definitions of CSR. CSR can be defined as a concept that addresses the social, environmental and economic consequences of the activities of corporations including their supply and value chains. CSR initiatives seek mechanisms to ensure corporations can be held accountable for these consequences, on the basis of internationally agreed standards and principles.<sup>1</sup> When it comes to trade, CSR should also address business practices, such as pricing, delivery deadlines and other contractual conditions. These should still enable compliance with international social and environmental standards throughout the supply chain. The issue of fair pricing is therefore of particular importance when CSR is applied to trade. Resistance by developing countries to the development of international CSR standards applicable to trade is often caused by a lack of assurances of fair prices that include social and environmental costs in the setting of prices.

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 non-discriminatory trade obligations based on a human rights rationale.<sup>2</sup> 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.

### CSR at the OECD level


Another international forum that is active on CSR issues is the Organisation for Economic Co-operation and Development (OECD). The set of the 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 the OECD and adhering countries to their MNEs covering broad aspects of CSR. 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 the recommendation contained in Chapter 2, paragraph X, dealing with relations among suppliers and other business partners, was made almost 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. NGOs have experience with raising issues concerning alleged violations of the Guidelines in the supply chains of the OECD based MNEs. Drawing on this, NGOs feel the interpretation by some governments has significantly narrowed the scope of the Guidelines in recent years.<sup>3</sup> 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, then OECD Watch calls for the development of a complementary instrument.<sup>4</sup>

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 production 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. This tendency of MNEs towards outsourcing links MNEs directly to trade. Sixty percent of the Foreign Direct Investment (FDI) is in services. Investment in services is defined as “trade in services” by the GATS/WTO. In other words, the differentiation between investors and traders becomes increasingly blurred. At the same time, improved information have increased knowledge about existing social and environmental problems, especially down the supply chains of MNEs. This in turn has led to legitimate concerns from consumers and civil society organisations about the responsibilities of MNEs. MNEs seem to disengage from these responsibilities while outsourcing.



## Case OECD Guidelines in the tea supply chain

Tea is produced both at tea plantations and at small holdings. Some tea plantations are directly owned by multinational tea companies such as Unilever, and Tata/Tetley. The OECD Guidelines apply to the investments by OECD based MNEs in the tea plantations. Currently, there is a major restructuring process underway in the Indian tea industry due to the fall in tea prices since the late 1990s. The major tea companies have announced plans to sell off their plantation holdings. They intend to concentrate their resources on the more lucrative business of branding and marketing, rather than production, of tea.<sup>5</sup> As a consequence of the restructuring, at least 60,000 tea workers in India have lost their jobs and plantations have closed down. Increasingly, tea companies source from small farmers, either directly or through auctions. Small farmers are not protected by the Plantation Labour Act and have no means of processing. If the OECD Guidelines are not made applicable to such trading relations, the relevance of this instrument is diminishing because many companies engage in outsourcing and restructuring. i.e. diminish their investments in production and increase their trade relations with producers. Such companies have no responsibility under the OECD Guidelines if conditions of production are worsening and falling further below social and environmental standards outlined in the OECD Guidelines.

## CSR at the UN level

Within the UN, The “Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights” (UN Norms), developed within the Commission on Human Rights has the potential to become the leading international framework for corporate accountability. From the perspective of applying CSR to trade, the UN Norms are interesting because they include a strong paragraph on supply chain responsibility. Even though the UN Norms have not been formally adopted in their present form, the work of the Commission on this topic needs to be closely followed and supported in the coming years. The Commission has appointed a Special Representative that will undertake research into a number of outstanding issues, one of which is “spheres of influence”. This study could prove to make a valuable contribution to clarifying the responsibilities of corporations throughout their supply chains.

## CSR at the voluntary level

At the voluntary level, a number of initiatives can be seen that address the social and environmental responsibilities of corporations with regard to 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, which allows them to comply with the high standards. 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 of the 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 recognizing 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 to take CSR seriously are lacking. Thus, the inherent limitations of voluntary initiatives demonstrate the need for a complementary, internationally agreed, instrument to guarantee that the production and trade of all products takes place under socially and environmentally sound conditions.





## European Parliament on CSR and trade

NGOs are not the only ones concerned about the lack of international CSR standards for trade. In a resolution of July 2005 the European Parliament (EP) outlined a number of recommendations to ensure that products imported into 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 investigates 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”.<sup>6</sup>

## Dutch government on CSR and trade

The Dutch government has also shown 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 the trade relations of Dutch companies. The Dutch government is now concerned that “resistance from consumers against (the) 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”<sup>7</sup>.

While it is to be welcomed that the Dutch government is raising these issues among its fellow trade policy makers within the OECD<sup>8</sup>, 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 come up 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 regarding 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, while the supply chains 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 made. Besides, it will be difficult to make a distinction between computer brands, as social and environmental problems can be seen in all these brands’ supply chains.<sup>9</sup> 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 trade freely as a result of further trade liberalisation should somehow be balanced by a framework of co-operative, binding and enforceable international treaties that protect human rights - including political, social, economic and cultural rights-, consumer rights and the environment. Such a framework should 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 the OECD level:

- The OECD members should broaden the scope of the OECD Guidelines to include supply chain responsibilities as stipulated in the 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 with the OECD Guidelines should be made a precondition to these policy instruments. As no company is forced to supply public authorities, or apply for insurance and subsidies, the OECD Guidelines remain voluntary.

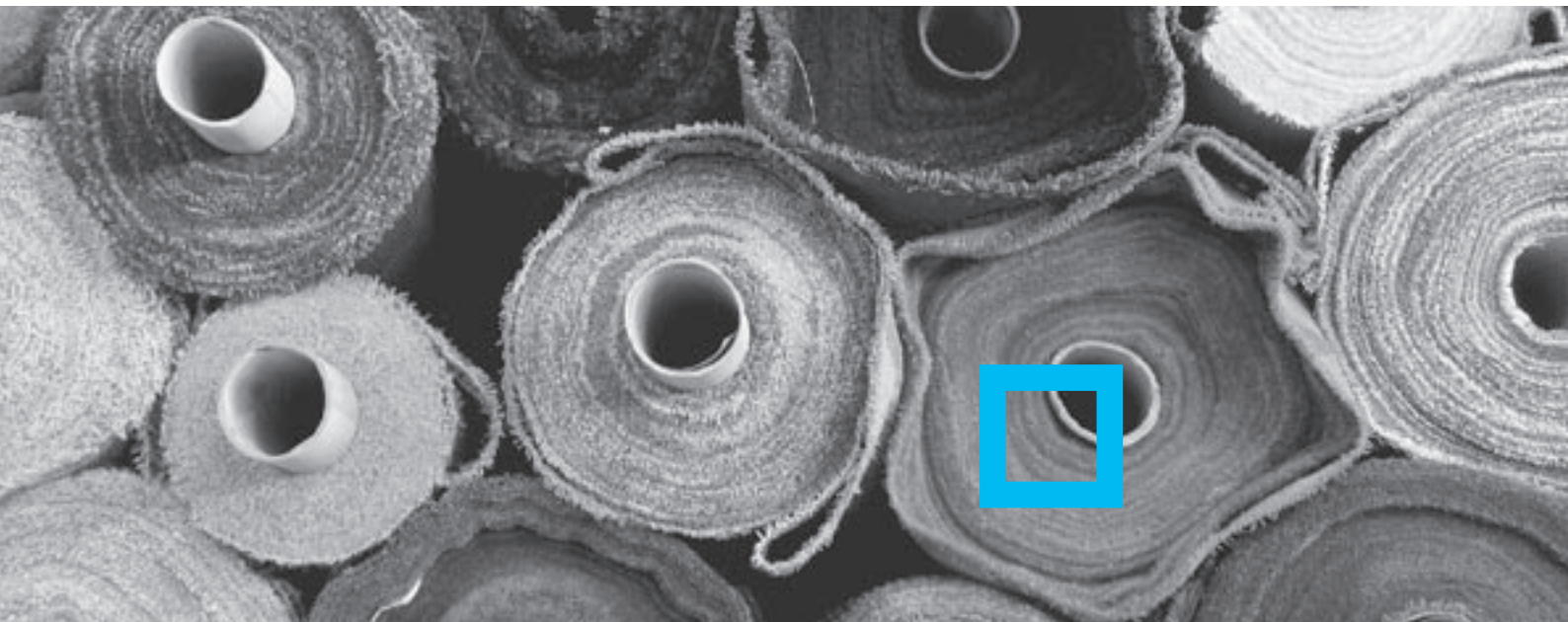
- The OECD should undertake research into social and environmental problems and causes in different sectors. In addition to the proposal of the Dutch government, research should be done into pricing mechanisms and price setting in product chains, best practices in pricing and contracts, and into what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

### □ At the WTO level:

- The WTO rules should not prevent governments from adopting social and environmental regulations and ensuring compliance by companies. The principles of non-discrimination, such as the National Treatment and Most Favoured Nation principles 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 the GATT 1994 and the GATS XIV on exceptions to WTO rules.

In principle, the WTO members and dispute settlement system should acknowledge that, when a dispute relates to both WTO and human right agreements, the Human Rights treaties prevail.





□ **At other international forums:**

- Governments should take their commitments to corporate responsibility and accountability made in international forums such as the United Nations Conference on Trade and Development (UNCTAD) XI and the outcome of the World Summit on Sustainable Development (WSSD) in Johannesburg, 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, in order to allow small producers to comply with the standards. The International Labour Organisation (ILO) should be strengthened in order to build capacity among producers and producing countries and monitor social auditing schemes.

**Endnotes**

- 1 CSR Frame of Reference, CSR Platform of civil society organisations in the Netherlands, July 2003
- 2 S.A. Aaronson, 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: C. Heydenreich, The OECD Guidelines for Multinational Enterprises and Supply Chain Responsibility (December 2004).
- 4 T. Feeney, Five Years On; A Review of the OECD Guidelines and National Contact Points (OECD Watch, September 2005).
- 5 ActionAid: A Tea Break, A crisis brewing in India.
- 6 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 National Contact Point, The Netherlands, Report 2005 (June 2004-June 2005)
- 8 The Dutch Government has put the issue of CSR and trade policy on the agenda of the OECD Trade Committee
- 9 I. Schipper & E. de Haan, ICT Sector Report; CSR issues in the ICT Hardware Manufacturing Sector (SOMO, September 2005).



## Colofon

This paper has been written by SOMO as part of its CSR & Trade project, financially supported by NCDO, Novib and FDHT (Human Rights at Work Foundation). This project seeks to identify the differences, similarities and gaps between the trade, investment and corporate social responsibility agendas. Where on 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. Special thanks to Sander van Bennekom from Novib (Oxfam-Netherlands) for his inputs into this paper. For comments please contact Somo.

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