

Sustainable supply chains

Recommendation of the German Council for Sustainable Development (RNE) for effectively embedding sustainability and human rights in global supply chains

Berlin, 13 May 2020

I. Framework conditions for sustainable development

At the behest of the German Council for Sustainable Development (RNE), in the course of updating the National Sustainable Development Strategy the German Federal Government replaced the existing management rules with six principles of sustainable development. These principles are as follows:

1. Systematic application across the board of sustainable development as a guiding principle
2. Assumption of responsibility globally
3. Safeguarding of natural resources as foundation for a good life
4. Strengthening of sustainable business practice
5. Protection and improvement of social cohesion in an open society
6. Use of education, science and innovation as drivers of sustainable development

Principles 2–4 in particular are the main focus of this recommendation. The RNE is advocating that due diligence regarding social and environmental aspects be embedded in globally linked supply chains and business relations by means of a *smart mix*. This *smart mix* comprises legal requirements and mandatory framework conditions, the outlining of minimum standards as well as voluntary initiatives in the business world and civil society.

Business activities create economic livelihoods and conditions for a good life. They are, however, also what jeopardises natural resources, for example when rainforests are cleared in order to cultivate soya or palm oil or when toxic chemicals are introduced into the environment in the course of raw materials extraction. The overexploitation of nature does not only affect the environment and biodiversity – it also frequently destroys the basis for existence of the people who are dependent on nature. This leads to hunger and poverty, which are to be eliminated in accordance with SDG 1 and SDG 2.

Companies, investors and consumers are increasingly giving preference to a socially and environmentally sustainable approach to business. In order for sustainability to become established as a guiding principle of business, framework conditions and minimum requirements are needed that are binding in equal measure for all companies and which offer guidance and create a *level*

playing field for sustainable business practice. This involves the principle of commensurability being applied and specific company attributes such as size or sector being taken into account when deciding on the framework conditions.

Deciding on such framework conditions is also part of the global responsibility of a leading economic nation that benefits from globalisation. Germany's position as the third-largest importing country additionally supports the aspiration of improving production conditions around the world by establishing social and environmental standards. Germany's Federal Government has already provided important stimuli for this through its G7 Presidency in 2015 and G20 Presidency in 2017, and these were widely well received internationally. The Federal Government should continue to pursue this commitment during its Presidency of the Council of the European Union, which begins in July 2020. The Federal Government should use this Presidency to become the driver and moderator of a solution at the EU level which would have a major effect due to the size of the EU economic area while also establishing a *level playing field* within the EU. Using suitable proposals, it should emphasise how the topic can be advanced through partnership with companies and with the National Contact Points for the OECD Guidelines, through dialogue on the rule of law and together with civil society organisations in the regions. The coronavirus pandemic and the resultant restrictions on international economic exchange have put the importance of global supply chains even more at the heart of political debate. In the current political and economic environment, which has changed immensely and which is so dynamic that the next developments cannot be accurately forecast, many fundamental questions regarding global economic trade are being asked anew and schedules are being readjusted. It is the belief of the RNE that, far from being called into question, the importance of supply chains which are both functional as well as socially fair and environmentally sustainable has actually been confirmed.

II. The cornerstones of effective incorporation of sustainability into supply chains

a. Embedding binding rules within a smart mix

The RNE argues in favour of a *smart mix* comprising mandatory legal requirements, the outlining of minimum transparency standards, the promotion of voluntary initiatives and the introduction of new digital technologies for supply chain traceability in order to effectively integrate corporate due diligence regarding sustainable development into supply chains. Supply chain legislation should take up societal expectations. As a mandatory element within an effective *smart mix* of various instruments, it would complement voluntary, market-based measures and would give companies guidance for the fulfilment of human rights due diligence obligations and protection of the environment within their global business dealings. A clear legal basis would provide those affected with the opportunity to sue for damages in the event that a company has demonstrably failed to fulfil its due diligence obligations in spite of having had the opportunity to do so. To account for the complex structure of companies' production processes and business relations, these mostly taking the form of global supply networks, mandatory rules and voluntary initiatives should complement one another. Ambitious voluntary initiatives should not be rendered obsolete by legally defined minimum standards – ideally, they are boosted by and capitalised on by legally defined minimum standards.

The raising of social and environmental standards generally goes hand in hand with an increase in (production) costs. To make higher standards economically viable and create fair competition between sustainable and non-sustainable business models, taxation and subsidisation policy

instruments could be modified in such a way that responsible business practice is rewarded and is ultimately reflected in pricing. For example, access to funding programmes could be made subject to sustainability requirements or demonstrable endeavours on the part of companies to incorporate sustainability aspects into their core business. Forging a link between these requirements and the existing reporting obligations would contribute greatly to the coherent formulation of political measures and would be a clear signal indicating that the Federal Government is making credible endeavours to create an eco-social market economy.

The RNE believes the focus should be on partnership-based shaping of transformation processes, in which civil society stakeholders should be involved.

Government initiatives, for example in the area of textiles (Germany's Green Button, the Partnership for Sustainable Textiles), and company initiatives such as the *value-to-society* approach of, for example, BASF and also the *Value Balancing Alliance* which have the aim of additionally balancing the environmental and social effects of business activities must become integral parts of an ambitious sustainability policy. Modified incentive systems and pricing mechanisms should also be considered in order to promote companies' broad involvement in sector-specific experiential spaces. Globally recognised certification systems should be incorporated as part of the *smart mix* or should be developed where they do not yet exist, in order to make the consideration of environmental and social aspects all along the supply chain transparent for procurers within the companies and for consumers at the product level (ideally at the pricing level). New digital traceability systems with real-time technology can be of assistance here.

Due to its immense leverage effect, the public sector has a particular responsibility when it comes to enforcing sustainability aspects within the supply chain. This responsibility also features in the UN Guiding Principles on Business and Human Rights under the heading "The State-business nexus". Where the State is itself economically active, it has a particular responsibility to respect universal human rights. State-owned enterprises, agencies involved with foreign trade promotion, and public procurement are explicitly named as examples. State-owned enterprises and the procurement bodies at the national, federal state (Länder) and municipal levels should integrate sustainability criteria into their procurement guidelines more strongly than is currently the case. Supply chain legislation could establish a reliable basis for assessing sustainable procurement.

b. Considering social and environmental responsibility together

The RNE sees it as the responsibility of the Federal Government to bring the opposing positions concerning global supply chains within politics, business and civil society together within constructive dialogue – a *smart mix* must be founded on and supported by *smart discourse*. The RNE offers its support here and is willing to play an active part in such a dialogue process.

The RNE is advocating the swift development and implementation of a *smart mix* comprising binding legal requirements and the promotion of voluntary initiatives in order to increase sustainability in the supply chains of German companies and also foreign companies that engage in business in Germany. This is directed in particular at companies, the lawmakers and social partners, and also civil society stakeholders. Making the proposed *smart mix* the basis for all companies that offer goods and services in the German market is an important prerequisite for the competitiveness of environmentally and socially responsible companies. To promote sustainable development, supply chain legislation should explicitly also address environment-related expectations of corporate due diligence in addition to human rights expectations. It makes sense for human rights and environmental obligations to be regulated jointly as essentially comparable management processes are applied for these within a business. A recent study conducted by the European

Commission's Directorate-General for Justice and Consumers showed that these two topics are often treated separately in "silos"¹. The RNE considers this to be problematic as negative environmental impacts (e.g. relating to raw materials extraction and agriculture) often go hand in hand with human rights violations and these therefore ought to be tackled together. Concrete elaboration of the *smart mix* should also take into account national, European and international standards such as the OECD Guidelines for Multinational Enterprises (in particular Chapter V), the International Labour Organization's core labour standards, and management systems such as the *Eco-Management and Audit Scheme* (EMAS) and ISO 14001. Ideally, companies should be able to link the formulated expectations to their existing processes for the fulfilment of human rights and environmental due diligence.

The RNE also proposes that reporting be improved as an element of companies' human rights and environmental due diligence, ideally through clarification of the EU's CSR Directive and Germany's CSR Directive Implementation Act. To boost the coherence and therefore also the effectiveness of the instruments, recognised standards such as the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises and reporting standards such as the Sustainability Code should be linked and incorporated.

c. Supporting learning processes and identifying solutions through industry dialogue

Supply chain legislation must adequately take into account industry- and company-specific circumstances such as company size (principle of commensurability). Industry windows that would be filled by the social partners by means of binding agreements for the industry in question would make sense for the concrete formulation of a *smart mix*. Quality requirements would have to be defined for these sector-specific dialogue formats such as the involvement of non-governmental organisations and other stakeholders, as expected by the RNE in the Sustainability Code. Additionally, existing measures for companies such as the industry initiatives of Germany's Federal Ministry of Labour and the NAP help desk ought to be expanded. Uniform requirements regarding, for example, reporting in accordance with the Sustainability Code, redress and the coherence of certification systems can be defined within such forums in order to offer companies guidance. These endeavours could be supported by international dialogue on the rule of law and regional dialogue formats.

d. Establishing Germany as a trailblazer

The RNE expressly supports the Federal Government's intention to make sustainable supply chains a focal topic of Germany's Presidency of the Council of the European Union. The cornerstones of supply chain legislation should be adopted in Germany ahead of the Presidency. Germany should then engage in negotiations in this area with France and other member states that have either already implemented legal measures or are in the process of doing so. During its Presidency of the Council of the European Union, the Federal Government should credibly advocate a European solution and steer the debate along the lines of the German proposal. In other words, the Federal Government should tackle the topic of sustainable supply chains simultaneously both domestically and at the

¹ Cf. European Commission (2020, p. 16): "Study on due diligence requirements through the supply chain. Final report." Available at: <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en>.

European level. If insufficient progress is then made with the negotiations at the EU level, supply chain legislation should be immediately initiated in Germany.

Background: voluntary commitment, the status quo regarding environmental and human rights protection

The United Nations adopted the Guiding Principles on Business and Human Rights in 2011. They are founded on the insight that in the course of globalisation there has been a steady increase in the influence of transnational companies on compliance with social standards at production sites abroad. The Guiding Principles therefore provide for companies themselves assuming responsibility for the protection of human rights alongside states, which have primary responsibility. Author of the Guiding Principles, Harvard professor John Ruggie, recommends that companies be encouraged to assume this responsibility via a *smart mix* of voluntary and mandatory specifications.

The German Federal Government implemented the Guiding Principles in 2016 with its National Action Plan for Business and Human Rights (NAP), which for the time being adheres to the principle of companies making a voluntary commitment to protect human rights. When it comes to tackling environmental impacts, the approach pursued to date includes companies improving their environmental performance of their own accord and introducing environmental management systems (ISO 14001) or the *Eco-Management and Audit Scheme* (EMAS). Chapter III of the NAP sets out the expectation made of companies that they should introduce the process of corporate due diligence for respecting human rights as outlined in the NAP in a manner appropriate to their size, sector and position within the supply and value chain.

This process comprises the following five core elements:

1. A human rights policy statement
2. Procedures for the identification of actual or potential adverse impact on human rights
3. Measures to prevent adverse impacts and reviewing of the effectiveness of these measures
4. Reporting²
5. A grievance mechanism

The NAP stipulates that monitoring will be used to determine by 2020 how large enterprises of more than 500 employees are voluntarily meeting these requirements. If it becomes apparent that fewer than 50% of enterprises are meeting the requirements, a legal obligation to do so will be considered. The coalition agreement concluded by the CDU, the CSU and the SPD in 2018 goes slightly further and includes an agreement that legislation will be introduced “should an effective and comprehensive review of the NAP in 2020 come to the conclusion that a voluntary commitment on the part of companies is not sufficient”.

Representative surveying divided into two phases is currently ongoing and is scheduled to be completed in June 2020. Of the approximately 7,200 enterprises with more than 500 employees, 3,300 were contacted between July and October 2019 and were invited to participate in the survey. The enterprises contacted were able to complete the questionnaire regarding implementation of the core NAP elements on the basis of the “*comply or explain*” principle. The details of the enterprises’ self-assessments were checked for plausibility as part of a multi-stage model. The submission deadline

² Companies have been able to report on their implementation of the NAP via the Sustainability Code since 2018.

was extended twice due to initial difficulties with distributing the questionnaires to the companies. The stipulated minimum number of 460 evaluable company responses was eventually achieved after the sample was expanded in October 2019, thus meeting the monitoring process's minimum statistical requirements.

The first results of this survey phase have been available to the Federal Government since 10 December 2019. "On the basis of the results of the evaluations and the application of the statistical weighting procedures described above, 17 to 19 percent of the enterprises are considered to be 'compliers' while 78 to 81 percent of the enterprises are deemed to be 'non-compliers'."³ As such, the quota has so far not been achieved. The results of the second survey phase, which is currently ongoing, are scheduled for release in June 2020.

Labour Minister Heil and Development Minister Müller used the results of the first survey phase as an opportunity to develop some initial benchmarks for supply chain legislation so as to be prepared for the possibility that the second survey phase might lead to a similar result. A broad civil society alliance that includes trade unions, environmental and social organisations and also human rights and development organisations is pushing for supply chain legislation irrespective of the outcome of the NAP monitoring, with the support of top representatives of the two major churches and numerous enterprises that point to the need for a *level playing field* – companies that take their human rights and environmental due diligence obligations seriously throughout the supply chain and also meet them should not suffer any competitive disadvantages. Enterprises that are as yet inactive would be forced to tackle the requirements, resulting in the same conditions for all market participants. For this reason, numerous enterprises are now in favour of supply chain legislation.⁴ Many enterprises already have supply chain management systems in place that focus on, for example, forward-looking digital technologies for supply chain optimisation and in particular for traceability. The latest study conducted by the European Commission's *DG Justice*, in which the responses of more than 300 enterprises were evaluated, likewise concluded that many enterprises hoped that the mandatory embedding of due diligence obligations would promote legal certainty and a *level playing field*.⁵ However, there are reservations among sections of the business and political fields concerning statutory regulation. The primary concern is that a national statutory obligation alone could result in excessive demands being made of and competitive disadvantages for German enterprises.

³ German Federal Foreign Office (2019; p. 4): "Monitoring of the status of implementation of the human rights due diligence of enterprises set out in the National Action Plan for Business and Human Rights 2016–2020." Available at: <https://www.auswaertiges-amt.de/blob/2333700/d15fc19d05e831966bccb305ad7622ca/nap-monitoring--summary-of-the-interim-report-2019-final-data.pdf>.

⁴ Cf. Business and Human Rights Resource Centre (2020): "Our responsibility in a globalised world. A call for mandatory human rights and environmental due diligence legislation." Available at: https://www.business-humanrights.org/sites/default/files/BusinessStatement_Update_30042020.pdf.

⁵ Cf. European Commission (2020, p. 146 ff.): "Study on due diligence requirements through the supply chain. Final report." Available at: <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en>.