

## IASS-Blogpost

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### The Challenges of Regulating Global Supply Chains

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**The German Bundestag is considering a bill that would force companies to manage risks in their global supply chains (GSCs). While the passage of the bill would help to ensure better labour and environmental standards, revisions are still needed in key areas.**

The COVID-19 pandemic has exposed the fragility of globally dispersed, just-in-time production chains, with numerous countries suffering disruptions to the supply of medical equipment, medicine and food. As a result, there have been increasing calls for [protectionist measures](#) as well as supply chain [nationalization](#) and diversification.

While the intense media focus on GSCs is new, as a topic of research they are far from novel. For more than a quarter century, [GSC studies](#)<sup>ii</sup> have been a prominent strand in political economy, helping us to understand how contemporary global trade is structured and organized. Indeed, some [70%](#) of international commerce today involves GSCs, making them the [defining feature](#) of 21<sup>st</sup> century trade.

In the domain of environmental protection, as well, GSCs have garnered increasing attention, as extensive academic and policy debates have been devoted to [sustainable supply chains](#). Growing consumer awareness of the social and environmental impacts of trade has spurred the private sector to adopt voluntary standards for product and supply chain sustainability – a trend that was gaining steam even prior to the COVID-19 pandemic. Civil society calls for effective regulation have only increased considering the growing body of research on the multifarious public health implications of economic activity. These include, for example, the augmented risk of animal viruses crossing to humans from unsanitary animal husbandry practices, or from deforestation for mining or agriculture. *Supply chain laws have an important role to play.*

While rules governing sustainable supply chains first proliferated as voluntary private standards, government regulations seem to be catching up. This month the Germany cabinet [approved](#) a draft law requiring companies to perform due diligence to ensure their GSCs comply with human rights and environmental standards. The draft law, which has progressed to the Bundestag, Germany's lower house of parliament, would apply to companies with over 3,000 employees from 2023 onward. The European Commission plans to present a similar [legislative proposal](#) next spring.

**! Zum Aktualisieren der Textelemente, Zitation markieren und dann F9 drücken !**

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The German bill is not the first of its kind. Other cases include Netherland's 2019 [Child Labour Due Diligence Act](#), France's 2017 [Loi de Vigilance](#), and the UK's 2015 [Modern Slavery Act](#). At the EU level, there also sector-specific examples, including the [2010 EU Timber Regulation](#) and the [2017 EU Conflict Minerals Regulation](#). Despite their differences, these laws share a common goal of requiring companies to conduct due diligence. Companies' responsibilities for their supply chains are also being discussed again in the [US Supreme Court](#) under the [1789 Alien Tort Statute](#).

Civil society groups and academics have [welcomed](#) supply chain laws as a way of making commitments foreseen under voluntary standards legally binding. Advocates contend they should come as no surprise to companies, as human rights and environmental protection have been embodied in treaties and soft law for many decades now.

For many environmentalists and human right activists, however, Germany's draft law does not go far enough. They have criticized the bill's focus on direct contractual partners (tier 1), as abuses are most likely to be committed further up the supply chain by indirect suppliers. Furthermore, actions regarding [climate change and biodiversity loss](#) are not covered by the law.

Companies, for their part, are raising questions regarding the potentially unintended consequences of such laws. One concern is that such regulations will place firms at a competitive disadvantage internationally (for this reason, German companies [prefer a European solution](#)). Yet another is that companies will simply withdraw from supply chains in developing countries (i.e. "[cut and run](#)"). In this way, supply chain laws could work as *de facto* trade barriers, meaning that affected countries would have less access to expertise, inputs and technology, with negative effects on employment, economic growth and sustainability.

*Lessons learned from private social and environmental governance.*

While the social and environmental challenges posed by GSCs demand policy responses, the concerns voiced by critics are not without merit. Criticisms mostly pertain to the distributional impacts of such laws given their extraterritorial reach, creating winners and losers beyond national borders. Indeed, [academics](#) have been calling attention to the fact that legal regimes are a major determinant of power, governance and value creation within supply chains.

Because the few existing examples of due diligence laws are recent, comprehensive studies assessing their impacts are scarce. Nonetheless, voluntary standards have existed for several decades now, and have received widespread academic attention. Accordingly, examining some of their well-known challenges may be of use for evaluating supply chain laws.

The challenges posed by voluntary standards are important, **not least due to the inclusion in the [unofficial draft key points](#) put together by the German Ministry of Labour and Social Affairs and Ministry for Economic Cooperation and Development of a possible "safe harbour" exemption.** This would enable companies that join and implement an officially recognised (industry) standard to limit their civil liability to intent and gross negligence. Although a "safe harbour" exemption was not included in the Federal Cabinet draft, its Appendix (*Anlage*) states that joining industry-specific or cross-industry initiatives is an important tool for working with other companies to take preventive action.

Here I present three examples of challenges associated with private standards, which can serve as criteria for evaluating supply chain laws:

- 1) Despite expectations that private environmental governance might help "[fill the Paris Gap](#)", sceptical conclusions have been reached in various studies seeking to assess the meaningfulness of GSC impacts. Some have argued for a rethink of the traditional compliance model – by which suppliers are rewarded or punished for their performance – in

favor of [commitment-based approaches](#). For example, a study shows that the improvement of labour conditions in supply chains depends on the commitments adopted by buyers in investing in long-term, [mutually beneficial](#) relations with suppliers. Therefore, [positive](#) incentives such as capacity-building should complement contractual standards enforcement.

- 2) A second challenge relates to meaningful stakeholder involvement. In private governance, despite the existence of various voluntary standards based on multi-stakeholder initiatives, these standards are often criticised as “Western dictates” due to the lack of representation afforded to producers and NGOs from the Global South. Beyond more participatory and representative discussions, there is also a need for [“companies to focus their attention on individuals and communities who are or could be affected by their operations or supply chains”](#), thus including dialogue with workers, trade unions and indigenous people.
- 3) A third challenge relates to a broader [“process of unequalization”](#) in GSCs. Specifically, the ownership of key nodes in a supply chain guarantees important leverage for nations and companies, but profits accrue predominantly to [big companies in wealthy countries](#). Aware of the uneven accumulation of wealth, redistributive business innovations are being developed and include solidarity, fair, and direct trade, and [the profit-sharing model](#). Sustainability-driven demands can aggravate the reality of iniquitous GSCs. Through sustainability-driven demands, costs are pushed upstream, and lead firms [capture value for themselves](#). Sustainability standards have, therefore, become a business unto themselves and are criticized as a distraction that impairs more radical and sorely needed economic and social reforms.

More radical reform is needed in a variety of areas, not only to reduce consumerism, but also to generally rethink the capitalist model. Industry concentration, for example, is now seen by activists as a structural feature that can be [leveraged](#) to impose social and environmental standards on suppliers. The same logic underlies due diligence laws, which target large firms and anticipate a cascading effect through the supply chain.

However, many social and environmental problems [arise in the context of](#) highly concentrated markets. As profits are concentrated in the hands of a few large and powerful firms, suppliers may be pressured to decrease their costs. In extreme scenarios this leads to child labour, slavery and environmental harm. [Cocoa production](#) is a well-known example of such eventualities.

Further criticism of due diligence laws takes issue precisely with their attempt to make large firms liable for what happens upstream in their supply chains, without recognising that the contemporary capitalist system itself is the cause of social and environmental harms. For such critics, such laws merely offer “intra-systemic solutions”, which validate rather than critically challenging the fundamental flaws of the prevailing capitalist system.

*Supply chain laws: boon or bane?*

While legal regulations can promote the sustainability of supply chains, effective solutions require a broad approach that includes (1) commitment-based strategies to build trust between buyers and suppliers; (2) the involvement of all relevant stakeholders; and (3) the genuine integration of upstream actors in supply chains. Such integration should include, at the very least, the payment of a

minimum price that guarantees worker livelihoods. Furthermore, supply chain laws should consider the downsides of concentrated market structures and the uneven distribution of value in GSCs.

Taking the three criteria presented above as a touchstone for the design of effective law, how should we assess the draft version of the German [Sorgfaltspflichtengesetz](#)?

The German bill establishes an “obligation to make efforts” (*Bemühenspflicht*) but does not impose an obligation for fulfilment or mandatory liability in the event of violation. The draft sets forth rules for risk management and analysis; preventive and remedial measures; a complaints procedure; and documentation and reporting.

The corporate due diligence obligations defined in the draft are anchored in the [UN Guidelines for Business and Human Rights](#) and the [OECD Guidelines for Multinational Enterprises](#). This would suggest that the draft bill is at least notionally equipped to address the challenges outlined previously.

The German draft applies the principle of “empowerment before withdrawal” (*Grundsatz Befähigung vor Rückzug*), which encourages companies to seek solutions with suppliers or within the industry first. The termination of business relationship with a supplier should be a last resort.

However, positive incentives and commitment-based approaches are [not sufficiently emphasized](#). For example, one of the preventive measures a company must establish in relation to a direct supplier is the implementation of training courses and further education for the purpose of assuring contractual promises (§6.4.3). Furthermore, as a corrective action in the case of violation, the joint development and implementation of a plan with immediate suppliers is to be considered (§7.2.1). In the Appendix it is stated that support of indirect suppliers in risk prevention and avoidance may be an appropriate measure that can lead to the building of stable business relationships based on targeted and long-term support.

The same can be said about affected individuals and communities. For example, regarding risk management, the draft states that a company must take due account of the interests of its employees, the employees within its supply chain and those who may be directly affected in any other way by the economic activity of the company or by companies in its supply chains (§4.4). More concretely, internal or external procedures must be set to enable the filing of complaints by affected individuals (§8); and German-based trade unions and NGOs may go to court on behalf of victims (§11 *Besondere Prozessstandschaft*).

In the Appendix, discussions with employees, their union representatives, and local residents are recognised as an important source of information gathering; assessment of preventive and remedial measures can take the form of direct consultations with individuals and legitimate interest groups such as trade unions; and it is conceivable for companies to support social projects in a region that serve to strengthen certain rights, such as **freedom of association**. Nonetheless, these suggestions and examples mean that the draft law does [not sufficiently emphasize](#) the need for companies to focus their attention on (potentially) affected individuals and communities, nor does it clearly impose an obligation for meaningful stakeholder involvement.

Regarding the problems of industry concentration and uneven accumulation of value, the draft law does not seem to recognise nor engage with them. While businesses must identify and analyse risks caused by their activities (and their business relationships), the law does not discuss the risks caused by industry consolidation. Moreover, the preamble recognizes that by complying with the law, the prices for some goods and services may increase – although it is impossible to quantify such impacts – and that indirect effects are to be expected in supply chains. However, the draft does not call for the equal distribution of costs and benefits.

In addition to revisiting the current draft, reforms are also needed in other legal fields such as [tax](#) and competition law. For example, although competition law is rarely concerned directly with [distributional questions](#), it can shed light on how to remedy asymmetries in bargaining power (e.g. between smallholders and large corporations). While the competitive marketplace is global, no formal multilateral competition regime exists at the [global level](#), except for some bilateral and multilateral cooperation agreements, such as the EU antitrust system. Without a global regime that at least establishes [common basic rules](#), national competition systems overlap in long and complex supply chains, resulting in the intervention of [multiple jurisdictions](#).

The same argument could be made for national supply chain laws. The lack of global regimes diminishes the potential impact of laws in promoting more equitable supply chains. Here the solution demands not only well-designed legislation, but also multilateral cooperation.

Thus, while supply chain laws are certainly a welcome step in the promotion of more sustainable business practices, they are not a silver bullet. Indeed, any critical assessment of the complex and interrelated challenges that abound in this area will necessarily conclude that answers are unlikely to be found in a one-size-fits-all solution.

Supply chain laws certainly represent an important piece of the puzzle. However, to be effective they must be oriented to benchmarks that are attuned to the specific challenges facing supply chain standards, as discussed in the foregoing.

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<sup>i</sup> I am grateful for comments and suggestions on earlier drafts by Andreas Goldthau and Veronika Ertl. Any error is, of course, mine.

<sup>ii</sup> There are different strands of thought in the study of contemporary global trade, and a variety of acronyms, including Global Value Chains (GVCs), Global Production Networks (GPNs), and more recently Global Poverty Chains (GPCs). For more on this topic, see: Gereffi, G. and K. Fernandez-Stark (2018). *Global Value Chain Analysis: A Primer* (Second Edition). [Global Value Chains and Development: Redefining the Contours of 21st Century Capitalism](#). G. Gereffi. Cambridge, Cambridge University Press: 305-342; Coe, N. and H. Yeung (2015). [Global Production Networks: Theorizing Economic Development in an Interconnected World](#) (Oxford/New York: Oxford University Press, May 2015); and Selwyn, B. (2016) "Global value chains or global poverty chains? A new research agenda." [Working Paper Series](#).