From the Board: International Trade and the Regulation of Responsible Global Value Chains

Recent hiccups notwithstanding, international trade remains resolutely intertwined with the concept of global value chains. One could even claim that the current modern configuration of the global trade system is founded, and dependent, on global value chains. Helped by the spectacular diffusion of technology and declining transportation costs, producers have been extremely efficient in decentralizing parts of production to suppliers located across the world in order to exploit comparative advantage and local excellences, as well as lower labour costs and relaxed regulatory frameworks. To give an idea of the sophistication of the integration of global production, an iPhone contains components from more than 700 suppliers located in thirty-one different countries. World trade in intermediate goods has recently become greater than that in all other traded goods combined. However, trade regulation struggles to keep the pace of the current hyper-connected and hyper-integrated configuration of production.

It is not just about tariffs, which harm consumers and also disrupt the value chains in which national businesses are integrated. The rise of global value chains brings to the fore the challenges for regulators across the globe in addressing some of the oldest and more vexatious externalities associated to economic integration: detrimental social and environmental impacts of transnational corporations. As the global outrage following the collapse of the Rana Plaza building in Bangladesh aptly illustrates, global value chains make the connection between negative social and environmental externalities in developing countries on the one hand, and consumers and producers in the West on the other, inescapably visible to consumers and regulators alike. Old WTO debates about 'trade and environment' and 'trade and labour' have been revamped in a global, transnational and multi-actor conversation on how to offset the negative effects of global value chains. In this context, the European Union has been playing a leading role in the identification of creative regulatory forms for that purpose. EU approaches hardly indicate a clear and consistent strategy; however, several recently adopted measures share an intermingling of public rules with private rules and standards, non-mandatory international standards, and the strategic endorsement and activation of Western businesses' regulatory capacity in value chains. These approaches also hide a somewhat Western-centric

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approach to transnational regulation. A combination of public and private authority ends up bypassing multilateral trade rules and the constraints traditionally associated to forms of regulation with extraterritorial effects. Private actors' rules in line with EU requirements, or chosen by the EU, contribute to determining the substance of product features and production processes abroad. To a large extent, EU forms of co-regulation of value chains centred on private authority and international standards are very complex to appraise under WTO rules.

In the EU, private standards are being incorporated in some measures regulating responsibility and sustainability-related concerns in value chains such as biofuels, timber, and conflict minerals. This incorporation constitutes a formal element, but EU practice as it stands does not seem to contemplate mechanisms for controlling, let alone accurately selecting, schemes. Standards continue thus to operate independent from EU incorporation and its possible requirements. Both EU procurement rules and transparency and reporting obligations for corporations rely strongly on private standards in defining and monitoring various sustainability-related obligations of businesses. Private standards allow regulators to bypass jurisdictional constraints and, through private forms of monitoring and enforcement offered by standards, allow implementation of EU requirements abroad. Certain private standards are also capable of ensuring chain-of-custody certification and traceability especially of agricultural products, meaning that products can be traced back to all businesses in the value chain which contributed to their production, and that all these operators have complied with the standards. While this approach is potentially positive for the public goals these standards pursue, the lower tiers of a value chain, often the weakest actors with limited operational capacity, may be structurally and negatively impacted by standards to whose drafting they neither contributed, nor could actually choose not to apply. Regardless of various concerns raised about the role of Western brands and retailers in private standard-setters and by the claims of trade-restrictiveness and discrimination by developing countries' producers, EU regulators display a growing extent of trust towards transnational private regulators. A key role for standards emerges from EU policy documents from the Commission and not just in global value chains regulation, but also in the framework of bilateral trade agreements.[1] More nuanced has been the position of the Parliament which, at least in the context of palm-oil certification, acknowledged the criticism about ecological and social integrity and the confusing effects of consumers caused by the existence of different schemes, which would justify the creation of a single EU-wide scheme.[2]

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1 Non-paper of the Commission services of 26 Feb. 2018 'Feedback and way forward on improving the implementation and enforcement of Trade and Sustainable Development chapters in EU Free Trade Agreements'.

2 European Parliament resolution of 4 Apr. 2017 on palm oil and deforestation of rainforests (2016/2222 (INI)).

A second prominent feature in global value chains regulation is the role of public 'international standards' in defining the boundaries of responsible corporate conduct. The OECD has been at the forefront of this process since the first version of the Guidelines for Multinational Enterprises in 1976, the last update of which occurred in 2011. The Guidelines, and their sectoral implementing instruments, represent the most comprehensive guidance for companies in matters ranging from labour practices to corruption. As OECD Members are under an obligation to promote and employ the Guidelines in their measures, the instrument has been 'hardened' by public use. Recent measures in the US and in the EU addressing conflict minerals make it mandatory for importers to follow the 2016 sectoral Guidance on conflict minerals. Among its many requirements, the Guidance mandates importers to trade only with entities in compliance with the OECD Guiding Note for Upstream Companies Risk Assessment, containing specific (and burdensome) internal processes concerning their on-the-ground, day-to-day operations. In this way, compliance with the Guidance is ensured throughout the supply chain. However, this process also results in the imposition of OECD rules in non-OECD countries which may not have been involved in the drafting of the Guidance.

Another global value chain-related international standard which is similarly finding its ways in EU legislation and in measures enacted by its Member States are the 2011 United Nations' Guiding Principles on Business and Human Rights (UNGPs), and in particular the concept of human rights due diligence. A product of an extensive multi-stakeholder consultation, the UNGPs establish a moral responsibility of corporations to respect human rights in their activities. The UNGPs determine the situations in which a business may be considered to cause, contribute or be directly linked with negative human rights impacts in its activities and in its value chain. Through the performance of human rights due diligence, corporations are supposed to monitor, identify, address and remedy situations of human rights impacts to which they are connected. Among the impacts corporations are called to account for, human rights impacts caused by a supplier, possibly even a second or third-tier supplier are included. In those instances, corporations have to address the activities of other economic entities both by means of economic and non-economic leverage. Corporations are thus conferred broad regulatory functions in their value chains concerning human rights, which are made mandatory by a number of measures turning human rights due diligence into an enforceable obligation. This is the case, although with some remarkable differences, of the French Law establishing a Duty of Vigilance, the UK Modern Slavery Act, the Dutch Child Labour Due Diligence Law, and a pending Swiss initiative aiming at similarly creating a human rights due diligence obligation for companies operating in high-risk sectors.

The UNGPs and the concept of due diligence, the core of which also appears in the OECD Guidelines, constitute the most innovative approach to tackle labour,

human rights, and environmental concerns in global production, as they establish clear responsibilities and expectations for corporations. The EU timber Regulation represents the first instance where due diligence obligations were imposed, and the concept of due diligence was transposed away from the financial domain where it originated. The EU and its Member States are arguably under an obligation to support and ensure the implementation of the UNGPs, which could occur though their incorporation into mandatory measures. The European Parliament recently urged the Commission to come up with a regulatory proposal for due diligence in the garment sector, where high risk of labour rights violations persist.[3] The Commission seemed to favour a more hands-off approach, focused on financial support to developing countries producers in the context of international cooperation, the promotion of social and environmental best practices via multi-stakeholder dialogue, and increasing consumer awareness of production practices in the garment value chain.[4] However, the position of the Commission may rapidly change in light of the considerable activity at the Member State level. As different national rules may distort the playing field in the internal market – in particular in light of measures with a broad scope of application such as the French Law – the Commission may feel constrained to come forward with a proposal for harmonization.

While the multilateral origins of the OECD Guidelines and, especially, of the UNGPs seem to re-establish the centrality of international fora in the regulation of social and environmental elements of global production, the actual features of due diligence could indicate otherwise. The third characteristic of the current trends in global value chain regulation, closely connected with the two elements discussed above, consists of the strong reliance on corporations' internal management, procedures and indicators in 'disciplining' other entities in a value chain. This approach stems from UNGPs, and generally reflects a global consensus in favour of management processes in the regulation of business. In other words, instead of choosing more detailed and direct forms of public regulation of social and environmental externalities, with a varying degree of compulsion corporations are required to do the heavy lifting though the design and implementation of internal processes neither immediately visible, nor under public scrutiny. This reliance on corporations in regulating social and environmental elements of value chains does not change by turning due diligence into an obligation for corporations. It will be internal corporate procedures determining the extent of monitoring and, when necessary, intervention in remedying adverse human rights impacts connected to production. The public (as well as governments) depend on corporate reporting and on the monitoring

[3] European Parliament Report of 28 Mar. 2017 on the EU flagship initiative on the garment sector (2016/2140(INI)).

[4] Commission Staff Working Document SWD(2017) 147 final. Sustainable garment value chains through EU development action.

functions exercised by civil society and non-governmental organization to understand how corporations deal with human rights due diligence and, more generally, with human rights violations in their value chains. As the Commission cannot resort to the enforcement options it has in the domain of competition, enforcement must be decentralized to national courts. Given the variety of possible breaches, and the latitude enjoyed by companies in determining their procedures, it is unlikely that courts will develop a uniform understanding of what constitutes sufficient or appropriate due diligence. In a similar manner, also private standards require the adoption of internal management systems and procedures to ensure compliance, often referring to relevant ISO standards.

All these trends in the regulation of value chains are clearly visible in a 2017 Resolution by the European Parliament putting value chains at the centre of EU trade policy and calling on for clear rules and responsibility for regulating governments and companies.[5] The Parliament reiterated its calls on the Commission to develop mandatory value chain human rights due diligence legislation, in the context of a 'smart mix' of regulation and voluntary corporate action which, in the view of the Parliament, has so far yielded positive results. The Resolution also calls on the Commission to further promote the uptake of sectoral OECD Guidelines possibly in EU legislation along the lines of the 2017 Conflict Minerals Regulation. Parallel to a request for public intervention, the Parliament aims at establishing a more prominent role for private-sector engagement and private initiatives. Unfortunately, in doing so, it takes a 'business-case' approach to social and environmental considerations whose logical corollary would be that corporations do not have to respect human rights if that does not hurt their business. In particular, the Parliament welcomes the 'many promising initiatives taken by the private sector such as codes of conduct, labelling, self-assessment and social audits'. It is difficult to understand that the Parliament accepts all these initiatives as positive *per se*, without considering issues such as the inclusion of non-performance of social and environmental clauses in codes of conduct as a ground for contractual termination, rigorous public benchmarking of the highly varied landscape of labelling schemes and private standards, or measures establishing the financial independence of social auditors from the entities they certify.

The way the transnational regulation of global value chains unfolds in the EU raises several questions concerning the role that the WTO could play in the future in ensuring compliance of such measures with the rules of the multilateral trading system. For example, it is far from clear what would be the extent of responsibility of the EU for the employment of private standards in legislation in modalities which do not correspond to the usual delegation of regulatory competences. The actual obligations

[5] European Parliament resolution of 12 Sept. 2017 on the impact of international trade and the EU's trade policies on global value chains (2016/2301(INI)).

for Members under the TBT Code of Good Practice for standards are rather unclear, as well as the precise actions that Members should take to ensure its compliance by non-governmental bodies. OECD standards may be a source of concerns if producers in countries which did not participate in their elaboration are de facto obliged to comply with them. In addition, it is totally obscure whether discriminatory or trade-restrictive effects generated by corporations implementing due diligence obligations contained in legislation may be attributable to a Member. As a whole, these measures expose how rigid rules of attribution of private conduct are insufficient at capturing the complexity of nowadays' transnational regulation of social and environmental externalities in value chains. This results in a potentially limited application of WTO law to private conduct which factually regulates economic activity under a visible, albeit peculiar, delegation of regulatory competences performed by WTO Members. It is dubious that requiring corporations to undertake HRDD under the threat of sanctions would meet the test for delegation of regulatory powers under Article 5 of the Articles on Responsibility of States for Internationally Wrongful Acts and mirrored in Article 6 of the Draft Articles on the Responsibility of International Organizations. Similarly, the commingling of activities with a regulatory and an economic character would be difficult to reconcile with the requirement in Article 5 ASR that 'the conduct of an entity must accordingly concern governmental activity and not other private or commercial activity in which the entity may engage'.[6]

The WTO has vital battles to fight these days, some of which will be crucial for its own continued existence. In case of survival, or whatever will come next, it will have to come to grip with the fact that Members' endorsement, activation, or orchestration of private actors in the regulation of value chains largely unfolds outside the scope of WTO disciplines. This trend is the outcome of fragmentation in international law and, more specifically, reflects an allocation of international regulatory competence to the more legitimate institutions and fora to pursue social, environmental and human rights-related objectives. However a balance will have to be struck with the need to ensure WTO consistency of Members' measures with far reaching impacts on trade. More precise and broader obligations than those currently (indirectly) applicable to private standards should be established, in order to better identify the expected conduct of Members with respect to their use of private authority in regulating value chains. These rules should hinge on the effective participation of a broad range of interests in the elaboration of private standards and, as also already partially required by the UNGPs, in the elaboration of corporate responses to human rights impacts in the framework of human rights due diligence.

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[6] Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries. Yearbook of the International Law Commission, 2001, vol. II, Part Two, at 43.