RESPONSIBLE BUSINESS CONDUCT & THE "SMART MIX"

Speech by Tyler Gillard, Head of Sector Projects, OECD

18 September 2019, Berlin, Germany

Ladies and Gentlemen,

I'm grateful for the invitation to join you today for a conversation that is both important and timely, looking at the distinct roles and responsibilities of business and governments when it comes to sustainable supply chains.

In sharing with you a few reflections this evening, I'd like to start telling a story.

15 years ago, I worked on a project in northern India guiding a local community in their negotiations with a subsidiary of a global soft drink company over water rights. The community claimed their wells had dried up since the soft drink factory began operation. New zoning rules and pollution from the factory prevented the community from using their traditional forms of irrigation to water their wheat, maize and jowar fields.

Although the OECD Guidelines for Multinational Enterprises had been in place for almost 30 years at the time, responsible business conduct was still limited philanthropic "corporate social responsibility" initiatives. The reaction of the soft drink company at the time was evidence of that mind-set: they initially rejected engagement with the community and separately proposed a rainwater catchment programme in another Indian State. It took eight long years of negotiation for the community to secure a meaningful water-sharing and pollution control agreement.

Today, the landscape has changed dramatically. And I share this story to illustrate two things that help us understand where we've come, and where we still need to go.

First, governments and investors worldwide have begun to realise the alignment between long-term growth and RBC.

New standards of responsible business conduct, business & human rights, expect companies to integrate a new form of corporate risk management into their DNA – a risk management that looks to prevent or mitigate risk to people, planet, and society, beyond commercial risk to the company.

This concept of "due diligence" to prevent or mitigate harm is not new for the environmental experts here. In fact, environmental risk management, and principles like "polluter pays" and the "precautionary principle", helped pave the way for many of these developments. What is new, however, is the extension of these principles to the supply chains of companies. I'll get more into some of this. But the first refelction of what's changed in the last 15 years is that the world increasingly expects companies to do their part, challenging traditional notions of shareholder primacy, and the purpose of business in our society. Today's Financial Times leads with a cover story asking the question on whether Capitalism needs a re-start.

Secondly, my story also illustrates how interconnected impacts on human rights, corruption and the environment actually are. The pullution of the fields and the fall in their water table threatened the community's ability to grow food, access clean water, and pursue their traditional livelihoods. The new zoning rules - which had forced the community to ditch their traditional surface water irrigation - were said to have been introduced as a result of corruption and undue influence.

Now, don't get me wrong. Just because these impacts are often interconnected that doesn't mean that simply using a human rights lens is sufficient to address environmental impacts in the supply chain. It isn't. We need to recognise the interconnectedness between the various strands of business ethics – *but also ensure policy and action is fit for purpose when dealing with each distinct issue.* Take the example of water sharing agreement with soft drink company – a prevention plan that focused only on human rights could see a solution that allowed the company to shift pollution onto land that didn't impact the community, or focused on restoring traditional livelihoods, instead of adopting best available techniques for water use, mitigating pollution.

****

So now, what has been driving these developments over the last 15 years, and where are we going? I will get to international policy action in a moment – a clear driver – but let me start by saying a quick word about investor and market action.

Market levers have started to create significant incentives for companies to take action on their supply chains. Corruption as well as human rights and environmental harms caused by business activities are linked to a range of market, legal and reputational risks.

Currently, there is $23 trillion USD worth of funds that consider, in some shape or form, "ESG" requirements. Unfortunately, there is a real lack of clarity on what this means, as the metrics and standards vary considerably. *Still, here we have a trend that shows how we need to think beyond simply supply chains, to value chains.* The environmental and particularly the climate movement have helped to lead many of these efforts.

Let us also consider the trend in commodities markets. Across the globe, most major gold markets and exchanges now require gold refiners to undergo regular "responsible gold" audits in line with the OECD Due Diligence Guidance for responsible mineral supply chains. Today, this *industry-driven* requirement covers over 90% of gold production. The London Metal Exchange, whose accredited metal "brands" account for 75% of base metal production, recently announced that they intend to introduce OECD-based requirements for producers across all their metals. These pinch points in supply chains – exchanges, processing and trading hubs – can create a major incentive for business to change.

There has also been furious activity by the international community, which has set a poltical tone that enables further action at domestic and market level.

- The OECD Guidelines for Multinational Enterprises were updated in 2011, and governments worked hand in hand with the Ruggie team to ensure alignment with the new UN Guiding Principles on Bubsiness and Human Rights. The update of the OECD Guidelines update also took the supply chain due diligence recommendations and extended it to the other chapters of the guidelines, beyond human rights – to environment, corruption, labour and consumer protection.

- Since then, OECD and non-OECD countries representing 48 governments have adopted due diligence standards in minerals, agriculture and garment supply chains, as well as for investors and banks. Last year, Ministers from these 48 countries came together and released a new Due Diligence framework for all sectors of the economy, covering all the major areas of business ethics, including the environment.
- There have also been major political commitments at the G7 and G20 levels. Germany has helped to drive much of this through its Presidency in 2016 and 2017, although much of the political push at these levels focused on labour. However most recently, this year G7 environmental ministers met and called on implementation of OECD Due Diligence Guidance in all sectors to address increasing harm to biodiversity.

At a domestic level, there has also been an impressive flurry of action. Governments have:

- Dramatically increased their development aid budgets to build capacity in developing countries to regulate business behaviour and enforce their own environmental, labour, anti-corruption laws. Primarily focused on agriculture, mining and manufacturing sectors. Our data shows that funding for projects to support responsible mineral supply chains alone has increased almost 900% since 2009. Germany, the United Kingdom, Canada, the United States and the EU stand out as leaders here.

- Governments have also set new rules for public procurement and government-backed funding and support that require implementation of RBC standards, including the new OECD Due Diligence Guidance in the supply chain. Notably, export credit agencies in Sweden, Norway and Canada have recognised that they have their own responsibilities to carry out due diligence under OECD standards. Canada also conditions it economic diplomatic support to companies, e.g. whether they allow companies to join them on trade missions, depending on their adherence to OECD GL and UNGPs. And the United States has adopted far reaching measures for public procurement to guard againt a raft of human rights and environmental impacts.

- Governments have also collaborated with their industries on supply chains, and made efforts to provide more and better information on origin of goods and products to enable company's to do their own supply due diligence. The Dutch covenants on responsible business conduct, now covering I think close to 25 sectors, and the German textile partnership are good examples. In China, we are working with customs authority to improve the traceability data made available to importers and exporters or metal products.

However because of uneven action to date, broad government commitments to "promote" non-binding standards of responsible business conduct are often seen as an escape clause to do nothing (or the bare minimum).

Activists instead tend to favour stronger "stick-based" commitments. The trend towards binding supply chain legislation is driven by frustration with the slow pace of change and continued reports of human rights and environmental harms attributed to global business.

And here, with some exceptions, Europe is clearly leading. France's "Duty of Vigiliance" Law sets mandatory due diligence on the human rights and environmental impacts for its largest companies. The Swiss Responsible Business Initiative, which is a popular initiative that has worked its way through National Council, Council of States, and now back to National Council proposes mandatory human rights due diligence for companies.

Sectoral or issue-specific laws and standards helped pave the way for broader work across sectors. Here of course I'm thinking of legislation on responsible mineral supply chains in the United States and Europe, as well as in central Africa and soon China. Legislation expecting business to combat and report on modern slavery their in supply chains have been introduced in the UK and adopted earlier this year in Australia. Since 2015, the US customs authority can even seize goods at the border if have reason to suspect they were made wholly or in part by child or forced labour.

Advocates of new mandatory laws often don't provide much nuance on the types of regulation that could be most effective. Policy makers are regularly presented with a false dichotomy – to regulate more or not at all. I know this is a particularly sensitive topic here in Germany.

But not all regulations are equal – some can integrate readily into business practice and drive change at the point where the harms are occurring. Others just create more red tape, pushing company resources into costly "tick box" compliance systems and into the arms of third party auditors. And even when looking at the laws already on the books, there are numerous potential conflict – e.g. competition law, fiduciary or director's duties, laws of negligence, parent-company responsibility.

So for those advocating that governments should introduce new mandatory due diligence, I share the following three lessons:

1. **Due diligence is a process, and rules should allow for some flexibility and progressive improvement when good faith is demonstrated**. Due diligence requirements that provide a shield against liability or favour a "comply or explain" model would be consistent with this approach.
2. **Use international standards benefiting from multi-stakeholder support** – like the new OECD Due Diligence Guidance – to define what is expected of companies. This can help companies to streamline cross-border processes, avoid conflicting laws and unnecessary compliance costs. On this basis, countries can seek to establish mutual-recognition regimes with other like-minded countries.
3. **Build on and integrate existing industry or multi-stakeholder initiatives** that have proven their credibility and effectiveness.

****

Ladies and gentlemen, there is both good news and bad news when looking at the pace of change and our future outlook on supply chains.

The good news - there is greater consensus than ever before on what business should do to address impacts of its supply chains. Policy is changing, laws are changing all over the world. Even markets are recognizing sustainability and responsible business as fundamental.

The bad news is that this is just the beginning. We are consuming and polluting more than ever before. Millions of people worldwide still work in desperate conditions. The next frontier will be to consolidate this progress and translate them into demonstrating *actual impact on the ground*. It will still take a while. But there is a sense of urgency – sustainability of supply chains is no longer a niche issue, but fundamental.