# The OECD Guidelines for Multinational Enterprises and Supply Chain Responsibility

A Discussion paper[1]

December 2004

## Introduction

International business has witnessed far-reaching structural changes. Through international business transactions and global production networks the boundaries of enterprises tend to blur. The globalised economy is characterised by the enlargement and complexity of supply chain relationships. Civil society organizations demand that multinational enterprises take responsibility for their supply chain. This requires an assessment of how far the responsibility of multinationals for social and environmental issues in the supply chain goes, and where it stops.

One of the most important international instruments to hold companies accountable are the OECD Guidelines for Multinational Enterprises (the Guidelines). Recently, NGOs have become concerned that the interpretation by some governments of the Guidelines and supply chain responsibility is being significantly narrowed. A key issue in this debate relates to what kind of business activities the Guidelines apply to – whether only to ’investment’ or also to ‘trade’ activities. The debate around ‘trade’ and ‘investment’ has resulted in several individual National Contact Points (NCPs) advising that specific cases are not relevant to the Guidelines. In these instances, NGOs strongly asserted the Guidelines did apply. OECD Watch members are concerned with this development, and the impact on weakening the Guidelines. This paper presents the views of OECD Watch on supply chain responsibility and implementation of the Guidelines – both by governments and by enterprises.

## OECD Guidelines and supply chain responsibility

The 2000 review of the OECD Guidelines resulted in a significant expansion of their applicability to the supply chain of Multinational Enterprises (MNE) in both OECD and non adhearing countries. Business representatives opposed it strongly, but the states adhering to the Guidelines recognised the validity of the need to include the supply chain into the scope of the Guidelines. This inclusion signifies one of the most meaningful improvements to the Guidelines. Business experience demonstrates that whilst many OECD enterprises consider themselves good corporate citizens by not, for example, employing child labour or causing serious environmental damage, this can not always be

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said for the labour and environmental practices of their suppliers, subsidiaries and trading partners.Increasingly the critical aspects of business activities are outsourced. Companies may choose to place ‘riskier’ parts of their activities in separate legal entities for insurance purposes. Or they may aim, through outsourcing, deliberately to isolate themselves from the reputational impacts of risky activities. But while some multinational enterprises have responded to the corporate social responsibility (CSR) issue domestically, many are reluctant to apply standards internationally and particularly amongst their supply chains.

## The compromise of 2000

The 2000 review of the Guidelines involved considerable pressure from NGOs to ensure that the scope of the Guidelines included supply chain responsibility. The result of the review was a relatively weak compromise in the eyes of the NGOs involved. Chapter II, paragraph 10 of the revised Guidelines asks enterprises to: “Encourage, where practicable, business partners, including suppliers and subcontractors, to apply principles of corporate conduct compatible with the Guidelines.”[2] NGOs instead asked to replace the word ‘encourage’ with ‘enable’ as well as deleting the words ‘where practicable’.[3] This was because in many cases, merely ‘encouraging’ or even ‘requiring’ would not be enough to ensure compliance. Too often, contracts between the MNE and suppliers are set at such low price-level that the supplier cannot comply with the additional demands placed on them. ‘Enabling’ would mean that the MNE should set contract prices at such a level that its suppliers can also fully comply with the OECD Guidelines.

To aid in the interpretation of the Guidelines when conflicts arise, the OECD developed a set of commentaries to the Guidelines. The commentary recognises that compatible conduct is sought with all entities with which MNEs enjoy a ‘working relationship’, although ‘established or direct business relationships’ are the main objective of the recommendation.[4] It is further acknowledged that, while there are practical limitations on the ability of an enterprise to influence the conduct of business partners, companies with market power vis-à-vis their suppliers may be able to influence business partners' behaviour, even in the absence of investment, giving rise to formal control. As the commentary explains, these limitations may depend on the sectoral, enterprise and product characteristics such as the number of suppliers or other business partners, the structure and complexity of the supply chain and the market position of the enterprise with its suppliers or business partners. During the revision, NGOs insisted on recognising that MNEs have a strong influence on supplier behaviour through the contract terms they negotiate with, or impose on them.

## The 2002 Roundtable on Supply Chain and the Investment nexus

Developments within the Guidelines policy-making and implementation processes, since their adoption in 2000, has further weakened even the modest provision of the 2000 review. The 2002 Roundtable on Corporate Social Responsibility, with its focus on responsible supply chain management, saw BIAC, the US enterprise Dole, the US and German NCPs exercise considerable influence concerning the supply chain issue. In retrospect, this Roundtable proved to be a critical point in the scope and implementation of the Guidelines. The outcomes led to intense controversy around a reinterpretation of the Guidelines and ultimately the introduction of the ‘investment nexus’ issue.

[2] OECD 2000: The OECD Guidelines for Multinational Enterprises, pp.19.
[3] Oxfam, FoE EWNI, ANPED, Traidcraft 2000: Key issues for civil society. Submission to CIME.
[4] OECD 2000: The OECD Guidelines for Multinational Enterprises, pp. 43.

The 2002 Roundtable heard presentations from BIAC, Proctor and Gamble, TUAC, Human Rights Watch, the Clean Clothes Campaign and the Brotherhood of St Laurence.[5] Several presentations gave examples of developments in CSR and the application of the Guidelines in supply chain responsibility with reference to specific companies. Human Rights Watch (HRW) presented information on labour rights violations throughout the banana supply chain in Ecuador of the US based enterprise Dole. This information, despite being already published, resulted in the OECD Committee on International Investment and Multinational Enterprises (CIME) encountering significant pressure from business groups (BIAC and Dole) and the US NCP to censor the publication of the HRW (and the Brotherhood of St Laurence) written submission to the Roundtable, and the official record of the June 19, 2002 Roundtable on Corporate Responsibility. It revealed an unwillingness by CIME, BIAC and some NCPs to treat all presentations equally and CIME's interest in only hearing 'good news stories'. This compromised the credibility and transparency of the Roundtable and the collaborative spirit in which all stakeholders participate. The most significant outcome was the reinterpretation of the scope of the Guidelines. A distinction was made between trade and investment, and the precondition of an existing 'investment nexus' for the Guidelines to apply.

As a result of The Working Party of the Declaration and subsequent CIME deliberations, CIME stated in 2003 that the Guidelines apply only to investment, in conformity with the name of the Committee and the Declaration on International Investment and Multinational Enterprises.[6] Trade would, in this scenario, be specifically excluded. The CIME further held that the Guidelines have been developed in the specific context of international investment by multinational enterprises and their application rests on the presence of an 'investment nexus'.[7] To implement this, CIME considered flexibility would be necessary and that a 'case-by-case-approach' would be warranted.

Not all NCPs or governments supported this change. Some NCPs accept that "foreign direct investment gives rise to control (and, therefore, direct influence) but direct influence can stem from other circumstances as well" like 'structural characteristics' as market power or 'other business practices' as certification and product tracing systems.[8] NGOs used several occasions, such as the CIME consultation in April 2003, to raise their concerns about what in their view amounts to a re-interpretation of the supply chain issue. With its decision in 2003, the CIME narrowed the scope of the Guidelines significantly by redefining supply chain responsibility. Since then, NCPs initiated the practice of using the investment nexus as a basis for rejecting specific supply chain cases.

## Practical experiences: Implementation Problems

The CIME decision concerning the investment nexus has had far reaching implications. Since the 2000 review, more than 30 NGO cases have been filed, out of which one third has a supply chain relationship. In a number of cases the complaint has been rejected by NCPs because of the alleged lack of the so-called 'investment nexus'. However, whereas

[5] OECD 2002: OECD Guidelines for Multinational Enterprises. Annual Report 2002.
[6] OECD 2003: OECD Guidelines for Multinational Enterprises. 2003 Annual Meeting of the National Contact Points. pp. 12.
[7] Ibid. pp. 12
[8] Working Party on the Declaration, 'Background paper on the scope of the Guidelines'. This paper is reproduced in OECD Guidelines for Multinational Enterprises: 2003 Annual Meeting of the National Contact Points, Report of the Chair, pp. 25-28.

NGOs have demonstrated that there is a strong dependency and therefore the capacity to influence the activities of the product partner.

### The investment nexus in action

The following three cases clearly demonstrate how the narrowing of the Guidelines with the ‘investment nexus’ interpretation has limited the implementation of the Guidelines and hindered corporate accountability.

*Total Fina Elf*

Greenpeace Germany filed a case against the German branch of Total Fina Elf which receives oil from Russia via a pipeline. In this case it was absolutely clear that Total has more than a trading relationship with the Russians. Total significantly depends on this supply route. Total guarantees bank loans for investment in Russian oil-producing areas with existing long-term agreements to accept deliveries that last for a period of up to ten years. Finally, Total controls the market for Russian oil in Germany as its main importer. Despite this evidence, it was still not enough to convince the German NCP to accept this case under the Guidelines.

*Chemical Pharmacy Holland*

The Dutch NCP declared in his statement that they found the OECD Guidelines were not applicable to the case of Chemical Pharmacy Holland (CPH) and their involvement in the coltan trade in DRC, because of an alleged lack of an investment nexus. Despite the fact that CPH has been involved in the financing, the quality control, transport and marketing of coltan for Eagle Wings (EWRI), the Dutch NCP concluded the Guidelines were not applicable for it to be a business relationship and not an investment relationship. Furthermore, the complaint covered a period of 2.5 years and the Dutch NCP stated - after long deliberations – that 3 years is the minimum period for an investment relationship.

*West LB*

Another case filed by Greenpeace was against the public German bank WestLB. The bank provided financial credits  for a pipeline in Ecuador. The case was not accepted because of a perceived lack of an investment nexus. It was argued that project finance is not the same as investment like loans and therefore an investment nexus did not exist.

These cases demonstrate a tendency by OECD governments to limit strongly the flexibility of the supply chain chapter of the Guidelines. These examples highlight the lack of consistency in the implementation of the OECD Guidelines. Whereas NGOs in the Netherlands were told that it would be necessary to have a relationship of at least 3 years, the case against Total Fina Elf was rejected by the German NCP although the business connections (with the loans) lasted for up to ten years. Furthermore the German NCP accepted a case filed against garment manufacturer (Adidas) without significant discussion, yet the Total case involved considerable discussion and assessment. This suggests an acceptance by some NCPs that it is appropriate to include supply chain responsibility in sectors like the textiles industry where there is greater awareness of poor working conditions. This is not the case in the oil sector where NCPs still see a more limited supply chain responsibility.The third example concerning the financial sector is further evidence of the inconsistencies in implementation that are emerging. The Belgian

NCP recently accepted a complaint against three banks that provided loans for the BTC pipeline (without discussing the issue of an investment nexus). However, the case against the German WestLB was not accepted because of a missing investment link.

The arguments used to reject the above-mentioned cases severely undermine the usefulness of the Guidelines as a global instrument. NGOs are greatly disturbed at the way an alleged absence of investment nexus is protecting companies whose long term business activities appear to breach the supply chain provision of the Guidelines.

## Scope of the Guidelines

Any limitation of the applicability to the 'supply-chain' provision, on the grounds that trade relationships are outside the scope of the Guidelines, represents a partial interpretation. The background paper of the Working Party on the Declaration (WPD), including questionaire responses from NCPs, supports some of the NGO views regarding the scope of the Guidelines.[9]

Firstly, while the Guidelines form part of the OECD Declaration on International Investment and Multinational Enterprises, the latter does not define investment. The Guidelines recognise that MNEs encompass a broad range of business arrangements and organisational forms in which strategic alliances and closer relations with suppliers and contractors tend to blur the boundaries of the enterprise.[10] The WPD background paper asserts: 'In this context, definitions of business activities such as investment may be quite broad. This suggests that there may be room for flexibility in assessing multinational enterprises' influence and the presence of an investment relationship in the supply chain, depending on the specific circumstances.'[11]

Secondly, the way in which the Guidelines are formulated militates against their narrow application to investment activities per se: (1) a number of international standards – inter alia, the Universal Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work, the Copenhagen Declaration for Social Development – are cited which are relevant to the application of the Guidelines.[12] These cover a broad range of relationships and areas of conduct. Several OECD instruments are also referenced in this regard. (2) The Guidelines are recognised as complementing and reinforcing private efforts to define and implement business conduct.[13] Often in these instruments no distinction is made between investment and other activities when discussing the applicability of those principles and concepts. To cite one example, the International Chamber of Commerce's (ICCs) rules of conduct and corporate practices manual on fighting bribery contain recommendations that are relevant to both trade and investment.[14] They adopt a broad view of the business transactions to which the rules apply.

Thirdly, the text of the Guidelines gives explicit recognition to the trading dimension of the activities of MNEs whereby 'through international trade and investment [they] have strengthened and deepened the ties that join OECD economies to each other and to the rest of the world' and 'their trade and investment activities contribute to the efficient use of

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[9] Working Party on the Declaration, 'Background paper on the scope of the Guidelines'. This paper is reproduced in OECD Guidelines for Multinational Enterprises: 2003 Annual Meeting of the National Contact Points, Report of the Chair, pp. 25-28.
[10] Guidelines, op. cit., Preface, paragraph 2.
[11] 'Background paper on the scope of the Guidelines,' op. cit., I.3.
[12] Guidelines, Preface, paragraph 8.
[13] Guidelines, Preface, paragraph 7.
[14] 'Background paper on the scope of the Guidelines,' op. cit., I.2.

capital, technology and human resources';[15] and to the promotion of sustainable development 'when trade and investment are conducted in a context of open, competitive and appropriately regulated markets'.[16] The Guidelines also state in the first chapter, that 'Governments adhering to the Guidelines encourage the enterprises operating on their territories to observe the Guidelines wherever they operate' - without distinguishing between trade and investment activities. The General Policies section of the Guidelines asks enterprises to encourage their 'business partners, including suppliers and subcontractors' to follow the principles of the Guidelines. In addition, the Commentary on General Policies devotes a whole paragraph[17] to the importance of the Guidelines for all business partners – 'suppliers, contractors, sub-contractors, licensees and other entities with which MNEs enjoy a working relationship'. In this regard there is little doubt the OECD Guidelines offer a broad understanding of the activities and responsibilities of MNEs.

## Supply chain in business practice and political debates

All stakeholders involved in the promotion and implementation of the Guidelines must consider to what extent should the OECD Guidelines reflect the reality of the corporate responsibility agenda. Present-day business practice is not making a distinction between investment and other business activities, if their brand name is affected. Some examples can be found in documentation of a recent conference held in Germany on supply chain responsibility.[18] In one OECD complaint against two middle-sized Korean companies operating in Guatemala, the US retailer Liz Claiborne, for whom the companies were producing, initiated involvement. The US retailer spontaneously took action to see how best it might address the sensitive issue of repression of trade union rights in their supplier factories, in a way that is consistent with their own code of conduct. Many companies have a much more progressive understanding of these issues – even if motivated by fear of loss of reputation or competitive advantage. They assess risks according to all factors that can be attributed to the enterprise, including the risks associated with the labour and environmental standards amongst suppliers.

At the European Conference on Corporate Social Responsibility, it was stated that "CSR applies to all activities of a company, including cross-border investment and trade."[19] These business activites are synergistic and cannot be differentiated.

These arguments demonstrate that if the Guidelines wish to be *the* CSR instrument, limiting its scope to investment is insufficient, outdated, and not part of the corporate reality with regard to its responsibility and accountability.

## Interpreting levels of influence of the Guidelines

To achieve a joint understanding of how the Guidelines are applicable to business, OECD Watch suggests a four-level framework.

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[15] Guidelines, Preface, paragraph 4.
[16] Ibid., paragraph 5.
[17] Guidelines, Commentary, paragraph 10.
[18] Germanwatch, EED, TUAC, OECD Berlin "Where is the Limit to Corporate Responsibility? Trade Relations and Supply Chain Responsibility of Multinational Enterprises", 2004, soon at www.germanwatch.org.
[19] The European Conference on Corporate Social Responsibility: Final Conclusions, Maastricht, The Netherlands, 7-9 November 2004, at: http://www.csr2004.nl/print/english/index.html.

#### Level one: Direct Investment

- In the case of direct investment such as through purchase of a subsidiary, location of a fully or partially owned plant, joint venture, merger, or other forms where a clear ownership of the entity or operation exists. Here the Guidelines need to be fully implemented.

#### Level two: Shareholder Investment

- Where a company has invested money by buying shares. It can be further distinguished between main share and minor shares, whereas significant shares would mean a company has to fully implement the Guidelines, as it is a subsidiary company. In case of minor shares a company is expected to raise the issue with the management and/ or other shareholders.

#### Level three: Supply chain and production network

- Established and direct business relationships and direct influence other than investment from market power (sourcing and manufacturing), from other business practices (certification and product tracing systems). The supply chain chapter of the Guidelines should be fully implemented.

#### Level four: Sector responsibility

- In cases where the potential influence is limited, a company is expected to show how it uses this influence to promote the implementation of the Guidelines by its business partners. This can for example be done by urging business partners to apply principles of corporate conduct compatible with the Guidelines, by means of dissemination of general policy statements of the enterprise or membership in business federations that encourage business partners to apply principles of corporate conduct compatible with the Guidelines.

## OECD Watch-position

This paper identifies the importance of responsible supply chain management as part of the scope and implementation of the OECD Guidelines for Multinational Enterprises. It recognises the Guidelines as one of the most significant and meaningful mechanisms to promote corporate social responsibility, and to contribute to sustainable business practices that encourage decent working conditions and protection of the natural environment. To this end, OECD Watch recommends:

### To OECD governments:

- That no artificial distinction between trade and investment should be made in the interpretation or implementation of the Guidelines. The scope of application of the OECD Guidelines should be interpreted as recommendations for responsible international business conduct.
- That governments promote the Guidelines as the ‘state of the art’ corporate social responsibility mechanism, which can only be done by interpreting and implementing them in a no less comprehensive and advanced way as other instruments of global significance like for example the UN Norms and the ICC code (see page 4), and sector-specific codes and initiatives that recognise supply chain responsibility.

- That NCPs take up supply chain issues irrespective of their link to investment or trade, as an investment nexus is not relevant to enterprises who judge their risks according to all factors that can be attributed to the enterprise, including risks from suppliers.
- That NCPs explicitly look at the underlying nature of relationships between enterprises and their suppliers, and the nature of the relationship, rather than assuming a world in which 'trade' and 'investment' exist on parallel and unrelated tracks.
- That NCPs, when handling cases, should have a consistent view and thus follow the demand for the 'functional equivalence'[20] of NCPs.
- That further research should be carried out and that the topic be discussed more intensively. For instance, sectors like the oil industry and the financial sector seem to need more discussion.

### To enterprises:

- That enterprises  apply the principles of the OECD Guidelines to all their activities, including global production networks. To emphasize the responsibility for all their activities, enterprises should apply and incorporate the OECD Guidelines in their contracts or other arrangements and dealings with contractors, sub-contractors, suppliers and licensees in order to ensure the implementation and respect of the Guidelines.
- If companies readily accept responsibility for product quality in the supply chain, this responsibility should be extended to the issues as covered in the Guidelines in relation to that supplier.
- Enterprises should take concrete steps on an ongoing basis (like training, capacity building and orientation programs) for building technical and managerial capacity in business partners, including suppliers and contractors/ sub-contractors to facilitate them in complying with principles of corporate conduct compatible with the Guidelines.
- Enterprises should enable their suppliers to fulfil the OECD Guidelines. An important precondition is fair purchasing practices, such as in like fair prices and adequate delivery time. Enterprises should not simply pass the implementation costs of environmental and social requirements up the supply chain to producers who may not have resources to respond to the pressures. The leading buyers must share the costs of doing so along the value chain.
- Enterprises should develop criteria for selection of suppliers based on measures advocated by the Guidelines and through phased training programs ensure that the suppliers are enabled to meet the criteria. They should develop a monitoring system whereby performance of the suppliers is constantly monitored and based on the results decide on the continuation of the contract with the suppliers.
- If a company alone has not enough influence on a supplier, it should team up with other companies or participate in sector initiatives. Some interesting examples can be find in the textile sector.

*This publication has been made possible through funding from the European Commission, Employment and Social Affairs, Novib (Oxfam-Netherlands), Miserior and EED. The sole responsibility of this report lies with the authors and the Commission is not responsible for any use that may be made of the information contained herein*

[20] The OECD asks in the Procedural Guidance of the OECD Guidelines for 'functional equivalence' of the operation of NCPs, see: OECD 2000: The OECD Guidelines for Multinational Enterprises, pp. 35, pp. 58.