LSE IDEAS
UN Business and Human Security Initiative
Briefing Note

Europe's drive to improve corporate responsibility: Be careful what you wish for

The Corporate Sustainability Due Diligence Directive (CS3D) approved by the Council of the European Union at the end of May is set to come into force this autumn giving thousands of European companies, and others operating in the EU, two years to meet new social impact obligations. CS3D is a key piece in the mosaic of European legislation on climate action, environmental policy, and sustainability. This raft of legislation stems from the European Green Deal[1] , a commitment to **reduce net greenhouse gas emissions by at least 55% by 2030**. CS3D will directly apply to an estimated 5-7,000 companies with more than 1 000 employees and a turnover of more than €450 million.

CS3D and the Corporate Sustainability Reporting Directive, (CSRD) sit within an envelope of sustainable supply chains, which also includes action on critical raw materials, deforestation, batteries and forced labour. The CS3D reflects the Commission's determination to create a level playing field within the EU on corporate accountability and responsibility. In France and Germany, supply chain due diligence laws, different in scope but aligned with the new EU regulations, are already in effect. Corresponding laws have been tabled in Austria, Belgium, the Netherlands, and Spain. Outside of the EU, the UK, Norway, and Switzerland have passed laws regarding supply chain due diligence. Rather than only directed at economic competition, these laws target in the most explicit and comprehensive way yet for a public policy, the social role of business, by defining limits to the negative impacts companies can generate. The European legislative wave has put not just environmental but also social impact firmly in the policy frame, with the aim that the EU's Green Deal integrates a 'Just Transition' to net zero, injecting elements of equity and fairness into the move to lower carbon emissions. Focusing corporate responsibility on the lives of people and societies across what

[1] https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en

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the Commission terms 'chains of activities' is a key element in the EU's drive to change the rules of how economies, trade and business work for the rest of this century, in order to spread the perceived benefits of change.

Announcing the final hurdle for passing the directive on 24th May 2024, the Commission explained: 'Large companies must take their responsibilities in the transition towards a greener economy and more social justice. The Corporate Sustainability Due Diligence Directive will give us the possibility to sanction those actors that violate their obligations. It is a concrete and significant step towards a better place to live for everyone.'[2] But will this initiative live up to its own ambitions?

As a new Commission prepares to take office in the wake of last month's elections to the European Parliament, the message from Brussels is clear: there is no going back on Europe's commitment to changing the rules of the game for business. Even though this highly normative agenda puts it on a different path to global competitors in the US or China where sustainability and environmental social and governance (ESG) agendas are being pushed aside in favour of pro-growth economic behaviour. Equally, having achieved its goals, after last-minute deal making in the European Parliament to address populist criticisms of the Directive which saw some key wording and elements toned down, the Commission regards the law-making phase of its Green Deal as complete and is now looking directly to business to implement the spirit and letter of the new laws.

This may be a tall order. CS3D and CSRD are unleashing a scramble for data on human rights, other social goals such as diversity and inclusion, and environmental impacts, which most businesses do not readily have to hand and are poorly equipped to process. Despite EU promises of support, most businesses wonder how to find resources in terms of finance and skills they currently lack. Companies in supply chains, including SMEs, fear that due diligence demands will be passed on to them, although their capacities are even more limited. In key sectors targeted by the Commission such as extractives and the garment industry, the pressure is not only on companies to improve their overall economic, social, and governance performance, but also on producer countries to align their regulations with international standards.[3] Governments and businesses worry they will be locked out of European value chains simply because they lack the capacity to enforce traceability or human rights internationally recognised standards. Producer countries are also caught in the middle of a tension between the EU's aims of wanting a secure supply of critical raw materials needed for net zero on the one hand, at the same time as requiring producers and buyers to demonstrate

[2] Pierre-Yves Dermagne, Minister of the Economy and Employment: https://www.consilium.europa.eu/en/press/press-releases/2024/05/24/corporate-sustainability-due-diligence-council-gives-its-final-approval/

[3] The so-called *de jure* Brussels effect – creating spillovers to behaviour and rules in third countries.

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the management of adverse human rights and environmental impacts from increased production and trade. For example, DRC has entered an MoU with the EU[4] on responsible minerals sourcing, which the EU hopes will improve the region's access to key minerals such as tungsten, cobalt and tin, but the country will require significant institutional reforms to align with international ESG standards, provide comprehensive regulatory frameworks and robust enforcement mechanisms to meet the due diligence requirements.

The EU's social impact ambition currently lacks mechanisms to connect its top-down political drive for corporate sustainability and accountability with the grass-roots realities in countries and communities which are integral to European supply and value chains. The legislation stirs memories of how this kind of normative law-making can produce unintended consequences, particularly if it does not take sufficient account of how such laws play out on the ground. The "conflict minerals" provision – Section 1502 – of the US Dodd Frank Act of 2010 - requires U.S. publicly-listed companies to conduct due diligence and report on tin, tungsten, tantalum and gold, coming from DRC, in order to stop illicit mining revenues from funding armed groups in the region. The *de facto* embargo on minerals trading which followed the legislation caused adverse human security consequences for an estimated two million people in the region, including loss of earnings, increased crime, collapses in retail trade and more school dropouts.[5] The most vulnerable communities in artisanal and small-scale mining which employs an estimated 44 million people worldwide, were hardest hit. A similar prospect could face producer communities in other sectors in fragile and conflict zones, where the new EU obligations require companies to make the greatest effort, and which also pose the greatest risks. It may be a gamble European companies are not willing to take, preferring disengagement instead. Evidence of apparel companies withdrawing from Myanmar suggests this is already happening.

CS3D requires companies to put in place 'effective stakeholder engagement'. Yet there is no systematic process or detailed guidance for what counts as effective or indeed what form engagement, and with which stakeholders, this ordinance requires. Faced with extended supply and value chains, companies are struggling to know where to intervene to produce the kind of consultation and engagement the legislation requires. Dialogue based approaches, such as Human Security Business partnerships[6], proposed by the UN Business and Human Security Initiative, are a methodology for constructing long-term structured relationships between global businesses and local communities, through which to conduct due diligence and manage and measure social impact. However, these partnerships will take time and

[4] Memorandum of Understanding EU-Democratic Republic of Congo on sustainable raw materials - European Commission (europa.eu)
[5] https://ipisresearch.be/wp-content/uploads/2023/12/Due-Diligence-and-the-risk-of-disengagement_Experiences-from-the-mineral-sector-and-a-way-forward-for-the-CSDDD_.pdf
[6] lse.ac.uk/ideas/Assets/Documents/reports/Human-Security-Business-Partnerships-Institutional-Report.pdf

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significant technical assistance to achieve. Multi-stakeholder initiatives – within and across sectors – are also an essential element in changing business behaviour and a basis for cross-learning. The EU is encouraging collaborative endeavours, but few companies have the confidence to forge such alliances on the ground and are nervous as they contemplate a seemingly endless horizon of expectations about corporate responsibility confronted to real barriers and dilemmas.

Without real investment in social capital at local level to implement due diligence, the danger is that CS3D and the rest of the EU legislative agenda will simply produce an unworkable compliance burden, and a tendency towards 'social washing' which will crowd out transformative initiatives by European companies in producer countries and inhibit them from going beyond Do No Harm. Anecdotal evidence of companies simply adding more questions to already lengthy supplier questionnaires to demonstrate due diligence illustrates the potential for jeopardy surrounding the new laws. In that scenario 'Just Transition' may come to mean exactly that: something minimal and less equitable than the legislators intended.

Furthermore, if the political landscape in Europe continues to shift, and the current momentum towards business social agendas suffers the kind of pushback seen in the US from the populist right, the Commission's follow-through to increase corporate responsibility may be curtailed. Drafting and passing the legislation is only the first step: business and governments now need serious help in achieving positive social impacts, worthy of the name.

<u>**About the programme**</u>

The **UN Business and Human Security Initiative at LSE IDEAS**, the **London School of Economics and Political Science** foreign policy think tank, is a research and implementation programme supported by the **United Nations Trust Fund for Human Security** which seeks to further and support the engagement of the **private sector in multi-stakeholder collaborations at local level**, to achieve **sustainable development outcomes**.