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# Small state, big companies

## Rules for economic globalization and the role of Switzerland

**Switzerland is small, rich, and profits greatly from globalization. Consequently, it is under growing international and public pressure from those who wish to make the world economy "fairer" and "more sustainable" by means of transnational rules. Home to many multinational companies, Switzerland is highly exposed to any such regulatory changes. Yet it need not assume a passive role. Indeed, the very process of implementing rules for multinational companies provides valuable scope for action. This factsheet places the issue in a historical and legal context.**

Switzerland is the most globalized country in the world, according to ETH Zurich's KOF Swiss Economic Institute. Numerous multinational enterprises (MNEs) have their headquarters here. The investment volume controlled from within Switzerland totals over CHF 1,200 billion (see Figure 1). Thanks to these ties, Switzerland is also one of the world's richest countries. At the same time, it is small and a bit of a geostrategic lightweight. This makes it particularly important for Switzerland to strengthen its position on questions of whether and how the activities of MNEs can be regulated more equitably and sustainably.

### The complex web of transnational governance

Transnational governance is the term used to describe the architecture meant to regulate and legitimize corporate activities across national borders. It forms a complex structure in which state and non-state actors interweave binding law ("hard law") and non-binding recommendations, codes of conduct, and standards ("soft law"). States are important regulators in this structure, but – unlike in national contexts – not the dominant ones.

What long-term developments characterize transnational governance? How did relevant sets of rules come into being, and how do they interrelate? What are the current and potential roles of Swiss politics and business when it comes to implementing transnational business rules – a process that is still poorly established? This factsheet addresses these questions from a historical and legal perspective.

Three sets of guidelines are crucial to these questions: the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, and the Sustainable Development Goals (SDGs) of the UN 2030 Agenda (see box). The three frameworks seek to legitimate global markets by embedding them in a broader normative architecture that is also committed to non-economic goals. In so doing, these guidelines respond to criticisms from states that view the global economy as unjust. But they also respond to criticisms levelled directly at MNEs – the engines of globalization – by communities around the world demanding that these businesses react to social and ecological concerns and contribute more to sustainable development.

Switzerland and other MNE home countries (i.e. domicile countries or corporate headquarters) face challenges stemming from these three sets of rules. They support them in principle. But implementing them in practice raises tricky questions. The UN Guiding Principles are a good example. The EU requires that

## The Sustainable Development Goals (SDGs)

→ Sustainable development meets the needs of the present without compromising the ability of future generations to meet their own needs (intergenerational equity). At the same time, sustainable development strives for greater equality between world regions (intragenerational justice). This concept, introduced in 1987 by the UN Brundtland Report, is concretized by the 17 SDGs. They are part of the UN 2030 Agenda for Sustainable Development and link objectives set out in various international agreements (including those relating to the environment, trade, and human rights). They emphasize that trade-offs between economic, social, and environmental objectives must be addressed and, wherever possible, resolved. They assign responsibility for doing so not only to state institutions, but also to private actors. They specifically call on companies, as well, to carefully weigh up diverse interests and to invest sustainably.

## The UN Guiding Principles

→ The UN Guiding Principles of 2011 outline how states can implement their obligation to protect individuals against human rights violations by third parties in the economic sphere. This obligation derives, among other things, from the near-universally ratified 1948 human rights conventions. Today, it is widely recognized that protection extends not only to people at home, but also to those abroad. Accordingly, companies should take care not to violate any human rights or environmental standards abroad, and anyone who has been harmed should be able to obtain compensation in the country where the company is domiciled.

## The OECD Guidelines

→ The Organisation for Economic Co-operation and Development (OECD), in 1976, issued Guidelines for Multinational Enterprises (MNEs). These call on governments to encourage MNEs domiciled or active in their country to act responsibly and in accordance with human rights. They also call on governments to provide mediation platforms for injured parties.

MNEs report on human rights and has advised its member states to consider further measures. France, the Netherlands, and Britain have accordingly expanded their due diligence requirements, and other member states are drafting similar rules. Legal adjustments are also under discussion in Switzerland.

## A historical perspective

### Governance in the "first globalization"

The emergence of the capitalist world economy and transnational governance are inseparably linked. The so-called first globalization occurred between the mid-19th century and the start of the First World War in 1914. In the absence of a "world government", the British Empire enforced important security and trade policy regulations *(Pax Britannica)*. In addition, a number of intergovernmental and private organizations were founded. They defined global time zones, spatial coordinates, and technical standards, and established compatibility between legal systems and other market parameters, for example currencies.

Transnational governance reduced transaction costs and made it easier to do business. Switzerland benefitted to a major degree. Between 1870 and 1913, the Swiss economy grew over 2.5% per year on average. Companies like today's ABB, Nestlé, Novartis, and Roche emerged. However, transnational governance hardly addressed the social problems that increasingly undermined people's faith in capitalism.

### Committing the market to non-economic interests

In the following decades, the capitalist order was gradually legitimized, in large part, at the *national* level. The working classes and other social groups successfully fought for greater political and material participation. The two world wars played a critical role in these developments. In order to mobilize their populations to the fullest possible extent, nation states required domestic private businesses and markets to accommodate non-economic interests. In Switzerland, for example, this led to establishment of the social compact between labour and capital as well as the Old-Age and Survivors Insurance (OASI) scheme.

National integration of Switzerland's economy continued during the Cold War. While many Swiss companies internationalized their activities at a blazing pace, they remained controlled by a small, tightly connected business elite. This group also maintained ties with the political and military elites, effectively insulating itself against domestic interlopers and foreign intruders.

The 1970s marked a turning point. Many barriers to transnational business activities that had been established during the two world wars were removed. Technical progress facilitated the circulation of production processes and goods. The so-called second globalization set monumental dynamics in motion that continue to this day. The number and significance of MNEs grew exponentially.

In the past, the legitimacy of the capitalist order in the global North had been judged primarily based on how much wealth it produced and how equitably this wealth was distributed within a given nation state. This now changed fundamentally. The second globalization triggered opposition immediately – far greater than the first. New social movements like the Third World movement, human rights movement, and environmental movement advocated new criteria to create a legitimate world economy. Trade unions and the political left pushed back against perceived erosion of the welfare state and other mechanisms of social compensation. Industries threatened by cheap imports, such as the textile industry and agriculture, also put up resistance.

### Soft instead of hard rules

The "Third World" countries' protest was particularly fierce. They criticized the world economy for undermining their sovereignty and their development, and demanded a New International Economic Order. They called for it to be coordinated more on an intergovernmental level and less by the market and by MNEs. Indeed, the rise of MNEs sparked widespread unease. Nestlé became the target of a long international campaign against its selling of baby formula in the global South.

It was in this context that industrialized countries adopted the OECD Guidelines (1976). The International Labour Organization likewise adopted principles on MNEs and social policy (1977). However, legally binding transnational regulations were forestalled. MNEs and their home countries in the global North were fundamentally opposed to any restriction of so-called free enterprise. States in the global South were similarly sceptical of social and ecological standards. Nonetheless, a dynamic had been set in motion. In the following decades, for example, Nestlé increasingly cooperated with non-governmental organizations on social and ecological standards in cocoa and coffee cultivation. The chemical industry also took the route of soft law to avoid "hard" regulations.

### Integration rather than rejection of MNEs

The ongoing development of transnational governance has resulted from diverse, sometimes competing efforts to regulate corporate activities – which are highly complex and always a step ahead. The SDGs, the UN Guiding Principles, and also the OECD Guidelines, which have been updated and expanded since 1976, interpret and link many of the established rules. These often apply to a specific sector (for example, certain industries). From a historical perspective, it is also important to note that the three frameworks constitute an effort towards transnational governance – in contrast to the proposed New International Economic Order – that does not reject global markets and MNEs, but rather seeks to achieve their normative integration.

Self-regulation as a typical feature of transnational governance is, however, complicated by the fact that MNEs are less and less embedded in national or local settings. Switzerland is a case in point: More and more of these companies have a globalized management and globalized capital structures. Managers and concepts from Anglo-Saxon countries are gaining in importance, while domestic elite networks are eroding. Social norms are weakening. As the power of highly mobile Swiss-domiciled economic actors continues to grow, the opportunities for Switzerland's government and society to influence them are dwindling.

## A legal perspective

### Applying the principle of due diligence across nations

Switzerland supports the UN Guiding Principles, the OECD Guidelines, and the SDGs. However, there is controversy over how the UN Guiding Principles should be implemented. The Swiss federal government has opted for dialogue. In the 2016 National Action Plan (NAP), it expresses its expectation of MNEs that they act in accordance with human rights standards, while also supporting the formulation of sector-specific standards. In addition, the Swiss government offers training for entrepreneurs in concretizing the concept of "due diligence", which is stipulated by both the UN Guiding Principles and the OECD Guidelines. The Action Plan on Corporate Social and Environmental Responsibility complements these efforts.

Civil-society movements as well as legal experts emphasize that these efforts are not sufficient under all circumstances. They request that companies' duty of care to observe human rights and environmental standards be more clearly enshrined in law, so as to articulate that this duty is not confined by territorial boundaries. At the same time, they call for concretizing the legal liability of MNEs by specifying that Swiss-domiciled parent companies are accountable for their subsidiaries. Article 55 of the Swiss Code of Obligations already states that "employers" are liable for damage caused by their "employees or ancillary staff in the performance of their work". Subsidiaries are generally regarded as ancillary staff, too. Companies may prove themselves not liable if they can show that they took "all due care to avoid a loss or damage of this type". This provision also applies to situations occurring abroad. Discussions are ongoing as to how it could be concretized in order to define the scope of liability more clearly for MNEs.

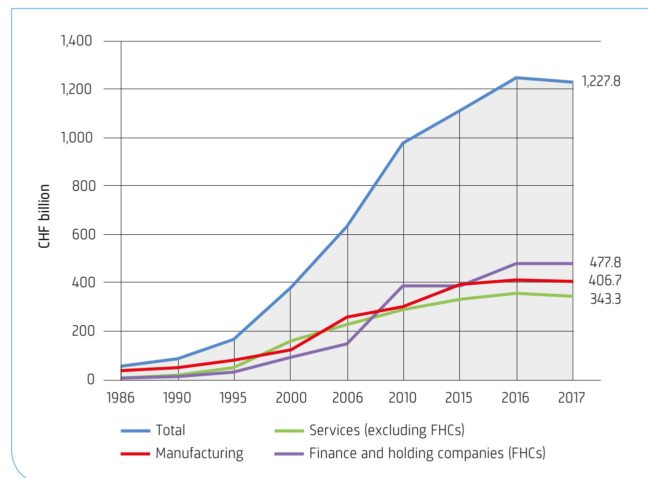


Fig. 1 Stocks of Swiss **direct investment abroad** have grown rapidly over the past decades. Source: Swiss National Bank

### No solutions without open questions

The Swiss popular initiative "Responsible Business: Protecting Human Rights and the Environment" (Responsible Business Initiative) – supported by aid agencies, churches, as well as women's groups, human rights groups, and environmental organizations – makes reference to this discussion. Its aim is to stipulate in law a duty of care for transnational situations. Further, it aims at clarifying in law that companies based in Switzerland are liable for damage that they, or companies under their control, cause abroad in violation of human rights or international environmental standards. Companies can still prove themselves not liable if they have exercised "all due care". Some ideas for a counter-proposal discussed by the Swiss parliament point in a similar direction.

Even if these proposals were implemented, questions would remain: How long should it be possible to claim damages (limitation period)? Who should have access to the adjudicating authorities (procedural law)? And what evidence should be eligible for consideration (international legal assistance)? Issues of private international law, which determines the applicable law, would likely also have to be addressed in subsequent discussions.

Scholars have long been debating open questions regarding the further specification of current liability law, which is largely tailored to the economic conditions of the 20th century. One argument suggests that business activities have always been embedded in a legal framework, and that this legal framework must be continually adapted to new circumstances; that states are, in fact, obliged to do so based on existing human rights conventions. Scholars also point to experience showing that more precise liability regulations have a preventive effect, leading companies to act more prudently and carefully. Moreover, easing access to courts in MNE home countries could strengthen application of the law in host countries by creating a situation of competition. Ultimately, all of this could enable injured parties to effectively obtain compensation.

Difficulties are anticipated regarding proper establishment of facts in cases where damage occurred abroad, and regarding assessment of "appropriate due diligence". Thus, scholars have called for procedures in which courts and mediation forums – like the OECD-supported National Contact Points – work together. At the same time, difficulties also lie in defining what constitutes a violation of human rights or international environmental standards, and where to draw the line.

Another issue of debate is whether legal enshrinement of the duty of care and concretization of liability rules would more likely encourage or discourage sustainable investments in "vulnerable contexts". The key question here is how the public sector can promote much-needed investments without weakening the principle of MNE responsibility. Ongoing discussions focus on how best to adjust regulations on trade, export and investment protection, fiscal and financial governance, and bilateral and multilateral financing for development so as to promote sustainable investments while preventing harmful ones.

## Due diligence: additional points of reference

A key challenge in implementing transnational guidelines relates to the determination of "due diligence" in today's unmanageable, highly complex world. How much care must a company take, and what are the limits of traceability and accountability? The OECD and various state and private actors provide companies with concrete recommendations about how to conduct themselves; but each specific case raises different questions.

Swiss law offers additional entry points besides civil law for concretizing "due diligence" in a transnational context. These include criminal law, competition law (unfair competition), legislation on the control of trade in precious metals, on banking and insurance supervision, and on public procurement, as well as customs legislation, stock exchange law, medical law, and legislation on environmental and labour protection. These areas have received less attention in the debate, but adaptation efforts are underway here, as well.

## Conclusion: Switzerland, a small country with considerable power to shape the future

Going forward, Switzerland will be increasingly confronted with heightened regulatory issues relating to its international business activities. Emerging regulations may accommodate or defy the specific interests of particular domestic actors. In principle, transnational governance frameworks that legitimate the global market in line with Western ideas stand to benefit Switzerland as a business location and a community of values. Whether our country decides to view itself primarily as a small state and a passively affected party or as an economic power and an active shaper of future developments is largely a political question. At the same time, this question is complicated by the fact that growing demands for nation states to assume responsibility for "their" MNEs are occurring simultaneously with the denationalization of market forces.

Existing law offers scope for action, as the implementation of transnational guidelines in the area of corporate responsibility is not yet well-established. This affords Switzerland an opportunity to independently apply the concept of due diligence in various legal areas, arriving at viable solutions by carefully weighing diverse public interests. Such a process always involves finding out how sector-specific efforts towards "due diligence" are best complemented, encouraged, and enforced. In addition to civil law and liability law, this also concerns other legal areas less prominent in the debate. All countries, not just Switzerland, currently face the task of adjusting existing national rules so as to promote sustainable development worldwide. In doing so, as both a small country and a global "economic power", Switzerland can make an important contribution to 21st-century transnational governance.

**SDGs: THE INTERNATIONAL SUSTAINABLE DEVELOPMENT GOALS OF THE UN**
In this publication, the Swiss Academies of Arts and Sciences make a contribution to SDGs 12, 16, and 17.

> sustainabledevelopment.un.org
> eda.admin.ch/agenda2030/en/home/agenda-2030/die-17-ziele-fuer-eine-nachhaltige-entwicklung.html


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